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Customer acquisition, saves and win-backs – issues paper

Market Development Advisory Group

The post-implementation evaluation of the saves protection scheme found that the scheme neither improved nor harmed retail competition and that win-backs were substituted for saves with no overall change in switching activity. A question remains as to whether there are problems with the customer acquisition process that result in a non-level playing field for acquiring retailers, including new retailers. This paper considers the nature of potential problems with customer acquisitions. Feedback is being sought to clarify whether there are problems with the customer acquisition process that could, potentially, affect the durability of the retail electricity market.

Note: This paper has been prepared by the Market Development Advisory Group for the purpose of seeking feedback on whether there are any potential issues with the customer acquisition process that may warrant work on any intervention. Content should not be interpreted as representing the views or policy of the Electricity Authority.

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Executive Summary

Objective

The Authority has asked the Market Development Advisory Group (MDAG) to investigate retail customer acquisition issues, including saves and win-backs, and to advise the Authority on whether there are problems that require further review.[1]

The objective of this paper is to gather information and feedback from stakeholders as we focus on problem definition and the following key question:

> *Is there a regulatory problem or market failure relating to customer acquisition, including saves and win-backs practices, and the switching process?*[2]

Background

In 2014 the Authority implemented a voluntary 'saves protection' scheme. The objective of the scheme was to promote competition.

Some retailers had been using notifications that a customer was switching to offer customers better deals to stop a switch from being completed. The Authority decided that the switch notification process was giving an unintended competitive advantage to retailers whose customers initiate a switch.

The Authority expected giving retailers the option of removing this advantage, by opting into the saves protection scheme, would increase returns to acquisition activity and promote competition. The Authority also expected this support for ongoing competition would improve the durability of competitive retail markets.

The Authority also considered whether the saves protection scheme should be extended to win-backs – where a switch is withdrawn after it has been completed – but decided not to do this because:

- win-backs do not rely on early notification of a switch
- there was no evidence that win-backs had a material negative impact on competition
- retailers could take steps, independently, to guard against win-backs.

An evaluation of the saves protection scheme in 2017 found no evidence that the scheme had either improved or harmed competition. It did find retailers had adapted to the limitations on saves by increasing win-backs and completing switches more quickly so they could effect win-backs more quickly.

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1 See 'Letter to MDAG – 2017-18 work plan – saves and win backs + battery storage', available at https://www.ea.govt.nz/development/advisory-technical-groups/mdag/meeting-papers/2018/8-february-2018/.

2 Ibid, 'Proposed project scope' item 1. p.2.

Snapshot of potential issues and data points in this issues paper

Loss avoidance (saves & win-backs)

Just one of the many strategies retailers can use to grow or maintain their customer base

Key data points on extent of switches

171,000 trader switches (8.8% of ICPs, 2018):
- 226,000 switches initiated (9% of ICPs)
- 55,000 (24%) withdrawn

40% of ICPs have never switched

Regulatory problems or market failures affecting competition?

Early notification of a switch may give some retailers an undue win-back advantage, caused by a regulatory problem and potentially creating a barrier to entry, exacerbated by:
- high 'search costs' to identify suitable customers
- cooling off periods not applying equally to all types of switches

Key features of retail competition

Competition on positive trajectory:
- more retailers
- market shares of big retailers fall

No systematic relationship between firm size and age and switch loss rates, switch avoidance (win-back or save) rates, or switch failure (lost to a win-back or save) rates.

Problem for consumers?

Consumers gain from either switch or win-back deals (to same effect, if competition is durable)

Key insights from consumer survey data

Financial gain is the main reason for switching or withdrawing a switch
New entrants need to offer sharper prices to entice consumers to switch

Issues

The key issue being considered here is whether there are regulatory or market failures relating to customer acquisition and the switching process that create barriers to entry or reduce the ability of some retailers to compete.

Are win-backs a feature or an issue?

A key question is whether the use of win-backs is simply a commercial strategy or something that stems from a problem with market design or fundamental market characteristics which constitute a market failure.

Win-backs are a significant feature of switching and customer acquisition activity. A win-back typically involves a retailer offering a departing customer the same price terms as their competitor along with an inducement such as a one-off credit on their bill in the order of $150, and up to $300. In 2017, approximately one-quarter of switches that were initiated were withdrawn, suggesting some 25% of potential switches are reversed by win-backs.[3]

Retailers use many different strategies to compete and all retailers have the option of offering deals to customers to win them back. Consumers, subject to win-backs, directly benefit from those deals e.g. through one-off payments or reduced prices.

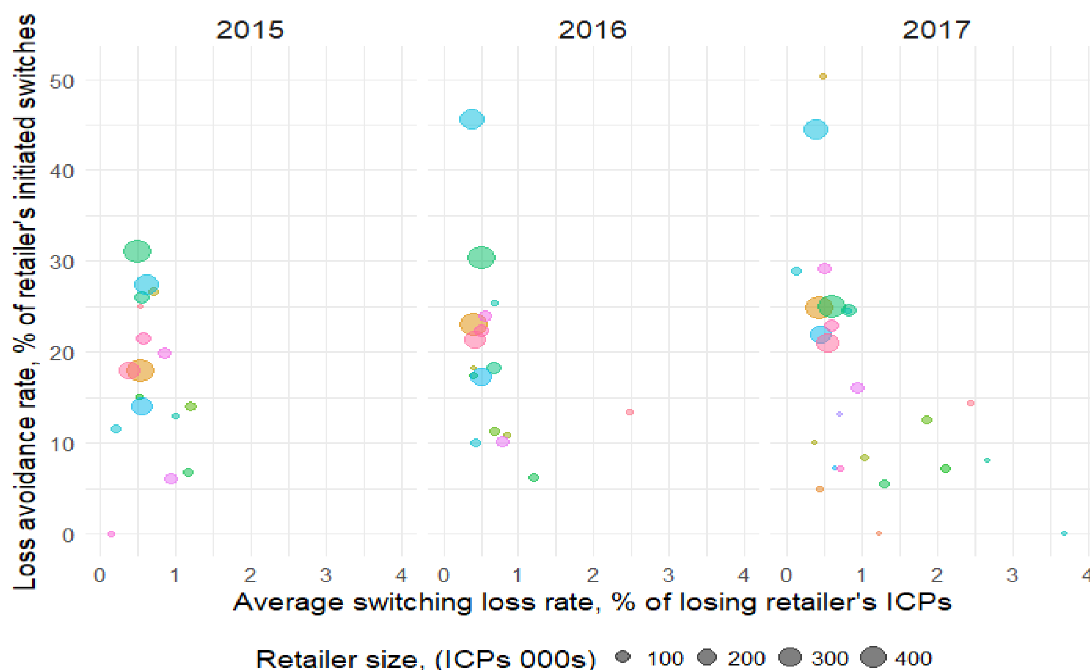
Data suggests win-backs are widely used by different kinds of retailers, big and small. An example from this data is provided in the Figure (0.1) below. The exact strategies used may differ.

The data also indicates not all retailers successfully engage in win-backs, so it is not, apparently, a prerequisite for competitiveness.

[3] Trader switches as opposed to ‘move-in’ or metering related switches.

FIGURE 0.1: SWITCHING LOSSES AND RETAILER REACTIONS TO REDUCE LOSSES

Annual averages of monthly switch data, from the losing retailer's perspective, 2015-2017. Colours are retail brands.



Are early switch notifications continuing to create an unlevel playing field?

In 2014 the Authority determined that saves involved a regulatory failure, advantaging some retailers over others and creating barriers to entry by competitors in the retail market. The advantage identified for saves could also be a source of undue advantage for retailers who engage in win-backs. If so, the regulatory failure may be broader than just saves and could be, or become, a barrier to entry for new entrant retailers.

On its own, this regulatory failure may not be serious because the advantage it gives is available to all retailers, in some measure. But other market frictions and potential regulatory problems may compound any effects in terms of barriers to entry. For example:

- new entrants are likely to have higher search costs than incumbents
- some retailers may be constrained in measures they can take to counter win-backs such as concerns that imposing or enforcing contractual terms such as fixed term contracts will damage their reputation. If gaining retailers could not enforce fixed term contracts, for reasons other than customer preference or competitive pressure, this could be a source of market or regulatory failure
- "cooling off" periods, required under the Fair Trading Act 1986, may not apply to consumers accepting win-back deals in the heat of the moment since, depending on the circumstances, this may constitute a renewal rather than a new agreement.

Are consumers prompted into making decisions against their best interests?

Consumers who switch are both beneficiaries of retail competition and important catalysts for retail competition. Were it not for bargain hunters and a willingness to switch there would be only limited demand-led competition in the retail market. If some

consumers are accepting win-back deals to withdraw switches this does suggest that they are benefitting.

Another view is that consumers can be prompted to make decisions that are not always in their best interests. In the 'heat of the moment', an offer of a one-off-credit is very attractive, even if it comes with a fixed term clause that the customer might otherwise avoid with more considered deliberation.

Retailers can, in principle, also mislead consumers as a means of winning them back. As can retailers when seeking to convince consumers to switch. If there was direct evidence of such conduct, it would certainly be a problem that should be raised with the Commerce Commission.

Commercial advantages do not constitute market failures or regulatory problems

Anecdotally, established retailers may have an advantage using win-back strategies. This may be because they have established knowledge of their customers enabling them to identify which will be beneficial to win-back. Winning back customers is, potentially, a relatively cheap way to compete for market share, because the retailer does not have to search around to find customers who are looking for a better price or better service, as willingness to switch is revealed by switching.

But commercial advantage, obtained, for example, through investment in learning about customers is not a regulatory problem or a market failure. And there are different ways to learn about (potential) customers, other than them being an existing customer. Acquisition of private information and competitive advantage from that information is an inducement to compete – supporting competition in a workably competitive market. Informational advantages cut both ways, in the sense that all retailers can benefit from the advantages once they are established in the market.

Key questions MDAG is seeking submissions on

MDAG is seeking information and feedback to assist in weighing these competing considerations. The following table sets out questions the group would like you to answer. Importantly, wherever possible, please provide evidence or concrete examples that support your views on these questions.

1	**Do some retailers have a distinct win-back advantage which others do not have and cannot ever have?**
i	What sorts of strategies do acquiring retailers have to defend against win-backs and how cost-effective are they?
ii	Is there a market or regulatory failure preventing acquiring retailers using contractual terms to counter win-backs, given that some retailers are prepared to enforce contracts when customers leave them before the completion of the contract term?
iii	Does early switch notification give an undue advantage to retailers seeking to win-back customers?
2	**Are consumers frequently prompted into making decisions when they switch or switch back that are not in their best interests?**
i	If consumers make mistakes in the 'heat of the moment', is there a way to tell which was intended and which was the error – the switch or the win-back?
ii	Is there any evidence that retailers have engaged systematically in proscribed marketing behaviours?
iii	Are there regulatory provisions that treat saves and win-backs in a different manner from other acquisition activity in such a way as to constitute a regulatory failure?
iv	What are the implications (if any) for consumers of saves and win-backs?
3	**Are there are any further issues related to saves and win-backs that we have not considered?**

Process for submissions

How to make a submission

This discussion paper is published by the MDAG, and the MDAG will be responsible for considering submissions received.

Submissions should be received by 5.00pm on 29 June 2018.

If possible, submissions should include responses to the questions the MDAG has included in this discussion paper (as per section 6).

Electronic submissions are preferred

The MDAG prefers submissions in electronic format (in Microsoft Word).

Submissions should be emailed to mdag@ea.govt.nz with "Customer acquisition, saves and win-backs – Draft issues paper" in the subject line.

Submissions can be made in hard copy

If you do not wish to send your submission electronically, you must post a hard copy of your submission to one of these addresses:

Submissions MDAG Chair c/- Electricity Authority PO Box 10041 Wellington 6143 Tel: 0-4-460 8860 Fax: 0-4-460 8879	Submissions MDAG Chair c/- Electricity Authority Level 7, ASB Bank Tower 2 Hunter Street Wellington Tel: 0-4-460 8860 Fax: 0-4-460 8879

Sending a hard copy is not necessary if you have sent your submission electronically.

The Authority will acknowledge receipt of submissions

The Authority, on behalf of the MDAG, will acknowledge receipt of all submissions electronically.

Please contact the Submissions Administrator at the Authority if you do not receive electronic acknowledgement of your submission within two business days.

The MDAG intends to publish all submissions

Please note that the MDAG intends to publish all submissions it receives. This is the usual practice with submissions.

If you consider that we should not publish any part of your submission, please indicate what part, and set out the reasons why you consider we should not publish it.

If you indicate that there is a part of your submission that the MDAG should not publish, we will discuss it with you. We will ask whether you can provide us with a version that we can publish (if you haven't already done this).

Submissions are subject to the Official Information Act 1982

Please note that all submissions we receive, including any parts that we may not have published, can be requested under the Official Information Act 1982 (OIA). This means that we would be required to release them unless good reason exists under the OIA to withhold them.

We will normally consult with you before releasing any material that you had identified should not be published.

Glossary

ICP - installation control point (customer connection to an electricity network)

Retailers – electricity retailers

> **acquiring or winning retailer** – a retailer who is gaining a customer from another retailer
>
> **current retailer** – the retailer who is currently providing services to the customer
>
> **established retailer** – a retailer who has been providing electricity retail services for a long time and with a 'matured' customer base.
>
> **new entrant retailer** – a retailer who is just entering, or has only recently entered, the electricity retail market, and has not yet established its target customer base

losing retailer – the retailer from whom a customer is switching away to a gaining retailer

Save – a switch that is stopped and withdrawn before the switching process is complete

Switch – when a customer moves their account from one electricity retailer to another

Win-back – a switch that is withdrawn after the switching process has been completed or when a customer switches back to the previous retailer shortly after the switch has been completed

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1. Purpose, context and scope

1.1 Purpose

1.1.1. The MDAG provides independent advice to the Authority on the development of the Electricity Industry Participation Code 2010 (Code) and electricity market facilitation measures. The MDAG advises on matters relating to pricing and cost allocation, risk and risk management, and operational efficiencies.

1.1.2. The Authority has requested the MDAG to investigate retail customer acquisition issues, including saves and win-backs, and to advise the Authority on whether there are problems that require further review.

1.1.3. This Issues Paper sets out evidence and arguments for and against the existence of regulatory problems and market failures relating to retail customer acquisition, including saves and win-backs practices.

1.1.4. The MDAG is seeking input from interested parties on the issues raised in this paper and any other matters related to retail customer acquisition and related efficiency and competition issues.

1.1.5. Following feedback, the MDAG will provide recommendations to the Authority about the next steps. The Authority may undertake subsequent work to consider if changes to the Code or market facilitation measures are warranted, including changes to the saves protection scheme.

1.2 Context

1.2.1 In 2014 the Authority examined customer retention strategies used by retailers (see Appendix A for further background).[4] The focus was on saves and win-backs, where a retailer, after a switch has been initiated, persuades a customer to withdraw their switch.

1.2.2 A save is a switch that is withdrawn before the switching process is complete. A win-back is a switch that is withdrawn after the switching process has been completed or when a customer switches back to the previous retailer shortly after the switch has been completed.

1.2.3 The Authority was concerned that saves were a barrier to the entry and expansion of retailers. The Authority considered saves to be problematic because retailers could intervene in the switching process before it was completed, because of procedural notifications of an intention to switch. It was reasoned that this information is not normally provided to firms in workably competitive markets and presents a regulatory problem.

1.2.4 In October 2014, the Authority decided to amend the Code to allow retailers to opt into a save-protection scheme.[5] The scheme prohibits retailers

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[4] Electricity Authority (2014a) 'Proposed Code amendment – Saves and early win-backs', Consultation Paper, 24 June 2014, available at https://www.ea.govt.nz/about-us/what-we-do/our-history/archive/dev-archive/work-programmes/market-wholesale-and-retail-work/winbacks-and-saves/consultation/. Survey results and submissions are also available here.

[5] Electricity Authority (2014b) 'Competition effects of saves and win-backs', Decisions and reasons, 21 October 2014, available at https://www.ea.govt.nz/about-us/what-we-do/our-history/archive/dev-archive/work-

contacting customers they are losing until a switch is complete, if either the gaining or losing retailer has opted into the saves protection scheme.

1.2.5 The Authority determined that the competition benefits from restricting saves were likely to outweigh any short-term costs that might arise from compliance costs and consumers not benefitting from retention deals. Because of uncertainty about the relative balance of these factors, the Authority chose to adopt an opt-in scheme and to monitor the effects of the scheme.

1.2.6 A 2017 review of the effects of the scheme found that it had no net effect on switch withdrawal rates.[6] There was a decline in saves, but this was offset by an increase in win-backs. Losing retailers accelerated the switching process to allow them to initiate win-back actions quicker. The review suggested that losing retailers may have an information advantage over gaining retailers, allowing them to make a more attractive offer, and this may mean early notification of an impending switch does not confer a material advantage.[7]

1.2.7 The review concluded there is no evidence the scheme has improved or harmed competition. But it also concluded that further measures are required to improve the effectiveness of the scheme.

1.2.8 An extended summary of the context for the saves protection scheme and related initiatives, here and overseas, is set out in Appendix A.

1.3 Scope

1.3.1 The objective of this paper is to gather information and feedback from stakeholders as we focus on problem definition and the following key question:

> *Is there a regulatory problem or market failure relating to customer acquisition, including saves and win-backs practices, and the switching process?*[8]

1.3.2 Related questions being considered in this paper are:

a) Are there problems with the customer acquisition process that result in a ‘non-level playing field’ for acquiring retailers, including new entrant retailers?

b) To what extent do perceptions around a potential ‘non-level playing field’ affect the durability of the retail electricity market?

c) If there are problems, would these warrant regulatory intervention on customer acquisition, including saves and win-backs?

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programmes/market-wholesale-and-retail-work/winbacks-and-saves/development/decisions-and-reasons-published/. Survey results and submissions are also available here.

[6] Electricity Authority (2017) ‘Post implementation review of saves and win-backs’, Final report, 29 August 2017, available at https://www.ea.govt.nz/monitoring/enquiries-reviews-and-investigations/2017/post-implementation-review-of-the-save-protection-scheme/.

[7] The terms of reference provided to MDAG notes that this issue of informational advantage is outside the scope of this review and is being considered elsewhere. Informational advantage is, however, commented on in this paper because differential capabilities of retailers is something that comes up as a matter of concern for some market participants and informational advantage is one such source of differential capabilities.

[8] Ibid, ‘Proposed project scope’ item 1. p.2.

1.3.3 This paper discusses:

a) potential and perceived regulatory problems and market failures relating to customer acquisition and the switching process

b) how customer acquisition processes work from consumers' perspectives

c) retailer customer acquisition and retention strategies

d) results of empirical analysis looking at the scale of impacts of potential problems on market functioning and barriers to entry including trends in retail competition, acquisition activity, and saves and win-backs

e) issues arising and questions for feedback.

2. Potential regulatory problems and market failures

2.1 Key issues

2.1.1 Looking at markets in general, firms' acquisition strategies can cause competition problems if there are persistent market failures or regulatory problems which create an uneven playing field and undermine competition or cause inefficiency.

2.1.2 However, diagnosing these problems based on conduct of firms, or determining whether to do anything about them, is complicated by the fact that differences amongst firms are both a result and cause of competition.

2.1.3 This section discusses why such problems might exist in markets in general, and why they are not easy to diagnose.

2.2 Distinguishing between competitive behaviour and competition problems

2.2.1 The issue being considered here is not whether some retailers are, through their saves and win-backs practices, more or less successful than others in their customer acquisition strategies. On its own, competition to win customers – whether through saves or win-backs or some other measure – is not a regulatory problem or a market failure.

2.2.2 The key question that is being considered here is whether some competitors or potential market entrants start from a disadvantaged position because the playing field is uneven, not because of their own decisions or capabilities, or the strength of their rivals but because of regulatory settings or market failures e.g. because some firms are precluded from accessing resources which are essential for fuelling competition (a market failure). If the playing field is uneven, this could be undermining competitive pressure in the electricity retail market.

2.2.3 The term 'competitive pressure' is used in this context, rather than competition, to underline that "*competition is not necessarily orderly or constant over time*". [9] To identify potential market and regulatory failures it is best to look beyond competitive behaviour in the market to determine if there is some underlying factor, which retailers take as given, but might be affecting market functioning and competitive pressure in particular.

2.2.4 One example of this is the undue informational advantage obtained by losing retailers during the switching process, which gave rise to the saves protection scheme. The rules which govern switching are very much part of the playing field as opposed to competitive behaviour. To the extent that these rules confer advantages to only some retailers, there is a potential regulatory problem – as discussed below in section 2.3.

[9] Electricity Authority (2011) 'Interpretation of the Authority's Statutory Objective', 14 February 2011, para A.26.

2.2.5 ‘Market failure’ occurs when non-regulatory impediments exist that prevent markets allocating resources efficiently. Causes of market failure include market power, externalities, asymmetric information or prohibitive transaction costs.[10] ‘Regulatory failure’ is when impediments, including asymmetric information and inability to design, prescribe and enforce effective regulation, inhibit regulation improving the resource allocation. Poor market outcomes can be the result of market failure, regulatory failure or a combination of both. It is not appropriate to simply observe poor outcomes and ascribe that to market failure.

2.2.6 Asymmetries, in terms of costs and information, can create barriers to entry which undermine competitive pressure. But asymmetry is key. A cost advantage is not a barrier to entry if the same advantage can be obtained by others. Barriers to entry are costs necessarily incurred by new entrants that incumbents do not (or have not had to) bear.[11]

2.2.7 The importance of asymmetry means that, although competitive behaviour should not be the focus of an investigation into potential market and regulatory failure, it is nonetheless important to take account of competitive behaviour because this can help to identify whether cost advantages are indeed asymmetric. It can also help to uncover whether costs (or advantages) are necessarily faced by new entrants, or whether they can be avoided as a matter of competitive strategy.

2.2.8 This distinction between advantages and asymmetrically obtainable advantages is important in the context of customer acquisition. What may look like an advantage may in fact be a symptom of competitive success or the result of costly effort. This is discussed further below in section 2.5.

2.2.9 Similarly, costs of having to search for customers (search costs) can cause friction in markets and are potentially barriers to entry that reduce competitive pressure. But only if search costs are asymmetrically high for entrants relative to incumbents and are inescapable. Below (in section 2.4) we briefly discuss the mechanics of search costs.

2.2.10 Two clear areas in which problems can occur from competitive or rivalrous behaviour are abuse of market power, through measures such as predatory pricing (discounting below cost to limit growth in a competitor’s market share or as a barrier to entry), and misleading claims.

2.2.11 These potential problems, while important in general, are already subject to regulation under the Commerce Act 1986 and Fair Trading Act 1986. The Authority (2014b) has previously noted that any evidence of breaches of the Fair Trading Act 1986 should be provided to the Commerce Commission.[12]

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[10] These examples are cited in the Authority’s Consultation Charter (2012) para 2.5.

[11] There are numerous definitions of barriers to entry but this one usefully distinguishes the source of problem from outcomes, which some definitions fail to do. It also accounts for the dynamic nature of competition by not considering sunk costs or capital requirements to necessarily be barriers to entry.

[12] This point has been made before in Authority (2014b). See, for example, paragraph 5.1.14 of that decisions and reasons paper.

2.2.12 The Authority is prevented, under the Electricity Industry Act 2010, from making Code amendments that purport to take actions or regulate matters that are the responsibility of the Commerce Commission under certain parts of the Commerce Act 1986. However, the Authority might investigate such matters, if evidence warranted it, to check for any contributing problems related to market or industry regulation. The Authority can notify the Commerce Commission of any issues as envisaged in the Memorandum of Understanding between the agencies.[13] But because such matters are already subject to regulation and oversight,[14] they are not considered in any further detail, except to the extent that the Authority can undertake initiatives that promote competition and mitigate market power.

2.3 Informational advantages obtained in the switching process

2.3.1 A key factor in the Authority's decision to introduce the saves protection scheme was that losing retailers have 'inside information' about switching customers[15] and, through the switching process, are warned of customers' intention to switch.[16] This notification is provided in accordance with clause 22 of Schedule 11.3 of the Code. The saves protection scheme was intended to resolve a regulatory problem by limiting losing retailers' use of their informational advantage and so levelling the competitive playing field.

2.3.2 The Authority determined that reducing the informational advantage of losing firms might increase retailers' returns to acquisition activity and increase competitive pressure in the retail market by reducing a potential barrier to entry.[17]

2.3.3 The post-implementation evaluation of the saves protection scheme found no evidence of a detrimental or positive effect on retail competition and that win-backs were substituted for saves with no overall change in retention of switching customers. This raises a question about whether the notification of a switch continues to provide a useful advantage to retailers using win-back strategies?[18]

2.3.4 That said, the informational advantage that was identified in the case of saves protection was not a clear-cut barrier to entry. The informational advantage from a switch notification is available to both entrants and existing retailers. And if the case for saves protection is not clear-cut, it is less clear cut in the case of a win-back which, crucially, does not rely upon early notification of a switch.

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[13] See https://www.ea.govt.nz/dmsdocument/8957.

[14] Including the Authority's market monitoring function.

[15] We refer to 'customers' when discussing commercial strategy and retailers' relationships with those that they sell services directly to. The term 'customer' is distinct from 'consumers' which is, in general, a broader category of those people or organisations that use and benefit from electricity services.

[16] Electricity Authority (2014b), paragraph 3.2.3.

[17] Ibid, paragraph 3.2.2.

[18] This is question (1)(iii) on which the MDAG is seeking feedback.

2.3.5 On the other hand, it is true that established retailers with larger existing customer bases may have more opportunities to use the informational advantage from switch notification. This may be a source of asymmetric advantage for incumbents. Ultimately, this is an empirical issue, and the data does not suggest any asymmetry (as discussed in section 5 with reference to the wide range of different loss and retention rates related to win-backs).

2.3.6 Furthermore, win-backs differ from saves because, with a completed switch and a new contract in place, it is possible to prevent a switch being withdrawn. This is not possible for a save. In its decision on the saves protection scheme, the Authority (2014b) concluded a restriction on win-backs was not necessary at that time because:

a) a win-back does not rely, necessarily, on information provided for the switch process

b) there was no evidence win-backs were a problem for competition

c) gaining retailers could mitigate this risk (e.g. through fixed term contracts).

2.3.7 If it was the case that these conditions did not hold, or no longer hold, then the rationale for the saves protection scheme (the regulatory problem identified) would provide a reasonable starting point for identifying a problem in the case of win-backs.

2.3.8 For example, some retailers may prefer not to enforce contractual terms on customers won back from them, because of concerns that it will damage their reputation. However, other retailers likely do enforce contractual terms on customers they have acquired.

2.3.9 Unwillingness to impose or enforce contractual terms because of potential customer reaction is a competitive choice. But if gaining retailers could not enforce fixed term contracts, for reasons other than customer preference or competitive pressure, this could be a source of market or regulatory failure. But there is scant evidence in this matter, prompting the question: Is there a market or regulatory failure preventing acquiring retailers using contractual terms to counter win-backs, given that some retailers are prepared to enforce contracts when customers leave them before the completion of the contract term?[19]

2.4 Search costs may exacerbate underlying market failures

2.4.1 In an active acquisition campaign, retailers would contact a range of potential customers using a variety of methods. Some of these potential customers will have no desire to switch or to engage in a discussion about switching. Searching around for customers who might like to switch comes at a cost. However, if you know that a person is apt to switch, then the cost of searching for switchers goes down.

[19] This is question (1)(ii) on which the MDAG is seeking feedback.

2.4.2 Imagine that there are two types of customers: switchers and stayers.[20] Also imagine that people shift between these two types from time to time. When a customer chooses to switch to another retailer that is proof that they are a switcher – at least for a while. The chance of the losing retailer successfully re-acquiring that customer is, in general, much higher than the chance of acquiring new customers by other means (as those potential customers may be switchers or stayers). There will still be some cost associated with contacting and convincing the lost customer, but search costs are reduced. Arguably, the existing retailer will pay up to their avoided search costs to keep that customer. At the same time, the retailer who caused the customer to reveal that they are a switcher will have higher search costs.

2.4.3 Notably, new entrant retailers may face search costs but not reduced costs of retention, because they have few, or no, customers to save or win-back. If this is the case, it could exacerbate any underlying market failures or regulatory problems.

2.4.4 On their own, search costs cannot be considered market failures unless they are persistently and inescapably higher, at the margin, for entrants than for incumbent retailers.

2.5 Private information may confer a competitive advantage but may not be a market failure

2.5.1 Retailers have an informational advantage over their competitors when it comes to knowing the characteristics of their existing customers and whether a customer is worth keeping. This advantage comes from having information about a customer's energy consumption, load profiles, expenditure, bad debts and past loyalty (tenure with the company).[21]

2.5.2 Some customer attributes can, however, be inferred, with error, by competitors. They can profile potential customers using characteristics such as locations or by asking consumers about their characteristics (e.g., income and household size). Competitors can also use credit ratings to assess the risk of bad debt. However, acquiring this information comes at a cost. And, retailers may spend time and money searching for and profiling potential customers only to find that a consumer is relatively high cost and relatively low profit.

2.5.3 Knowing whether a customer is loyal or not may be one aspect of customer information that is quite valuable. But there is a sweet spot in consumer loyalty. An acquiring retailer needs a consumer to be a switcher, to have much chance of securing their business. But extremely fickle consumers, who switch frequently, are also problematic because those customers may leave before the gaining retailer recoups the costs of acquisition.

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[20] We use the phrases 'types of customers' or customer 'types' to refer to differences between customers, which may or may not be observable. Terms, like customer categories or market segments, have roughly the same meaning but they suggest a specific operational or commercial context.

[21] Collecting and holding this information is not costless but is less costly to hold than it is for a competing retailer to acquire.

2.5.4 In this context it can be useful to think of three categories of customers: the frequent switcher, the sometimes switcher, and the never switcher. As before, people can change type and, while a customer's current type can be predicted (with error), retailers can predict their own customers' types better than the types of other potential customers.

2.5.5 The possibility of acquiring a frequent switcher exacerbates the search cost problem raised earlier. An acquiring retailer not only has to engage in a costly search to find a switcher, but there is also a risk that the switcher is a frequent switcher. This makes searching even more costly and increases the advantage that retailers have from better knowledge about their own, existing customers.

2.5.6 That said, if a losing retailer seeks to retain a customer, this signals that the customer is a good bet. In this way the information held by the incumbent is, at least partially, revealed to the acquiring retailer. Accordingly, innovative acquisition strategies could take account of this information (such as by offering to at least match a 'deal' if the losing retailer provides another offer). Additionally, retailers can check whether customers are frequent switchers by viewing ICP switching history in the registry. However, they can only legally check the ICPs of customers they serve or ICPs provided by customers who approach them seeking to switch.

2.5.7 As retailers, at a cost, build up information about their customers, that private information becomes a proprietary asset – supporting innovation and competition in a workably competitive market. That is, informational advantages cut both ways. All retailers can benefit from the advantages, once they are established in the market.

3. Consumer motivations and gains from switching

3.1 Key issues

3.1.1 Consumers are both beneficiaries of retail competition and important drivers of retail competition. Were it not for bargain hunters and customers who want to switch there would be only limited demand-led competition in the retail market. Thus, the consumer perspective on retail competition is crucial context for any appraisal of retailer customer acquisition behaviour. And importantly the long-term benefit of consumers is the Authority's key objective.

3.1.2 The evidence discussed here is largely a summary of information in prior consultations and research by the Authority. [22]

3.2 Why do customers switch?

3.2.1 A range of factors influence how customers react to retailers' customer acquisition and retention strategies. Amongst the factors that retailers have any control over, price and ease of joining are the main ones.

3.2.2 Consumer surveys indicate that price is *the* key factor for customers in selecting their electricity retailer. Surveys consistently find that a better deal or price is by far the most frequent reason people cited for changing retailer or plan (56 per cent).[23]

3.2.3 The main reasons for not switching, after having considered it, are also mainly financial. The most frequently cited reasons were that the current retailer provided a better counter-deal or a credit, or that the savings weren't large enough to justify switching.

3.2.4 Knowing about the potential for a saving is not sufficient to spur a switch. This is because it takes some effort to find out about different electricity retailers and their offerings. Consumers make a trade-off between incurring search and other transaction costs, and the expected benefits in terms of price and non-price attributes (such as customer service, environmental credentials, and ownership).

3.2.5 Customer surveys show that switching is perceived to be easy. The UMR survey for the 2014 saves and win-backs consultation paper noted that 85 per cent of switchers rated the switching process as easy or very easy.[24]

3.2.6 Two-thirds of customers see electricity as something worth actively shopping around for. Thirty per cent said they actively investigated different offers in the last year, even though they did not switch, while 17 per cent of respondents said they switched in 2016.[25]

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[22] In particular, the 2014 consultation paper on saves and win-backs (Electricity Authority, 2014b).

[23] Electricity Authority (2014a)

[24] By way of context, 60% of ICPs have switched at some point in the past 15 years.

[25] Electricity Authority (2017)

3.2.7 Reasons given for not switching include that people are happy with the service (86 per cent), do not trust there will be real gains from switching (77 per cent), or are too busy to shop around (43 per cent).[26] More generally, surveys report 'hassle' or variants thereof as reasons that people do not switch.[27]

3.2.8 Switching is also aided by price comparison sites that reduce the cost of searching for suitable plans and providers. However, plans are often not directly comparable, and consumers cannot always easily compare prices posted on price comparison sites with prices posted on retailers' websites. This can make it harder for customers to confirm the savings—and where plans are bundled with different services, it may be even harder to be certain about savings, or the unbundling may add to the customer's switching cost.

3.3 Different customer types

3.3.1 Survey evidence and switching data suggest that there are broadly four/five types of customers, in terms of switching behaviour:

- a small group of frequent switchers, who actively look for savings
- a larger passive group of people who would consider switching, if prompted
- a group that is currently not interested in switching, because they had already switched in the last couple of years
- a group that is not interested in switching at all.

3.3.2 A slightly different take on this can be found in switching data that is measured at an ICP level. This data shows that breaking ICPs into five groups, based on the probability of switching each year, explains the vast majority of variations in switching patterns.[28] These groups are:

- A group of **very frequent switchers** with an average annual probability of switching of 0.75 (comprising 27 per cent of ICPs)
- a **frequent switchers** group with an average annual probability of switching of 0.29 (comprising 17 per cent of ICPs)
- a **moderately frequent switchers** group with an average annual probability of switching of 0.17 (comprising 10 per cent of ICPs)
- an **infrequent switchers** group with an average annual probability of switching of 0.10 (comprising 4 per cent of ICPs)
- a **never switcher** (yet) group which comprises around 40 per cent of ICPs.

[26] Ndebele, T (2016) 'Consumer Demand for Green Electricity: A study of Consumer Switching in New Zealand Retail Electricity Markets', PhD Thesis, University of Waikato.

[27] See e.g. Electricity Authority (2014a).

[28] Clustering of switching frequency, of all kinds, at ICPs between 2013 and 2017 explains 91 per cent of the variation in switching rates.

3.3.3 This ICP data is not connected directly to individual consumers or people in households. It captures changes in retailers when a customer decides to switch as well as changes when people move into a new home – which may or may not reflect a customer's decision to switch retailers. Moving has a large effect because it constitutes more than half (64 per cent)[29] of all switches, which reflects typical household tenure.[30]

3.3.4 Some consumers will simply take their retailer with them when they move – which will be recorded as a switch if another company was serving that ICP before the move in. For others, the move may be a moment when switching comes to mind, as suggested by the survey data.[31]

3.3.5 Surveys also suggest some customers are generally more open to switching than others and are motivated in their choice of retailer more by financial benefits than other attributes. These surveys also show there is a very small group of frequent switchers. According to UMR (2014), among customers who had switched, 17 per cent had switched twice, and 2 per cent had switched three or more times, in the preceding two years. These proportions were similar to customers who considered switching but stayed.

3.3.6 The surveys also suggest differences in motivation or preference. Customers who proceeded to switch were more likely to have been actively considering it: 68 per cent had been approached by the retailer, but the others had first contacted the retailers and visited Powerswitch. This contrasts with potential switchers (those who were saved), where 80 per cent had been approached by the retailer.

3.3.7 According to the UMR (2014) survey, customer characteristics that increase the likelihood of having switched or having considered switching are:

- age – younger customers are more likely to switch than older customers
- income – higher income customers are more likely to switch than lower income customers
- location – urban customers are more likely to switch than provincial/rural customers.

3.3.8 Ndebele (2016) provides another source of insight about the relative influence of price and selected non-price attributes in electricity retailer decisions by New Zealand customers. The study finds that some customers value non-price attributes more than other customers and would be willing to pay a premium (forego a financial saving) for them.

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29 Average annual share in the 2 years to the end of 2017.

30 According to Census data, there is a one in five chance that a person in New Zealand, chosen at random, will have moved in the past year; average tenure for renters is around two years and for homeowners it is seven years.

31 ICP switches are recorded in the Registry according to whether they are related to: move-ins, a change in metering, or a non-move-in switch between retailers (a "trader switch"). In this paper, data on switches relates to move-in and trader switches. Switches can also occur when, for example, a retailer buys or merges with another retailer. This sort of switching activity is not considered in this report. Switches can also be withdrawn due to errors. Errors are not included in the data on switching used throughout this paper.

3.3.9 Non-price attributes included call waiting time, the length of term offered for fixed rates, loyalty rewards, environmental credentials, and local ownership. Ndebele (2016) identified three different classes of consumers, as outlined in the table below.

Table 1: Examples of retail customer segmentation

	Size	**Characteristics**
Bargain hunter	40%	• mainly concerned about price • would switch to save at least $125 per year • likes longer fixed term price guarantees • is younger, has higher income, higher education, and largest average household size
Discerned	46%	• would switch but values attributes, such as fixed rates, loyalty rewards, renewable energy, and local ownership • would need to be offered at least $135 per year • more likely to be female, have lower average income, and have highest environmental attitude score
Loyal patriot	13%	• shows lowest willingness to switch, and is less concerned about other attributes • would not switch supplier for a saving that is realistically going to be offered • is older, has lowest income, and smallest household size

3.4 Size of incentives required to switch or stay

3.4.1 There appears to be some variation in the amounts of money consumers need to be convinced they would save, for them to switch to a new retailer rather than stay with their current one. Ndebele (2016) asked survey respondents what level of savings they would need to be offered in order to switch retailers. The majority said they would have switched in the last two years if they had been presented with average annual savings of under $200 (Ndebele 2016, p105). Ndebele (2016) also estimates that new entrant retailers need to offer customers a higher saving than established retailers (of about $10-$52 per month).

Table 2: Savings needed to entice a switch

Annual saving	Number	Percent
$100	139	62%
$200	45	20%
$300	18	8%
$400	11	5%
$500	6	3%
Would not	5	2%
Total:	**224**	**100%**

Source: Ndebele 2016

3.4.2 Ndebele (2016) also notes that hypothetical switching behaviour – based on simply asking people if they would switch and for what savings – far exceeds the actual annual switching rate of 20 per cent. This partly reflects his methodology, but also that many customers are passive – with about a fifth of people saying they never looked at opportunities to switch, and another fifth only looking once every two years or more. The implication is that enticements to switch, to be effective, need to be greater than survey responses suggest.

3.4.3 Yet retention payments seem to sit within a range that would not be especially effective given the annual saving amounts from switching shown in Table 2. In 2014, retailers reported the usual amount given to retain customers (as a credit) was in the $50-150 range.[32] This accords with UMR (2014) who found that 57 per cent of customers who were retained were offered a credit, around two-thirds a credit of under $150, and the remainder $150 or over. These data do not give insight into why a portion of customers would accept a one-off credit to stay, foregoing annual savings. It may be related to risk- or loss-aversion. However, the data do provide evidence that consumer behaviour is an important driver in the relative cost-effectiveness of retention versus acquisition strategies.

[32] Electricity Authority (2014a).

4. Retailer customer acquisition and retention

4.1 Key issues

4.1.1 Customer acquisition and retention is an imperative for retailers. A key part of how retailers compete is making choices around how to acquire and retain customers and how to react to competitive threats from other firms. However, some retailers have reported concerns that some acquisition and retention strategies put small and new entrant retailers at an undue competitive disadvantage and undermine competition. The evidence is not clear.

4.2 Acquisition and retention strategies in competitive markets

4.2.1 Retailers face a number of choices when adopting customer acquisition and retention strategies, and none of these is without risk. As a result, we would expect retailers to adopt different customer recruitment, retention, and management strategies. This includes some retailers focusing on retention and others focusing on acquisition. We would expect these strategies to change in response to the actions of competitors and other changes to the commercial environment.

4.2.2 At a high level, retailers need to decide:

- methods to use to entice or retain customers
- the kinds of customers to target:
  - potential new customers
  - existing customers
  - particular types of customers
- when to target consumers
- how much time and money to devote to acquiring or retaining customers.

4.2.3 Retention strategies are not fundamentally different to acquisition strategies. Keeping a customer is as good, and sometimes better for a retailer, than having to find new customers.

4.2.4 The decisions that retailers make and the success of retailer strategies are affected, significantly, by the wider retail market environment, the amount of competition in the market and the strategies employed by other retailers. As a result, it is to be expected that some retailers may tailor their strategies depending on the kinds of competitors they face in localised markets.

Acquisition and retention methods

4.2.5 Methods that retailers use to entice customers include combinations of:

- direct marketing, such as door-knocking
- advertising and brand promotion

- sign-up discounts and other deals including discounts for referral
- innovative offerings, whether price-related or service-related, such as bundling electricity supply with other services
- buying other retailers.

4.2.6 Retention methods are a subset of acquisition methods, involving advertising and promotion, discounts and deals and other special offers or new services. They also include decisions about whether or not to have minimum term contracts for new customers to ensure that they have a higher likelihood of being retained.

4.2.7 Direct or active acquisition methods, such as direct marketing or buying other retailers, will generally have the highest cost, on a per-acquisition basis. They are highly targeted, which can have advantages when it comes to targeting particular kinds of customers, but they do not have the more general, potentially positive, effects of brand enhancement through advertising and promotions.

4.2.8 Discounts, special offers and special service offerings can be both direct acquisition and retention methods and play an important part in brand development.

4.2.9 Survey evidence suggests that direct contact is an important part of retailer acquisition activity. According to survey evidence in 2014, a majority of customers who switch, or consider switching, are prompted by being approached by a retailer, usually by phone or face to face contact.[33]

4.2.10 Of customers who were retained (or saved), almost all (93 per cent) had heard from their existing supplier (but of those who switched, a much smaller share – just over half – had been contacted by their existing retailer). This suggests that making contact with the customer is effective, and/or that retailers are good at targeting customers most likely to be able to be convinced to stay.

4.2.11 The most commonly reported tactic by losing retailers, to convince customers not to switch, was to offer a credit. However, many losing retailers also offered a similar or better deal than the competing retailer—and a third of potential switchers said there was a term attached to the incentives. Less common tactics were to question the accuracy of the deal (5 per cent mentioned this), or to be reminded of the termination fee (3 per cent), usually valued in the \$100-\$150 range.[34]

4.2.12 There is more information about acquisition behaviour than on how retailers defend against win-backs. This prompts the question: What sorts of strategies do acquiring retailers have to defend against win-backs and how cost-effective are they?[35]

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[33] Electricity Authority (2014a)

[34] Electricity Authority (2014a)

[35] This is question (1)(i) on which the MDAG is seeking feedback.

Targeting customers

4.2.13 Choosing customers to target involves balancing considerations such as:

- how much they are likely to spend
- their cost to serve, including costs of customer support, billing and late payment or default risk[36]
- how loyal they are likely to be
- how costly it will be to acquire the customer (including the likelihood of success).

4.2.14 For some retailers, particularly smaller retailers, the question of who to target will be intimately connected to their value proposition and their brand identity.

4.2.15 Amongst these decisions, retailers need to decide how much time and money to devote to retaining customers versus acquiring customers. The effects of which, will depend a great deal on the method chosen to entice or retain the customer and the methods chosen by other retailers to entice or retain their customers.

Acquisition strategies and timing

4.2.16 Considerations around timing of acquisition strategies include:

- when, in the customer life-cycle, to entice targeted customers
- whether to increase or decrease acquisition and retention activity when competitors are increasing their activities.

4.2.17 If, for example, a retailer gives an existing customer a special deal to stay with them, such as a one-off account credit, there is a risk that the customer will pocket the gain and then leave later anyway. If another retailer is actively promoting sign-up discounts, this risk gets larger.

4.2.18 More generally, there is a strategic trade-off between inducements now and inducements later. Saving deals for later reduces a retailer’s attractiveness to new customers but increases chances of keeping them later on. Offering very good prices and services upfront may be an effective way to attract new customers but it can also limit options for enticing customers to stay.

4.2.19 Similarly, retention strategies might include loyalty schemes that reward customers for tenure or for purchase quantities, but the more a retailer spends now on establishing loyalty, the less is available later to induce customers to stay if they are enticed to leave. So here too there is a trade-off.

4.2.20 This timing problem was addressed, partially, by Mercury Energy in 2016 when the retailer introduced a fixed price contract combined with a fixed term. Media reports suggest the contract was widely taken up. Mercury was able to avoid the problem of customers pocketing savings and moving on but

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[36] To the extent that there is any material variation. One source of variation in costs is geographical variation in wholesale energy prices and whether the retailer is pre-established in that area. Targeting customers in new areas will generally involve new fixed costs associated with, for example, agreeing to use-of-system agreements.

it remains to be seen whether they will be able to match or better these contracts when the terms expire.

4.2.21 For individual firms, the right strategy will depend on whether the firm is well-established. A new entrant retailer needs to focus on acquisition. Retention is a much less pressing matter because consumers are much less likely to leave if they have only recently joined.[37] But as the firm grows, and the tenure of its customer base increases, then retention may become a factor. The firm can continue to offer very competitive upfront deals and rely on a net inflow of customers, but competition for new customers and costs of acquisition campaigns can mean that continuing such a strategy is not profitable. If the firm decides to increase attention to retention, it may struggle to find ways to profitably retain customers if it offered very competitive deals to attract them in the first place.

4.2.22 Changes to technology and innovation in retail services will also affect firms' decisions about when to offer inducements to customers. There is a risk that competitors will come up with a better offer that the current retailer cannot compete with. If that happens, it could eliminate or reduce gains from any inducement.

4.2.23 Ultimately, when it comes to inducements and acquisition and retention there is no single effective strategy, in a competitive market, that will always work best.[38]

4.3 Sources of concern

4.3.1 Although retailers big and small, established or new, are free to choose, and do choose, a variety of acquisition and retention strategies, these choices are not without costs. Concerns have been raised that saves and win-backs impose inefficiently high costs and a potentially undesirable competitive disadvantage or barrier to entry for small entrant retailers.

4.3.2 One concern is that new entrant retailers may not have the same large dependable sources of cashflow that large and established retailers have, because the latter's customer bases include large numbers of customers who have never switched. This implies that smaller and new entrant retailers may be less able to afford reduced acquisition success rates (as discussed in the Authority's 2014 *Saves and win-backs consultation paper* and *decisions and reasons paper*).

4.3.3 It is true that long-established retailers do have larger customer bases. Based on available data on switches since 2002, 42 per cent of residential ICPs have never switched. By definition, all of those ICPs are customers of existing retailers. But this perspective needs to be weighed against the fact that just because a retailer is a new entrant or small does not mean it has no access to capital to finance the acquisition of a significant number of

[37] Switching data shows that switching loss rates are low initially and grow linearly with time until a new entrant's loss rates are, on average, no different to the market average. The only exception to this is that mid-sized and middle-aged retailers seem to have a slightly lower than average loss rate.

[38] This conclusion is reflected in the economics literature on monopolistic competition and marketing literature on client relationship management and behavioural price discrimination.

customers and grow its business. And, as time passes, customers who have never switched may choose to switch.

4.3.4 Another concern that retailers have raised around retail customer acquisition is that win-backs mean that small debts are left unpaid after a retailer is registered at an ICP for only a few days. We have been informed that this arises from commonly-used operational conventions. Presumably these conventions can be changed if no longer fit for purpose.

4.3.5 There has been some speculation that the relative cost-effectiveness of retention strategies may be causing some retailers to focus on switching customers and reducing pressure on retailers to improve prices to non-switching customers.

4.3.6 Retailers report that win-backs often involve losing retailers matching competitors' prices and offering an additional credit (as mentioned in section 4.2). However, the MDAG is aware that apparent switch withdrawals may be the result of factors other than inducements, such as retailers enforcing the terms of fixed term contracts (eg, customer responses to break fees). The MDAG does not have any information on the proportion of win-backs that are related to inducements or enforcement of fixed term contracts.

4.3.7 There is a view that if retailers were not able to engage in win-backs, then this would put broad-based downward pressure on all prices offered by the established retailers, who serve most non-switching customers. If retailers cannot win customers back by offering them better deals, then these retailers would have to offer a lower price to more of their customers.

4.3.8 Although retailers could continue to target switching customers—perhaps some time after the fact—this may not be as effective as a short-term win-back. There is a view amongst some retailers that it is easier to persuade customers to stay or to withdraw a switch than it is to entice them back, because when a switch is reasonably new or has not been completed (a save) the consumer is much more engaged in contemplating a choice of retailer. They are primed for convincing. In the 'heat of the moment', an offer of a one-off-credit is very attractive even if it comes with a fixed term clause that the customer might otherwise avoid with more considered deliberation.

4.3.9 This raises two distinct and potentially conflicting issues. One issue is whether, if win-backs were not an option, retailers would reduce price discrimination and offer better prices to non-switching customers. It seems unlikely that this would happen because offering deals is one of the ways (alongside offering non-price features, such as service quality) retailers can use to attract customers and to maintain and to try to grow market share.

4.3.10 A retailer that is looking to grow market share can offer larger up-front discounts to new customers, without compromising the retailer's financial sustainability, when those discounts are not also offered to existing customers. And offering reduced prices to customers at little risk of leaving has questionable commercial logic. Sky Television has recently reduced its prices available to existing subscribers, but "[t]he company said existing Sky subscribers will have no change to the cost of their current package - unless

they switch".[39] So there remains some degree of price discrimination between customers, although some sellers may lower prices across the board in response to competitive pressure.

4.3.11 The Authority (2014b) has previously said that it “considers that price discrimination is not necessarily anticompetitive (though in some circumstances it can be a sign of other problems)” (paragraph 5.3.10). Indeed, the sort of price discrimination raised above can be beneficial for consumers overall if customers who pay lower prices are, on average, more price sensitive than those who pay higher prices.

4.3.12 Another issue is whether consumers make decisions ‘in the heat of the moment’ that are not in their best interests. Even if they did, this is not necessarily a market failure that is specific to the switching process or to win-backs. And, if consumers make mistakes in the 'heat of the moment’, is there a way to tell which was intended and which was the error – the switch or the win-back?[40]

4.3.13 That said, the Fair Trading Act does mandate a “cooling off period” of 5 days, for direct marketing, within which consumers can change their minds, no questions asked.[41] It is unclear whether this applies to saves and win-backs. “Cooling off periods” do not apply for renewals of agreements and whether a save or win-back activity is considered to be a renewal agreement is fact-specific for each individual situation. This does raise questions about whether this is a source of regulatory problem(s). The MDAG would welcome feedback on whether there are other regulatory provisions that treat saves and win-backs in a different manner from other acquisition activity in such a way as to constitute a regulatory problem.[42]

4.3.14 Retailers’ marketing activities are regulated by a number of laws which prohibit activities that disadvantage or mislead consumers. This includes:

a) the Privacy Act 1993, limiting, amongst other things, the use of private information to the purposes for which it was obtained

b) the Unsolicited Electronic Messages Act 2007, which includes provisions limiting marketing messages to recipients with whom there has been prior contact or consent

c) the Fair Trading Act 1986, which deals with misleading claims in general and also includes provisions regulating direct and unsolicited marketing such as door-to-door sales. Those provisions include information disclosure requirements and rights for consumers to cancel any agreement within the first five working days.

4.3.15 Although enforcement of these laws is not within the Authority's jurisdiction, widespread use of misleading claims or incomplete disclosure, for example, could justify the relevant regulatory agencies taking further action.

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[39] http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=12003359.

[40] This is question (2)(i) on which the MDAG is seeking feedback.

[41] The Code also requires gaining retailers to notify customers about these cooling off periods where they apply.

[42] This is question (2)(iii) on which the MDAG is seeking feedback.

4.3.16 If a retailer were systematically using misleading claims to acquire customers or to affect win-backs, this would be a problem for the functioning of the electricity industry, for competition, and for the long-term benefits of consumers.

4.3.17 If these activities were also difficult to detect and prosecute on a case-by-case basis, then a regulatory change may need to be considered. There would need to be strong evidence of a persistent problem with wider implications and one that could not be readily and effectively addressed through existing channels.[43] What evidence is there that retailers have engaged systematically in proscribed marketing behaviours?[44]

[43] The Authority (2014b) has previously noted that any evidence of breaches of the Fair Trading Act 1986 should be provided to the Commerce Commission.

[44] This is question (2)(ii) on which the MDAG is seeking feedback.

5. Trends and patterns in customer acquisition and retention

5.1 Key issues

5.1.1 Trends around retail switching show no systematic differences in strategies employed by, for example, big or small retailers that would negatively affect competition in the long term.

5.2 Firm-level acquisition rates vary widely

5.2.1 In the past 12 months one in five ICPs switched between traders. This means that acquiring customers is an important component for financial survival.

5.2.2 On these numbers, a retailer who is not acquiring customers would lose all their customers inside five years. These are only average numbers and reasons for switching do vary. However, retailers must actively seek new customers if they want to maintain market share, let alone grow.

5.2.3 Trends in customer acquisition activity show that firms do indeed adopt a range of different acquisition and retention strategies with a wide variation in emphasis on acquisition and retention.

5.2.4 Based on the discussion above, while one might expect some positive relationship between retailer size and age and use of retention strategies, this does not appear to be the case, at least not systematically. Some evidence for this is summarised in Figure 1 (a more nuanced analysis can be found in Appendix B).

5.2.5 Figure 1 maps each retailer's customer loss rates (the horizontal axis), against their rates of loss avoidance – i.e., where a potential switch has been withdrawn (the vertical axis).[45] Retailer size is shown by the size of dots in the figure. Overall, it shows that large retailers and small retailers alike can have higher than average rates of loss avoidance. This suggests that firms of many sizes make use of switch withdrawals.[46]

5.2.6 This observation does rely on equating switch withdrawal (saves and win-backs) with retention strategies. Although retailers may of course have retention strategies outside of switch withdrawals, there is no data on this.

5.2.7 One might expect firms who are losing a lot of customers to work hard to retain customers. This also does not appear to be the case. Rates of customer loss do not appear to explain loss avoidance rates, but this may be because retailers have simply not been able to implement *successful* retention strategies. This would not be surprising in light of the trade-off between deals now and deals later.

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[45] This withdrawal rate does not distinguish between saves or win-backs because of the Authority's finding that saves and win-backs are substitutes.

[46] The focus here is on switch withdrawals rather than withdrawals plus short term switching of ICPs (as a proxy for customers) back to previous retailers (switch-backs). Short-term switch-backs, inside 60 days, are a small share of switching activity (0.7% of trader initiated switches and 3% of the number of win-backs).

FIGURE 1: SWITCHING LOSSES AND RETAILER REACTIONS TO REDUCE LOSSES

Averages of monthly switch data, from the losing retailer's perspective, 2015-2017

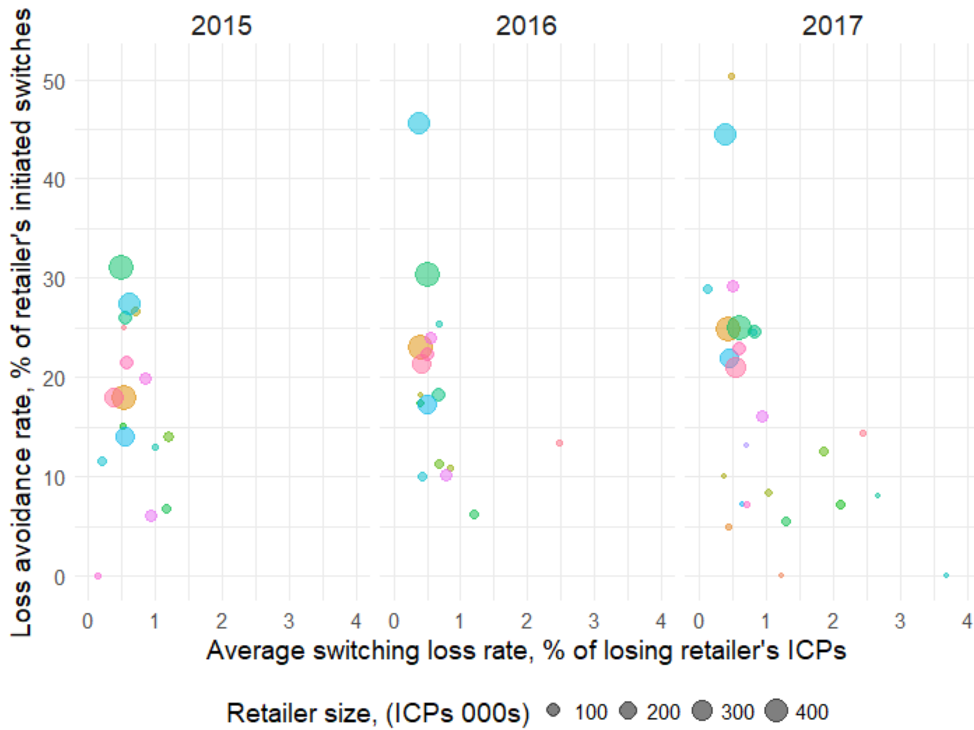
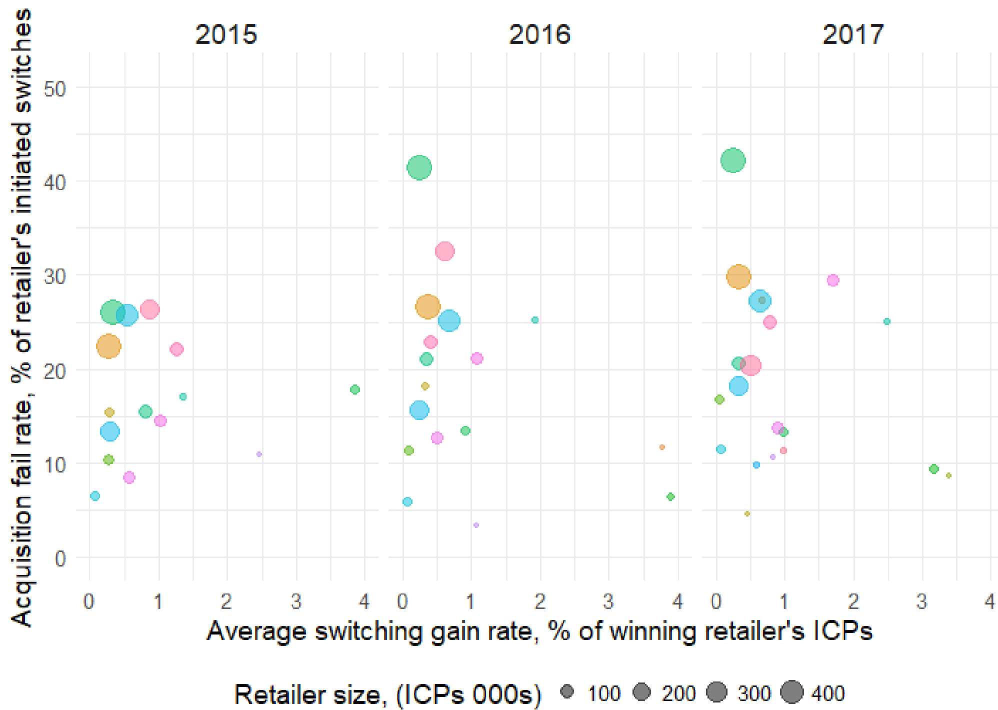


FIGURE 2: SWITCHING GAINS AND ACQUISITION FAIL RATES, AFTER SWITCH INITIATION

Averages of monthly switching, from the gaining retailer's perspective, 2015-2017



5.2.8 Variations in acquisition strategies are also reflected in data on switching gains. Figure 2 compares each retailer's switching gains against the rates at which they fail to gain customers due to a withdrawal (a customer being enticed back to the losing retailer).

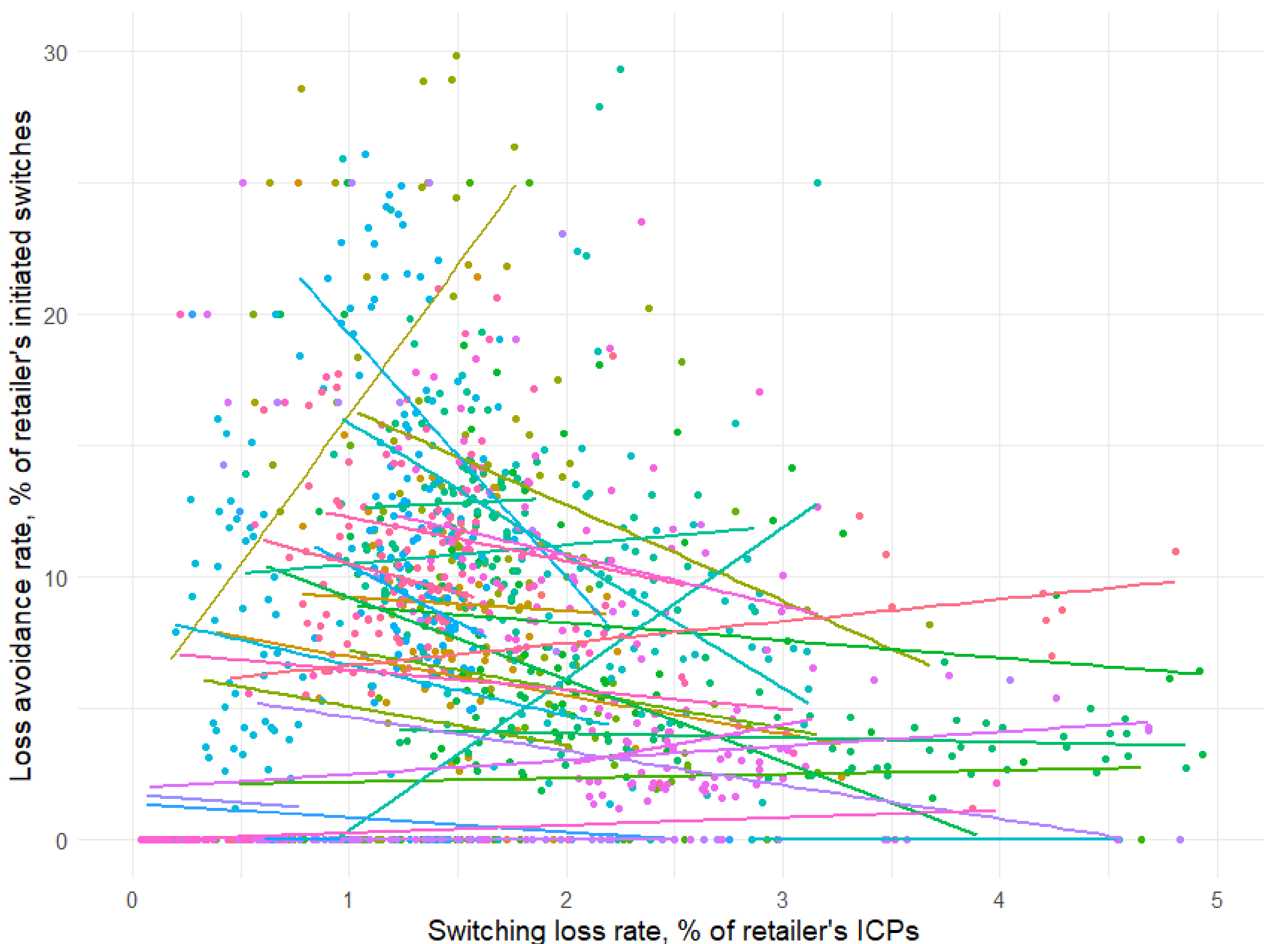
5.2.9 Size does not predetermine either rates of switching gains or whether a competitor will seek to retain customers by blocking acquisitions.

5.2.10 There is also evidence of firms adapting strategies and responding, at variable speeds, to changes in market conditions. This includes changes over time as firms grow.

5.2.11 This reveals itself in a wide range of firm-level relationships between loss rates and loss avoidance rates over time. This is illustrated in Figure 3 where monthly loss rates are mapped against monthly loss avoidance (withdrawal) rates. Relationships vary considerably as shown by the very different slopes of the lines showing average relationships between loss rates and loss avoidance for each retailer. When retailers experience higher switching loss rates they may have either low *or* high rates of loss avoidance. The reason the chart is 'chaotic' is precisely because that is the key message: there does not appear to be any systematic pattern in the data.

FIGURE 3: WIDE VARIATION IN RESPONSES TO SWITCHES AND RETENTION SUCCESS

Monthly switching, from the losing retailer's perspective. Each retailer is a different colour.



5.2.12 An examination of switching origins and destinations also reveals wide variation in who retailers attempt to recruit customers from, and who they lose customers to, and the use of switch withdrawals.

5.2.13 Figure 4 depicts retail customer loss rates by losing retailer (horizontal axis) and gaining retailer (vertical axis). The chart is anonymised. But the patterns indicate:

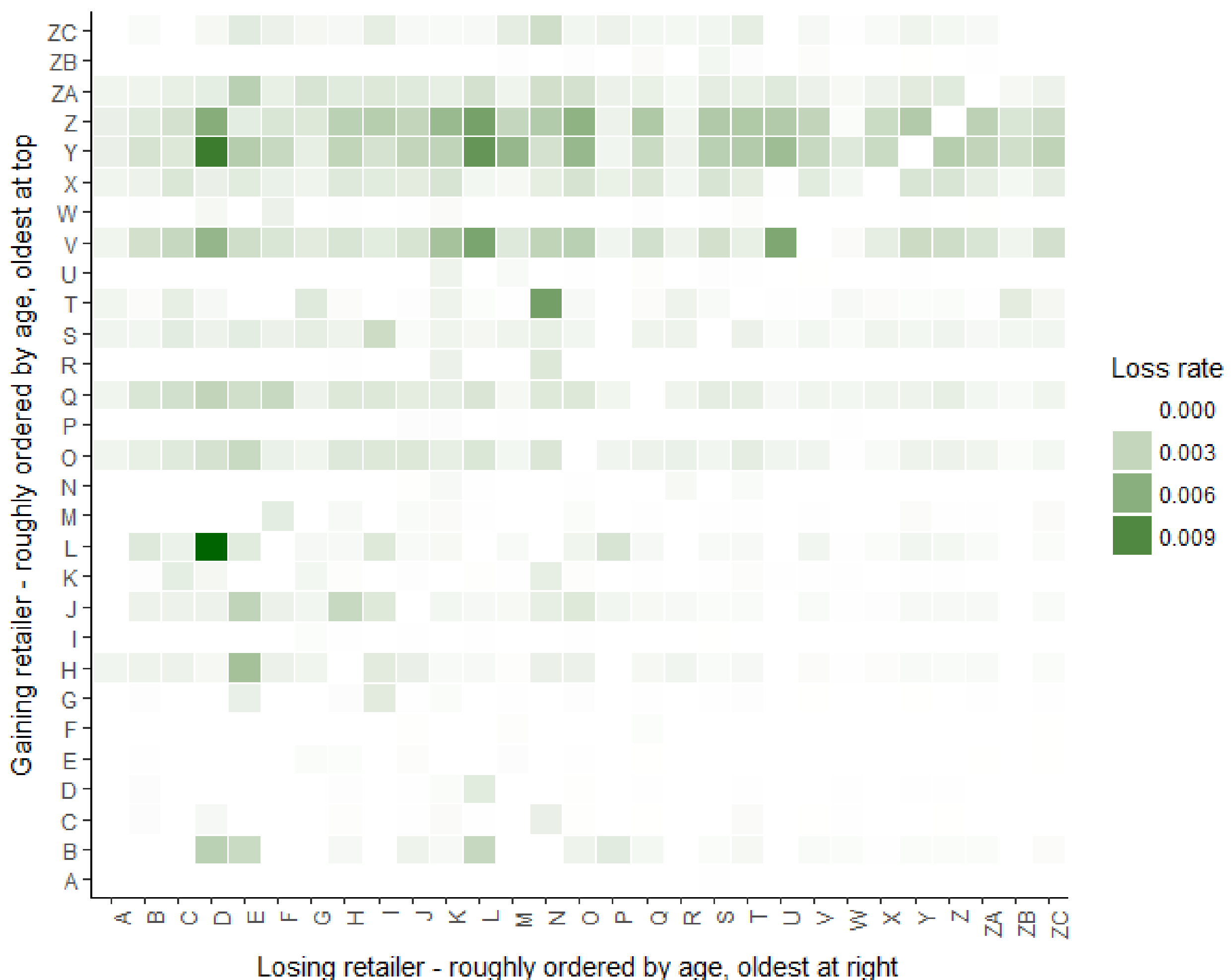
a) high switching rates in some specialised market segments (though this is not true for all highly targeted providers) – e.g. see D and L

b) competition among retailers in a segment, and with retailers in other segments – e.g., D and L have had high median losses (as a share of ICPs) to both large retailers and amongst themselves

c) loss rates vary a great deal with some older and larger retailers (e.g., X) having broadly similar rates of gain as newer mid-sized retailers (e.g., Q).

FIGURE 4: WIDE VARIATION IN RESPONSES TO SWITCHES AND RETENTION SUCCESS

Median monthly loss rates (retailer losses: retailer ICPs in previous month), 2013-2017.[47] Anonymised.



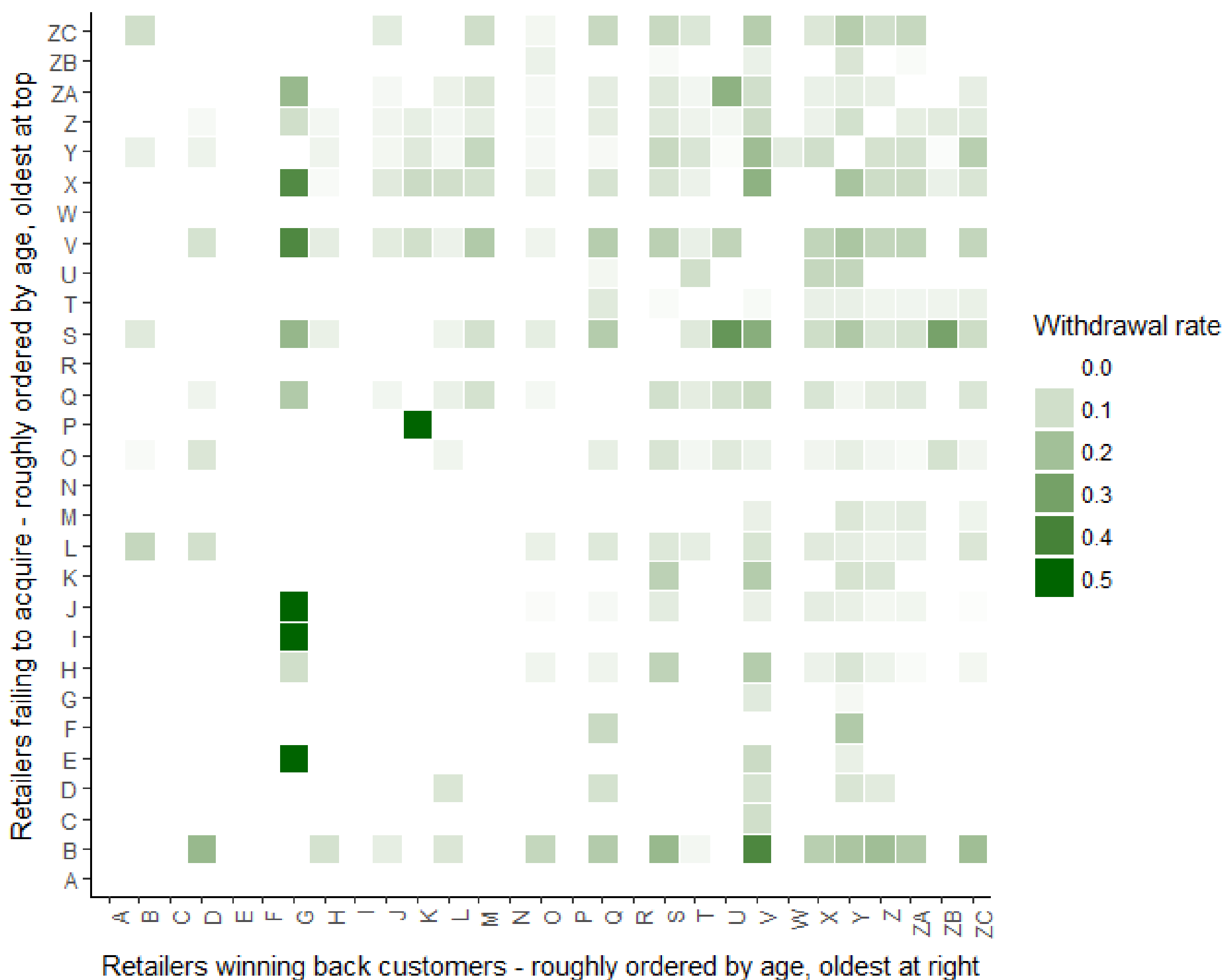
[47] Values in the legend are point values for each colour but the values in the Figure span values (and shades) between these values.

5.2.14 Switch withdrawal rates show significant variation by retailer size. Figure 5 presents withdrawal rates by retailers who have retained customers and the retailers who failed to acquire those customers. This shows that the retailer with the highest withdrawal rates is a small retailer (G) while similar sized retailers have very low or zero withdrawal rates (eg, R).

5.2.15 These observations confirm expectations that firm retention and acquisition strategies vary considerably. They also suggest that retailers have a wide range of choices open to them and that acquisition strategies are an important part of competition.

FIGURE 5: SMALL AND LARGE RETAILERS ENGAGE IN SAVES AND WIN-BACKS

Median monthly withdrawal rates (% of switches initiated at winning retailer), 2013-2017.[48] Anonymised.



[48] Values in the legend are point values for each colour but the values in the Figure span values (and shades) between these values.

5.3 No evidence of negative effects from switching rates on long term competition

5.3.1 Competition is a dynamic and complicated process. The firm-level data presented above illustrate this. These processes have had positive effects on market-level measures of competition.

5.3.2 Current rates of switching across retailers show that competition has been improving. The Authority tracks retail market concentration to measure market performance and competition and this data shows that concentration has been consistently declining since 2010 across all key national concentration measures.[49]

5.3.3 A simulation, summarised in Figure 6 below, suggests that if typical switching rates were to persist in the long run, then most of the larger retailers would lose market share given typical switching dynamics observed between 2013 and 2017.[50]

5.3.4 The simulation also shows that, if switch withdrawals were not an option (and nothing else changed), the effects on firm market shares would vary considerably. Most smaller retailers would benefit, but not all. The market share of most larger retailers would fall further, but not all.

5.3.5 This is a simulation of what would happen if switching patterns observed in recent years were to persist. It is not, and should not be taken as, a forecast of market shares. This analysis does not take account of the volatility inherent in the market and in switching. It also does not take account of changes to firm acquisition strategies and changes driven by technological changes or changes in consumer demand.

5.3.6 Instead, this analysis examines underlying implications of switching trends and whether these trends imply a weakening of competition. This is not possible by simply looking at firm-level switching rates because one firm's loss is another firm's gain and losses and gains today affect losses and gains tomorrow.

5.3.7 One of the key findings of the analysis is that, based on switching rates of the past five years, retail market shares will never settle down or stabilize at any particular value. In other words, there are no dominant players in terms of market share trajectories.[51]

5.3.8 The implication of the analysis overall is that there is strong evidence of ongoing and improving competitive pressure. The simulation implies an ongoing decline in market concentration with the national top four firm

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[49] These measures include the Herfindahl-Hirschman index and concentration ratios for the top 1, 2, 3, and 4 firms.

[50] The analysis is based on a 'transition matrix' of median loss rates between 2013 and 2017, which describes typical loss rates from each retailer to another retailer. Market shares are then calculated using an initial market share value based on counts of ICPs in the month of December 2017.

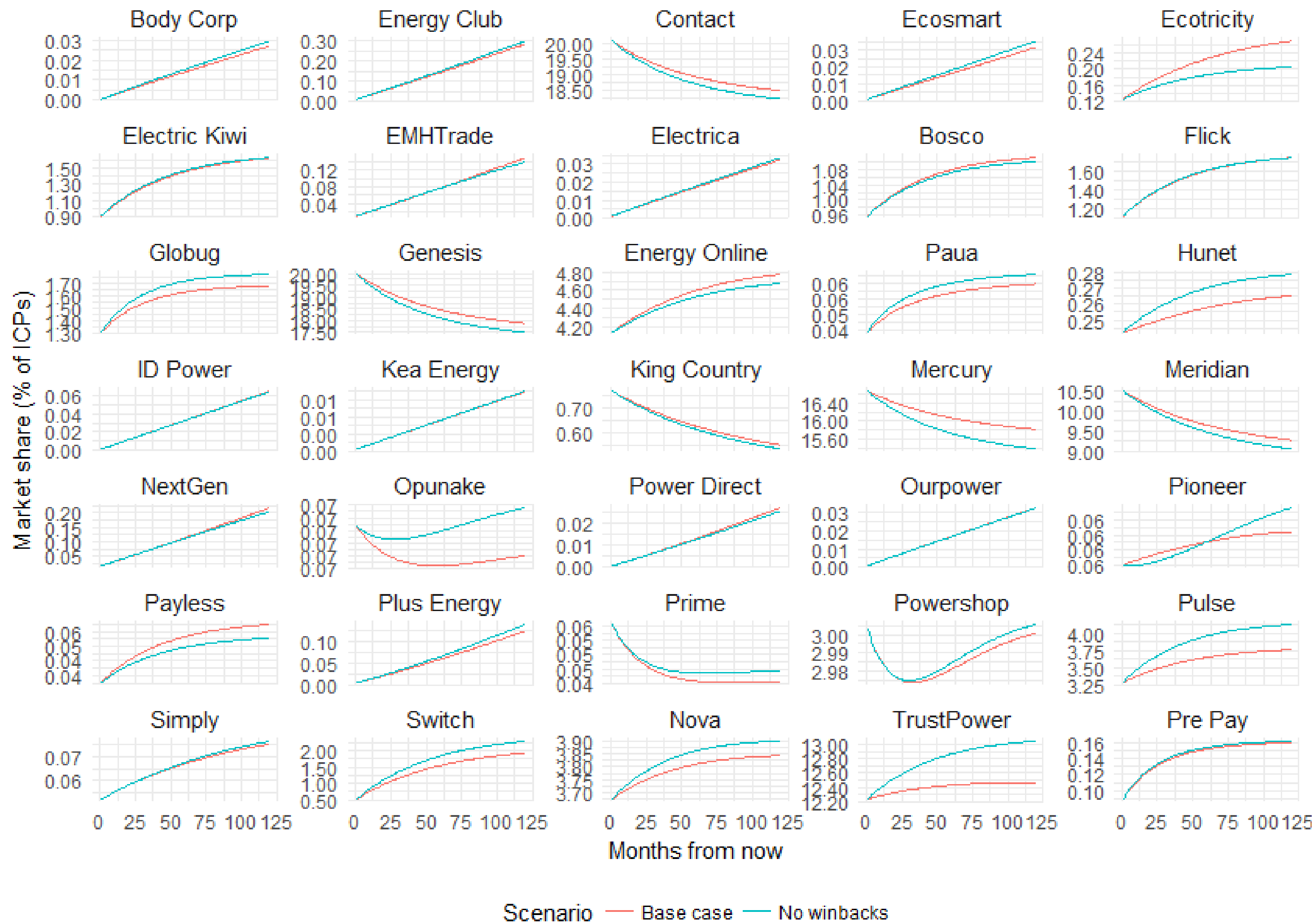
[51] In the analysis used here (Markov chain analysis), dominant players are referred to as 'absorbing states' and stable states exist if rates of transition point to an ultimate end point at which all players have a constant market share – in which case the transition matrix is 'reducible'. The observation made here that the market does not have a stable state only holds when very small retailers with zero loss rates are removed from the analysis. If a player has a zero loss rate it will capture the entire market, eventually. But that would take an extremely long time.

concentration ratio, by parent company, declining 4.5 per cent in the next five years, without any assumptions being made about new entrants (or changes in firms' strategies in response to competition, or other factors).

5.3.9 Absence of switch withdrawals would accelerate reductions in market concentration with the concentration ratio falling by 5.3 per cent inside five years. This result reflects the fact that reducing withdrawals increases the number of switches and consequently augments the overall trend of declining concentration ratios. That is, it reflects the fact that larger retailers are most affected by increases in switching rates.

5.3.10 The implications of increased switch withdrawals for competition are, however, ambiguous, at least in terms of magnitude of impact. This is because the large incumbent firms are assessed as having declining market shares and this decline on its own should suffice to put pressure on these firms to reduce price or improve service quality. It is unclear how much additional impact an increase in switching would have.

FIGURE 6: SIMULATED IMPACTS OF SWITCHING DYNAMICS ON FIRM MARKET SHARES



6. Conclusions and questions

6.1.1 Evidence suggests the market is functioning as one would expect a competitive market to function but there are some potential sources of regulatory failure which may undermine competitive pressure over the long term.

6.1.2 This paper notes that there might be residual and potentially asymmetric advantage to some retailers from early notification of switches – the same regulatory problem which caused the introduction of the saves protection scheme. There is no empirical evidence that this is a problem and it may be that this advantage is much less relevant in the case of win-backs. However, this is one potential issue on which feedback is being sought.

6.1.3 Similarly, there is a question of asymmetric regulatory treatment of acquisition activities, in regard to cooling off periods. That is where the Fair Trading Act provisions, reflected in the Code, apply to direct marketing but not, necessarily, to saves and win-backs. There is no evidence that this is a regulatory problem of consequence. But feedback on this matter is being sought.

6.1.4 A further potential issue is that some acquiring retailers do not enforce contractual terms on customers won back from them, because of concerns that it will damage their reputation. Unwillingness to impose or enforce contractual terms because of customer preference or competitive pressure is not a market failure. However, we would like to know if there are other reasons for not enforcing contractual terms that are a source of market or regulatory failure.

6.1.5 Several other issues have been considered, such as differences in the size of cash-flow or small debts left unpaid as a result of win-backs. For the most part, these other issues are examples of impediments and costs which all retailers face or asymmetric outcomes rather than underlying problems with the competitive playing field. These do not appear to constitute market failures or regulatory problems, but feedback on these matters would still be very welcome.

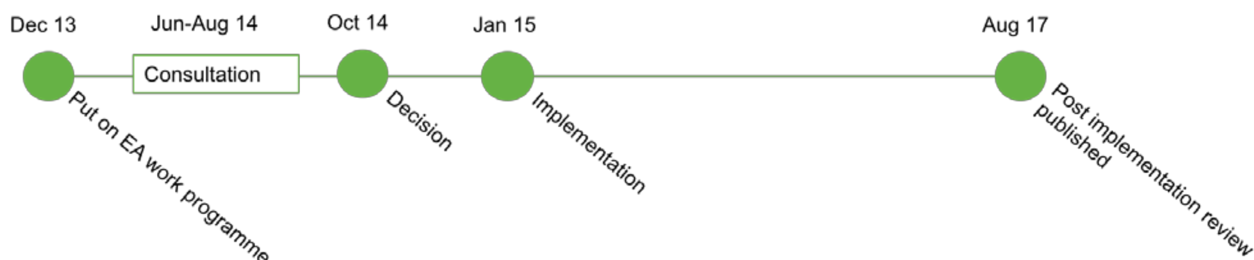
6.1.6 MDAG is seeking information to assist in weighing all the issues it has considered thus far. The following box sets out the key questions that the group is seeking answers to, and, most importantly, evidence or concrete examples that support these views, wherever possible. As noted at the start of this paper, the MDAG is interested in determining what underlying market failures or regulatory problems may exist, and not simply impediments which some retailers face.

1	**Do some retailers have a distinct win-back advantage which others do not have and cannot ever have?**
i	What sorts of strategies do acquiring retailers have to defend against win-backs and how cost-effective are they?
ii	Is there a market or regulatory failure preventing acquiring retailers using contractual terms to counter win-backs, given that some retailers are prepared to enforce contracts when customers leave them before the completion of the contract term?
iii	Does early switch notification give an undue advantage to retailers seeking to win-back customers?
2	**Are consumers frequently prompted into making decisions when they switch or switch back that are not in their best interests?**
i	If consumers make mistakes in the 'heat of the moment', is there a way to tell which was intended and which was the error – the switch or the win-back?
ii	Is there any evidence that retailers have engaged systematically in proscribed marketing behaviours?
iii	Are there regulatory provisions that treat saves and win-backs in a different manner from other acquisition activity in such a way as to constitute a regulatory failure?
iv	What are the implications (if any) for consumers of saves and win-backs?
3	**Are there are any further issues related to saves and win-backs that we have not considered?**

7. Appendix A: past work on customer acquisition issues

7.1 Past consultation and evaluation, and international practice

7.1.1 The following figure summarises past work the Authority has undertaken on these issues.



Consultation paper

7.1.2 The June 2014 consultation paper stated that saves and early win-backs – those occurring shortly after the switch – are likely to have a net negative effect on retail competition.

7.1.3 The reasoning was that, unlike in most other sectors, the current supplier gets advance notice that it is about to lose a customer and can use this information to 'save' the customer. As a result, the effectiveness and profitability of an acquisition campaign is reduced, creating an entry and expansion barrier for small and new retailers. The Authority sees (the threat of) new entry in particular as important for vigorous competition.

7.1.4 The Authority proposed an opt-in save protection scheme. When the gaining retailer opts-in, a losing retailer is not allowed to persuade a customer to cancel the switch or switch back, from the time of being notified of the switch to ten business days after the switch. The save-protected retailer is also not able to engage in saves and early win-backs.

7.1.5 An opt-in scheme was preferred so suppliers could decide for themselves if saves protection was of value, in line with the Authority's preference for non-prescriptive trial-and-error solutions when there is no clear single best option for addressing an identified problem.[52]

7.1.6 Saves protection would mean that some consumers may no longer benefit from retention deals. But the Authority considered that the change would be of long-term benefit to consumers because save protection would promote retail competition through increasing the returns to acquisition campaigns (lowering barriers to entry and expansion for smaller and new entrant retailers), and

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[52] An application of the tie-breaker 1, principles 4 and 8, in the Authority's Code Amendment Principles in the Consultation Charter (2012) available at https://www.ea.govt.nz/code-and-compliance/the-code/amendments/amending-the-code/. Principle 4 is a 'Preference for Small-Scale Trial and Error Options'. Principle 8 is a 'Preference for Non-Prescriptive Options'.

through encouraging retailers to pre-emptively offer their existing customers the best deal.

7.1.7 The benefits from increased competition, innovation, and/or dynamic efficiency were not quantified but were expected to exceed the relatively small costs of the proposal. These costs were expected to consist of compliance costs, increased acquisition retention and win-back costs, and increased retailer overheads.

Submissions

7.1.8 In general, submissions highlighted opposing views on whether saves and early win-backs were a problem.

7.1.9 One view was that saves and early win-backs create an uneven playing field for small and new entrant retailers, and that allowing some consumers to get a better deal than others (including through cherry picking) undermines transparency, which would reduce confidence in the market.

7.1.10 The other view was that there was already healthy retail competition, that the saves and early win-backs process is beneficial to consumers, that the save rate is generally low (especially for the smallest retailers), and that it is not clear that saves or early win-backs are detrimental to new entrants or that blocking saves would improve competition.

7.1.11 None of the submissions presented conclusive evidence in support of either view. Genesis did refer to data showing high switching rates, a declining market concentration index, and four new entrants in the last 12 months.

7.1.12 Submitters generally agreed that early win-backs were similar to saves, but there were different views on what ‘early’ meant.

Decisions and reasons paper

7.1.13 In October 2014, the Authority decided to amend the Code to allow retailers to opt into a save-protection scheme, which prohibits retailers contacting customers they are losing until a switch is complete (the ‘event date’ in Schedule 11.3 of the Code). The Authority decided that the scheme would not extend to early win-backs as it initially proposed, and customer-initiated saves would be unrestricted.

7.1.14 While the consultation document stated that early win-backs were equivalent to saves, and this was accepted by submissions, the Authority concluded a restriction on win-backs was not necessary at that point because:

a) a win-back does not rely on information provided for the switch process

b) there was no evidence win-backs were a problem for competition

c) gaining retailers could mitigate this risk (eg, fixed term contracts).

7.1.15 The Authority did comment that the use of the switch withdrawal process (within two months of the switch completion date) was undesirable unless it was to correct an error. It also stated that it would monitor win-backs and that, if the process was being used frequently, it may ask retailers to collectively agree not to use the switch withdrawal process, except to correct errors, or it would amend the Code to prohibit it (paragraph 4.2.9).

7.1.16 The Authority's paper also canvassed a number of other issues (slamming, overly pushy marketing and door to door and telemarketing sales, misinformation, fixed term contracts, last look clauses), but noted that these are covered under the Fair Trading Act 1986 or other complaints processes.

7.1.17 The Authority decided that it would undertake a review within two years of the scheme coming into effect.

Evaluation

7.1.18 At the end of August 2017, the Authority published a post-implementation review. The method involved analysis of switching data before and after the scheme (with some break-down by save- and non-save-protected retailers), and a survey of providers and consumers.

7.1.19 The evaluation found:

- a decrease in saves, offset by an increase in win-backs, with little net overall impact
- an increase in switching speed for both save-protected and non-save-protected retailers, from an average of 97 hours to 82 hours (p21)
- a reduction in the average time that a switch survives before being withdrawn, from 362 to 316 hours (p26)
  - the switch withdrawal time was shorter on average for non-save-protected retailers (271) than save-protected retailers (389) (p28)
  - the probability of a switch being withdrawn within 1,344 hours was unchanged at 10% (p26)
  - a slightly higher probability of a save-protected switch surviving 2 months (83.5 per cent) than for a non-save-protected switch (83.3 per cent) (paragraph 7.43)
- an indication, given these findings, that save-protection led losing retailers to speed up the switching process so they could start a win-back attempt (paragraph 7.47).

7.1.20 The Authority noted that retail market competition had continued to improve, based on a number of measures, but that this was unrelated to the scheme – the number and market share of small and medium retailers had continued to rise, and switching had stayed at around the same level as before the scheme.

7.1.21 It concluded that there was no evidence the scheme improved or harmed retail competition. It noted that survey respondents indicated cost to acquire customers had increased since the scheme was introduced, but that this may be partly due to other factors.

7.1.22 The Authority concluded that saves and win-backs should be considered together because they are substitutes (paragraph 4.1). It also found that "the problem of the losing retailer being notified that their customer is about to leave has not changed" (paragraph 13.2), and that "further measures are required to improve the effectiveness of the scheme" (paragraph 13.6).

7.1.23 The Authority also concluded that "notification of an impending switch, in itself, may not be a material advantage" because other privately held information about a customer's characteristics may be a more important source of informational advantage (paragraph 13.5). Part of the thinking behind this assessment was that an exchange of information about a trade or a switch of a customer is in fact essential and unavoidable in many markets.

Practices elsewhere

7.1.24 The Authority's consultation document referred to international experience. This is summarised and updated below.

7.1.25 There are two situations where save-protection has been implemented – one was to support fledgling competition in previously monopolistic markets (landlines and cable television), and the other related to privacy law, where a US Court found information provided to enable switching could not be used by that provider for other purposes (such as saves).[53]

Telecommunications

- In New Zealand, marketing to switching landline customers was prohibited to promote competition in the then new retail market. There are no restrictions in the mobile market.
- There are no save restrictions in Australian telecommunications.
- Losing retailers cannot use switch notifications to save telecommunication customers in the US as this information was provided for the purpose of switching (a privacy law point).
- In Canada, cable television companies were not able to market to customers for 90 days after notification of cancellation, but this restraint was eliminated in 2007 when there were no longer concerns about competition.
- In the United Kingdom, OFCOM was of the view that saves discourage market entry, but it recognized the alternate view that saves are beneficial to customers. It concluded the net impact was an empirical matter that comes down to:
    - the relative size of the switcher and non-switcher customers
    - their responsiveness to price
    - the state of competition
    - whether suppliers can target more profitable customers
    - the switching effort and cost.
- In December 2017, OFCOM decided to make switching of mobile providers quicker and easier for consumers.[54] Unwanted reactive save

[53] This may need to be explored in the context of New Zealand's Privacy Act 1993, in particular Information Principle 10, which limits the use of personal information to the purpose for which it was collected.

[54] https://www.ofcom.org.uk/__data/assets/pdf_file/0023/108941/Consumer-switching-statement.pdf.

offers were one potential source of difficulty that consumers experienced. OFCOM concluded that a quicker switching process would significantly reduce the window for the losing provider to get in touch with the consumer, but also that any consumer could simply reject unwanted contact. OFCOM commented that it expects providers not to use the switching process to retain customers and suggests providers could develop an opt-in or opt-out mechanism for consumers who do or do not welcome reactive offers.

Retail energy

- In the United Kingdom, OFGEM requires retailers to offer a limited number of tariffs in consistent formats, which effectively eliminates the ability to offer special deals to selected switching customers
- In September 2017 OFGEM released a consultation document proposing to introduce reliable next day switching, which would "eliminate" saves as a potential issue[55]
- The Australian Energy Market Commission, in its 2017 retail energy competition review, noted that the sector is competitive and that switching rates are higher than other sectors like insurance, and mobile phones, but that plans are harder to compare. Around a third of consumers investigated options to switch in the last 12 months and half of them did switch. It found that consumers needed to be offered a 23 per cent reduction in their energy bill to consider a switch[56]
- The ACCC is reviewing retail electricity supply and pricing (expected in June 2018). Its preliminary report, dated 22 September 2017, concluded there was insufficient competition in the generation and retail markets. On the retail side, it highlights the types of issues with saves that the Authority has raised, with some retailers commenting on an uneven playing field and aggressive strategies to save or win back customers, and proposing intervention, though other submitters dispute saves are an issue.[57]

7.2 Other customer acquisition and retail competition initiatives

7.2.1 The work on saves and early win-backs forms part of the Authority's broader programme to promote competition in the electricity retail market – in line with its statutory objective to "promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers."

7.2.2 This work includes creating a level playing field for suppliers and "to promote to consumers the benefits of comparing and switching retailers", one of the Authority's functions under section 16(1)(i) of the Electricity Industry Act 2010.

[55] https://www.ofgem.gov.uk/system/files/docs/2017/11/delivering_faster_and_more_reliable_switching_consultation.pdf.

[56] http://www.aemc.gov.au/Markets-Reviews-Advice/2017-Retail-Energy-Competition-Review/Final/AEMC-Documents/Final-Report.aspx.

[57] https://www.accc.gov.au/system/files/Retail%20Electricity%20Inquiry%20-%20Preliminary%20report%20-%2013%20November%202017.pdf.

7.2.3 This emphasis originates from the 2009 Ministerial Review of Electricity Market Performance, which found that there was insufficient competition in the retail market, resulting in excessive retail price increases compared to increases in the cost of new supply, and growing and relatively high retail profit margins.

7.2.4 From when it was established, the Authority has promoted switching, through improving consumer access to price comparisons (eg, Powerswitch), an award-winning 'What's my number' advertising campaign to raise consumer awareness of the benefits of switching, initiatives to reducing switching times, and data initiatives to free up access to individual consumption data to allow consumers to test the market and for new price comparison and switching services to enter the market to intensify competition.

7.2.5 There has also been an emphasis on levelling the playing field for retailers, and to promote entry and expansion of new retailers to increase competitive pressure in the market for the long-term benefit of consumers. This included government initiatives to transfer assets (including virtual asset swaps) among some SOE generator-retailers and allowing lines companies, under restricted circumstances, to offer retail services. Changes to prudential and settlement arrangements[58], and work on a default distributor agreement and hedge markets (including market making of ASX futures and the development of FTRs) all aim to make it less costly and easier for retailers to enter the market and expand.

7.2.6 More recently, the Authority has embarked on a review of switching processes and is consulting on costs and benefits of enabling consumers to use multiple service providers (the 'Multiple trading relationships' consultation).

7.2.7 The 'Multiple trading relationships' consultation also sits within the Authority's broader work programme on 'Evolving technologies and business models'. This programme covers initiatives to reduce inefficient barriers to development and use of evolving technologies and business models across the supply chain.

[58] These changes enabled retailers to have more customers with the same prudential securities in times of high spot prices, and reduced the amount of cash needed for settlement, freeing up working capital eg, for expansion.

8. Appendix B: Model of switch retention rates

8.1.1 The table below summarises results of a model used to examine switch retention or withdrawal strategies and see whether they are related to firm size, age, and the external environment affecting firm losses.

8.1.2 The analysis is only descriptive. It allows summaries of descriptive relationships across several dimensions.

Description	Marginal effect	Standard error
Age	-0.063	0.016
Size (ICPs)	-0.002	0.004
Switches as a % of ICPs in previous month	-0.451	0.7
Year = 2014	0.012	0.01
Year = 2015	-0.013	0.009
Year = 2016	-0.001	0.01
Year=2017	-0.005	0.01
Age, size interaction effect	0.006	0.002

8.1.3 The data is for residential switching rates, from a losing retailer's perspective, from January 2013 to December 2017, by month and by trader/retailer (calendar years, inclusive).

8.1.4 The factors used to explain retention rates are:

- year in which switching occurred (each year in the chart is presented with an effect relative to 2013 as a benchmark year)
- retailer size, measured by the logarithm of the number of ICPs the firm has
- age of the company (in months), also in logarithms, which makes marginal effects easier to see and interpret
- the retailer's loss rate in the month, which will be a function of how effective the firm has been at stemming losses and also external competition and internal operational decisions
- an 'interaction term', which helps to control for relationships between the firm size and firm age variables.

8.1.5 Rates of customer loss (switches as a percentage of ICPs in the previous month) do not appear to explain retention rates. It should be expected that attempts to retain customers would increase as loss rates increase – as retailers move to 'stem the tide' of losses. However, this will only show up in

retention rates if the retailer is reasonably successful. These results show that, across the whole market, retailers have not been successful.

8.1.6 The model results reflect the findings of the 2017 post-implementation review of the saves protection scheme. They show a reduction in retention rates (includes saves and win-backs) immediately after the scheme was introduced but in subsequent years the effect has been small if not zero.