

Executive summary

1 Some 20 million domestic customers in Great Britain spend around £6 billion a year on gas. Between April 1996 and May 1998 competition was introduced into the domestic gas market and all customers can now choose from whom they buy their gas. By February 1999, 25 new companies were selling gas and over four million customers had exercised their choice and switched from British Gas Trading, the former monopoly supplier. Introducing competition throughout Great Britain within two years is a major achievement for the Office of Gas Supply (OFGAS), the industry's regulator, and could not have been done without the co-operation of Transco, the owner of the principal gas pipeline network, and the rest of the gas industry.

2 The then Government decided in 1993 to introduce competition for domestic gas customers so that they could benefit from the lower prices, greater choice and improved services being enjoyed by large business users of gas, who were already able to choose their supplier. OFGAS have been responsible for overseeing the introduction of competition to ensure that it secures the benefits for customers expected of it. A key aim has been to secure effective competition, i.e. a real and lasting choice for customers, to ensure that competition is strong enough to protect the interests of customers.

3 This report examines how far the introduction of competition has benefited customers in the four key areas of price, choice, service, and safety. The expert economics consultancy London Economics advised us in the examination on key economic issues and, with OFGAS, we commissioned MORI to carry out a survey of a representative sample of customers.

Customers now pay lower prices

4 Figure 1 shows that as the market was opened to competition the average price paid by customers for gas fell in both cash and real terms. Since April 1996, British Gas Trading have reduced their prices so that at 1999 prices the annual bill of a typical British Gas Trading customer has fallen in real terms from £348 to £300 - a reduction of £48.¹ The new gas companies have set even lower prices and customers who have changed to a new supplier are making an average annual saving of £78 in real terms compared to British Gas Trading's prices before

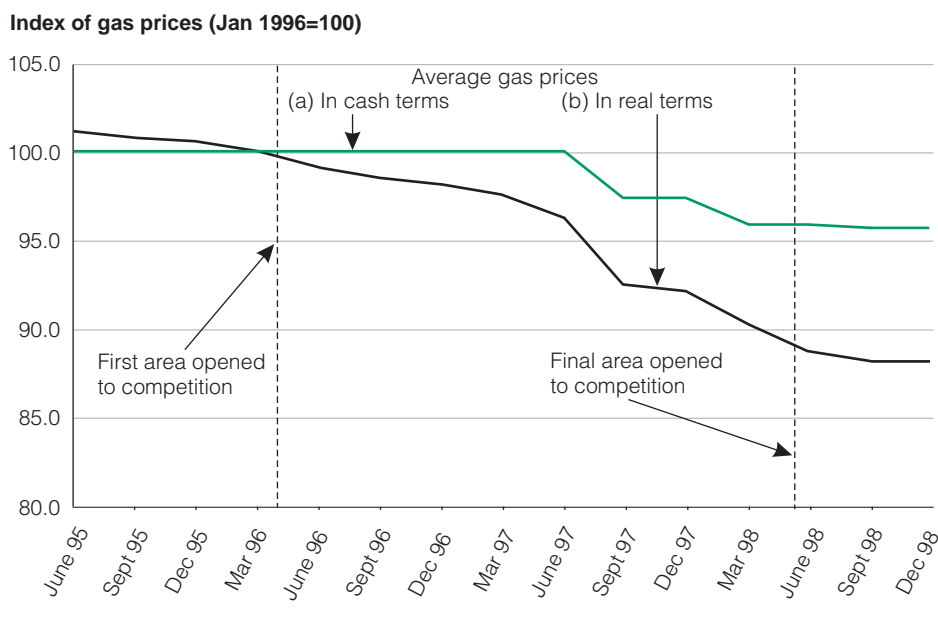
¹ All calculations of gas bills include the current rate of VAT (5 per cent). Savings are calculated for a customer using 19,050 kWh of gas a year – a typical amount for a domestic customer.

competition was introduced. The total reduction in customers' bills has been some £1 billion a year at 1999 prices. These reductions are partly the result of price controls imposed by OFGAS on Transco and British Gas Trading, but competition has also been an important cause of the reductions, especially for customers who have changed their supplier (paragraph 2.2).

Domestic gas prices and the opening of competition

Figure 1

This figure shows that gas prices have fallen since competition was introduced in both cash and real terms.



Source: Office of National Statistics

Customers' savings vary depending on how they pay for their gas

5 Prices have fallen in real terms for all customers, but the amount customers have saved varies according to the way they pay their bills. Since April 1996, customers who pay by monthly direct debit, for example, will typically have saved £56 in real terms on their annual bill if they had stayed with British Gas Trading, and up to £90 if they had changed to a new supplier. For some payment methods the total saving for a typical customer who has changed supplier might be as much as £101 a year. For the 1.4 million prepayment meter customers – customers who pay for their gas through their meter – the typical annual saving with British Gas Trading since April 1996 has been around £32 in real terms, and between £21 and £50 for customers who have changed to other suppliers (paragraphs 2.3 to 2.17).²

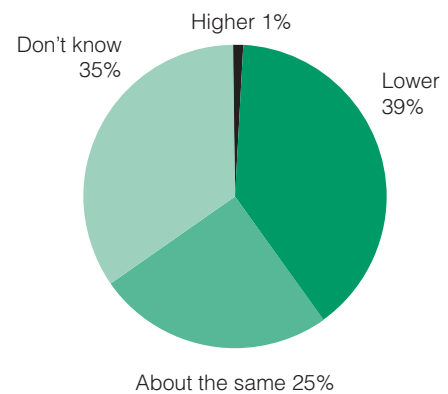
² Changes in bills for prepayment meter customers are based on a consumption of 12,300 kWh, typical for a customer using this payment method.

6 Many customers could save even more. Thirty five per cent of customers in our survey did not know whether the prices on offer from new suppliers were lower than British Gas Trading's and a further 26 per cent thought they were about the same or higher (Figure 2). Fifty seven per cent of customers who pay for their gas by either cash or cheque had a bank account, and therefore appeared to have scope, subject to the agreement of their bank, to change to paying by direct debit, but were not aware that it would be cheaper for them to do so. And while 30 per cent of customers found it easy to compare prices, 27 per cent said they found it difficult (paragraphs 2.32 to 2.37 and 3.2).

Figure 2

How customers think new suppliers' prices compare with British Gas Trading's
(Sample size 2,511)

This figure shows that 61% of customers did not know that the prices of the new gas suppliers were lower than British Gas Trading.



Source: National Audit Office/OFGAS survey of customers (by MORI)

7 There is therefore scope for customers to save more, by either:

- **Changing supplier.** For example, a British Gas Trading customer changing to a new supplier could save an average of £30 a year, and up to £67, even without changing his or her payment method. If 10 per cent of these customers changed, based on the average annual saving of £30, they would save a total of some £50 million a year (paragraph 2.34).

- **Changing their method of payment.** For example, an average customer currently paying by cash or cheque could save an average of £20, and up to £72, a year by changing to monthly direct debit. If 10 per cent of customers currently paying by cash or cheque did so, their total saving, based on the average annual saving of £20, would be some £11 million a year. If half changed, it would be some £53 million a year. If a customer changed both payment method and supplier, as many of the customers who have changed supplier have done, the saving could be even larger (paragraphs 2.35 to 2.37).



Customers now have a choice of gas supplier

8 Twenty six companies are now actively marketing to domestic customers, many of them on a national scale. And since the introduction of competition began in April 1996, over four million customers have changed supplier – more than 20 per cent of all customers. Our survey showed that 95 per cent of all customers said they were aware that competition had been introduced and that 58 per cent considered themselves to be well informed about it (Figure 3) (paragraphs 3.3 to 3.8).

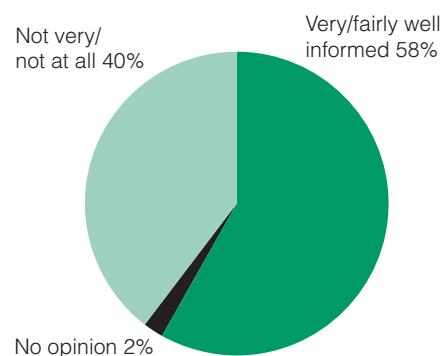
9 Prepayment meter customers have benefited from competition and 14 per cent have changed supplier but the level of price competition among companies for these customers is weaker than for other customers. Few of the new companies offer prices substantially below those of British Gas Trading. And the incentive for new suppliers to seek out such customers is reduced because other suppliers have the right to veto transfers of customers in debt to them, who make up 80 per cent of prepayment customers. Nonetheless 14 per cent of prepayment meter customers have changed supplier, compared to 20 per cent of customers as a whole. OFGAS told us that the number of prepayment meter customers changing supplier appears to be lower because some companies are encouraging these customers to use a different payment method when they change (paragraphs 3.9 to 3.13).

10 In other parts of the market, competition has grown on a very substantial scale. New suppliers have gained customers by offering lower prices, in part because they have been able to purchase gas more cheaply than British Gas Trading currently can do under their long term gas purchase contracts. British Gas Trading's prices remain substantially in line with the requirements of the price controls imposed on them by OFGAS. Except for a period in southern England in 1997, they have not reduced their prices to a level near that of their competitors and, owing to their dominant position, they are restricted by their licence in the degree to which they can reduce their prices below the level needed to cover their

Figure 3

How informed do customers feel about competition?
(Sample size 2,511)

This figure shows that most customers considered themselves to be well informed about competition although a large proportion did not.



Source: National Audit Office/OFGAS survey of customers (by MORI)

costs. The introduction of competition appears to have provided scope for a sustainable reduction in prices for domestic customers of around 10 per cent (paragraphs 2.18 and 2.20 to 2.31).

11 A number of factors suggest, however, that competition alone cannot yet be relied upon fully to protect customers in all parts of the market. A number of issues may inhibit the extent to which new companies may be able to maintain themselves in the market. These include, for example, low profit margins and lack of customer interest, although some of the new suppliers are benefiting from greater profit margins than British Gas Trading and others may have the financial strength to withstand temporary periods of low profitability because they are well established in other industries (paragraphs 3.15 to 3.22).

The quality of the service to customers is improving

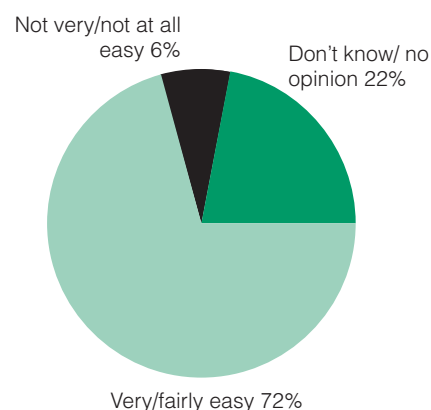
12 Our survey shows that customers generally considered it easy to change supplier if they wished – even among customers who had not changed supplier, 72 per cent said they thought it would be easy (Figure 4). Nonetheless, OFGAS and the Gas Consumers Council received 45,000 complaints about transfers in 1998 (paragraph 4.2).

13 One of the main areas concerning customers in the complaints received was certain aspects of doorstep selling techniques. A number of customers complained that attempts had been made to trick them into entering into contracts, and others complained that salesmen had provided misleading information. In the light of these concerns, OFGAS modified the suppliers' licences to include rules covering marketing which they then enforced, after earlier attempts to secure effective self-regulation by the industry failed (paragraph 4.3).

Figure 4

How easy would it be to switch supplier?
(Sample size 1,708 customers who had not switched supplier)

This figure shows that most customers who had not switched supplier considered it easy to change supplier.



Source: National Audit Office/OFGAS survey of customers (by MORI)

14 Other customer concerns have included the time spent waiting to transfer to a new supplier. At 31 October 1998, 723,000 customers who had entered into contracts with new suppliers were awaiting transfer - indicating an average waiting time of ten weeks. Much of this delay was the result of the build up of demand to change supplier as the market was opened to competition. By 1 January 1999 transfers were taking an average of some five weeks to carry out, with some 260,000 customers awaiting transfer (paragraph 4.3).

15 Our survey also showed that customers were generally happy with the service provided by their supplier. Sixty five per cent of customers who had changed supplier said they were very or fairly satisfied with the service they received (compared to 7 per cent who were dissatisfied), as did 90 per cent of customers who have remained with British Gas Trading (compared to 3 per cent who were dissatisfied). Most customers did not think the quality of service had changed since competition was introduced, but of those that did, more said that service has got better than said it has worsened (Figure 5) (paragraphs 4.4 to 4.6).

How customers rate the service of their gas supplier

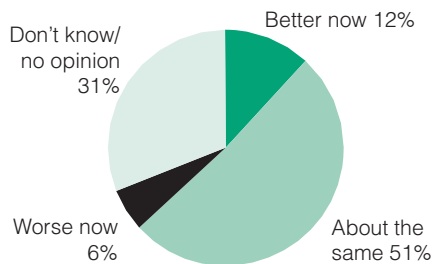
Figure 5

This figure shows that although most customers feel service is about the same more feel it has got better rather than worsened.

How does the service provided by your new supplier compare with that provided by your previous supplier?

(Sample size 762 customers of suppliers other than British Gas Trading)

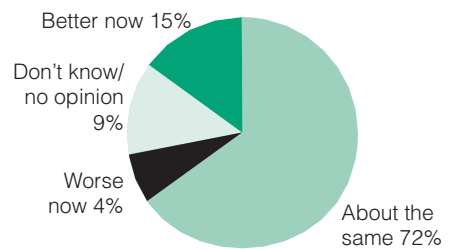
a) Customers of new suppliers



How does the service provided by British Gas Trading now compare with that of two years ago?

(Sample size 1,749 British Gas Trading customers)

b) British Gas Trading customers



Source: National Audit Office/OFGAS survey of customers (by MORI)

16 Some companies have introduced new services, such as loyalty points and dual fuel deals (lower prices when a company provides both electricity and gas). The elderly and the disabled are being offered the special services, such as replacement heating if their gas supply is disrupted, required of companies under their licences. But the take up of special services by this group of customers is only 9 per cent nationally, and 17 per cent in Scotland, and has not changed significantly since competition was introduced (paragraphs 4.8 and 4.9).

Safety has been maintained

17 The Health and Safety Executive, who regulate the safety of the gas industry, believe that the new gas safety regime put in place to support the introduction of competition in the domestic gas market is generally working well and has achieved its aim of maintaining safety standards. A key safety improvement has been the establishment of a single national emergency telephone number, and our survey showed that more than 90 per cent of customers knew about it. At the request of the Health and Safety Commission, the Executive are, however, reviewing the safety regime for the use of gas once it has been supplied to customers, for example with regard to the installation and maintenance of gas appliances. They plan to complete the review by the end of 1999 (paragraphs 5.1 to 5.10).

Recommendations

18 The benefits for customers already achieved by competition reflect well on OFGAS, Transco and the rest of the gas industry. But customers could benefit even more. We recommend, therefore, that OFGAS should:

- 1. Seek to improve customers' knowledge** of the impact on their bills of their choice of supplier and of payment method. While it is for companies to advertise their prices and terms, OFGAS should consider the scope for measures to make it easier for customers to make comparisons. These might include encouraging companies to provide information on prices in a standard format (paragraphs 2.32 to 2.37).
- 2. Consider how competition to supply customers using prepayment meters might be strengthened** to ensure that these customers benefit from competition as much as others. In particular, OFGAS should consider the scope for customers to move their debts with them when they change company, whilst safeguarding the rights of suppliers to whom money is owed (paragraphs 3.9 to 3.13).
- 3. Continue to monitor developments in competition** in the market closely. There has been encouraging progress in developing competition, as is shown by the savings that customers can make by changing supplier and the number of customers who have changed. But the extent of competition is greater in some parts of the market than others. It is too early to say whether it will be possible for new gas suppliers to maintain themselves successfully in the market to provide a real choice of supplier to all customers, although some of the new suppliers are benefiting from greater profit margins than British Gas

Trading and others may have the financial strength to withstand temporary periods of low profitability. OFGAS therefore need to continue to keep the development of competition under careful review (paragraphs 3.15 to 3.22).

- 4. Review the process by which customers are transferred to a new supplier** to establish if this could be done more quickly. OFGAS should also consider whether companies should be set targets for the time taken to carry out transfers. OFGAS should continue to monitor companies' performance and act quickly to prevent backlogs recurring (paragraphs 4.2 and 4.3).
- 5 Establish why there is a low take up of the special services for the elderly and disabled by customers of the new suppliers.** OFGAS should also consider what action might be taken to increase take up, for example by seeking improvements to companies' publicity campaigns (paragraph 4.9).