Written submission from Switchcraft (EPM0040)

Switchcraft
[By e-mail]
5 July 2022

Dear Mr Jones,

Thank you for your letter dated 26 May which was sent to us on 15 June. We're pleased that you're looking at the energy retail market and welcome the opportunity to comment on the issues that you have raised.

Switchcraft's mission is to tackle the loyalty penalty: the unfair way loyal customers are charged more. We have served tens of thousands of consumers and saved them hundreds of pounds each, initially in energy switching and more recently in broadband switching. We aim to modernise switching technology across many more product areas and grow internationally.

You're right to say that Third Party Intermediaries ("TPIs") including automatic switching firms play an important role in the energy market, but we fundamentally disagree that TPIs were the cause of the current state of the market including the recent spate of supplier insolvencies. Your letter refers negatively to "a race to the bottom on price" but we firmly believe that price is the single most important factor for consumers when choosing a supplier and that healthy competition is the best way to deliver low prices.

You're also right to say that commission payable by suppliers for each customer onboarded is the dominant revenue model for energy intermediaries and the way the wider price comparison sector works. This is the model we use for the customer-facing part of our business as it allows us to offer our service for free. We do not push customers to more expensive deals to maximise our commission: we have never favoured one member of our panel over another based on which supplier pays us the most. We only initiate automatic switches where the customer is set to save at least £50. We always address each customer's needs individually in the way quotes are presented on our website, in assessing automatic switches, and in responding to customer queries.

As you said, switching volumes have collapsed since autumn 2021 because wholesale energy prices have generally been above the price cap. That has meant that suppliers were forced to lose money on every customer, so they have been unwilling to onboard new customers. The price cap is not reducing the loyalty penalty, as it was designed to do, but has instead driven many well-run small energy retailers out of business while allowing their peers who operate further upstream to make billions of pounds in windfall profits. This structural distortion of the market is likely to result in significantly reduced competition in the years ahead and this risk needs urgent government attention. One possible solution might be to transfer the price cap to the wholesale market which is better positioned to handle the sophisticated hedging strategies that today's volatile markets demand.

We address the six numbered questions in your letter below. Some of the information is provided in summary form because the answers are commercially sensitive and we note that you may publish our response on your website. We would be happy to provide more detail if we can be assured of confidentiality.

1. How many customers have used your services in the past five years and what has been your analysis of how your services are used?

We have an active customer base in the tens of thousands of households, and generally each household signed up to our service has been happy to remain with us for many years.

2. How much revenue did your organisation make from auto-switching for each of the last five financial years? Please itemise this against each supplier that used your service.

Our service soft launched in May 2017 and we made negligible revenue that year. Since 2018 we have generally switched several thousand households each month and generated revenue in the six figure range each year. For comparison, the largest price comparison site in the UK generated £467m annually (not just from energy) according to their most recent public accounts.

The list of suppliers we've switched customers to since we launched is as follows:

Affect Energy
Avro Energy
Better Energy
Boost
Brilliant Energy
Bristol Energy
British Gas
Co-operative Energy
E.ON
EDF Energy
Engie
Enstroga
Entice Energy
First Utility
Flow Energy
GB Energy Supply
GOTO Energy
Green
Green Network Energy
Green Star Energy
Gulf Gas & Power UK
Igloo Energy
iSupplyEnergy
MoneyPlus Energy
Nabuh Energy
Neo Energy
Neon Reef
Northumbria Energy
npower
Omni Energy
Orbit Energy
Outfox the Market
OVO Energy
PFP Energy
Powershop
Pure Planet
Sainsbury's Energy
ScottishPower
Simplicity Energy
So Energy
Solarplicity Energy Ltd
Spark Energy

SSE
Symbio Energy
The People's Energy Company
Together Energy
Tonik Energy
TOTO Energy
Usio Energy Supply Limited
Utilita
Utility Point
Utility Warehouse
Zebra Power

3. In your view, what role did third-party intermediaries, particularly auto-switchers, play in fuelling a race to the bottom?

We and other TPIs promote price competition in the energy market. We fundamentally disagree with the premise that this is a bad thing. Small energy suppliers that are able to offer lower prices are enormously valuable to society and in particular to the most vulnerable households where energy costs make up a large proportion of their income. The existence of small suppliers also helps to put downward pressure on the prices offered by their larger peers.

Encouraging competition has been a core pillar of energy regulation for the last 20 years and a rare area of consensus across the political spectrum. For example, your colleague Julie Elliott MP mentioned her focus on opening up the market to smaller organisations when explaining Labour's policies to The All Party Parliamentary Group on Energy Costs in March 2014. Pro-competitive policies promote consumer welfare, and this is reflected in many published policy statements issued by the Financial Conduct Authority and the Competition and Markets Authority.

Suppliers do of course need to be financially robust, but ensuring that is obviously the job of the regulator and of government. We do conduct our own due diligence on suppliers we work with and until the unprecedented conditions of winter 2021/2022 no suppliers ceased trading while they were on our panel. We find the consistent stream of supplier insolvencies over the last few years during benign market conditions more shocking than the events of the last few months where we saw huge global energy price spikes.

We are now most concerned about an overreaction from regulators which would make it impossible for new suppliers to enter the market. In particular, we oppose the Market Stabilisation Charge which was introduced following intense lobbying by an oligopoly of large suppliers and which exists to ensure that their current extreme profitability continues. It substantially increases the cost to challenger suppliers of growing their customer base by requiring them to make a cash payment to incumbent suppliers for each customer they sign up, which seems incredibly anti-competitive.

4. Can you explain whether your business model is focused on chasing commission from suppliers or on consumers' needs and finding the best outcomes for the customers using your services? Should the commission that third-party intermediaries charge suppliers be regulated, and if so, how?

Our first priority is the interests of our customers. In order to offer a free service, we accept commission from the suppliers we work with, in line with norms in the price comparison industry. We make this clear on our website.

We also see some validity in revenue models where the customer pays for a switching service, but competitors operating in this way have not been successful. For example, Flipper closed down at the end of 2021.

Commissions for online energy switching are generally around £54 per household (£30 per fuel, an average of 1.8 fuels per household), which is modest compared to £300 or so that each household typically saved by switching before the current crisis. It also corresponds to around 4.5% of an annual energy bill pre-crisis and around 2.5% - 3% based on current high prices. That seems like a price well worth paying to ensure effective competition. For comparison, commission routinely accounts for over 20% of the product cost for telecoms products.

We continually reinvest our revenue on improving our product and have brought several important innovations to the industry, most importantly:

1. Automatic switching: we tackle the loyalty penalty by helping our customers switch at the end of each fixed contract term, so that they avoid punishing default tariffs without having to manage the admin themselves.
2. “Quick quote”: we are able to generate a personalised energy quote just from a customer’s address by sourcing information such as current supplier and usage. This makes it far easier to switch because customers don’t have to find a bill and then fill in a long form, and is of particular value to vulnerable customers. We invented this in early 2020 and since then one of the big four comparison sites has implemented the same technology with our help, and two others copied it without our direct involvement.

However, there are two areas where regulation of commission may help to deliver better customer outcomes:

1. Certain larger suppliers have resisted working with auto switching firms, while continuing to work with traditional comparison sites. That’s because they depend on the loyalty penalty to make outsize profits. You could consider making it illegal for suppliers to discriminate against auto switchers and instead force them to offer the same commissions to firms like us which put the customer first. This would be akin to the current competition law prohibition on dominant suppliers imposing different trading conditions on different partners.
2. We operate online switching only but are aware that in some cases suppliers pay much higher commissions (100% higher or even more) to intermediaries selling via telephone and doorstep sales teams. They are able to fund these very high commission amounts because the customers signed up via these means tend to remain on default tariffs for many years. Some standardization of commission levels would make these intrusive sales channels uneconomic.

5. Should money made from switching commissions be recouped from auto-switchers to mitigate some of the cost exposure to consumers from supplier failures?

We can’t see any possible moral or legal justification for such a course of action. We believe we’re a force for good in the industry and we don’t consider that we have contributed to supplier failures.

A retrospective tax on us would stifle innovation to the detriment of consumers and undermine our current exciting work simplifying telecoms and insurance switching, which we are doing with the help of a Smart Grant from Innovate UK.

6. What regulations should be placed on third-party intermediaries to protect consumers?

We don't see an urgent need for additional regulation on TPIs but feel that our suggestions in response to question 4 above would help to deliver better consumer outcomes.

Ofgem has a voluntary code of conduct for comparison sites called the Confidence Code. This has not been updated to reflect the introduction of auto switching but we would be very happy to consider applying to join if it was updated appropriately.

Thank you again for the opportunity to engage on such important questions and at such a critical time. Even though we may not see eye to eye, we are grateful for your efforts to reform the industry and are happy to help in any way we can.

Yours sincerely,

Andrew Long

Founder & CEO, Switchcraft