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CUSTOMER ACQUISITIONS, SAVES, WIN-BACKS: ISSUES PAPER

Flick Energy Limited (Flick) appreciates the opportunity to comment on the Electricity Authority's '*Customer Acquisitions, Saves, Win-backs: Issues Paper*' (Issues Paper).

As an independent, new entrant to the market we are particularly interested in the Electricity Authority's work to encourage competition and remove barriers to entry and growth - rules regarding customer acquisition and transfer processes are integral to these aims.

Promoting competition for the long term benefit of consumers

Within the New Zealand retail electricity market new entrants have played a critical role in driving price competition, better service and innovation for the benefit of consumers. This is evidenced by the price position of new entrants and the customer satisfaction surveys by Consumer New Zealand.

Effective competition and eliminating barriers to entry needs to be a priority if New Zealand is to take advantage of new technology and changing economics in this sector¹. This disruption will be led by new entrants with innovative business models, as incumbents simply do not have the incentives to disrupt themselves. The rules of this industry need to evolve beyond the set developed by the club of incumbent participants so that there is a level playing field for those entering and expanding in this market.

¹ As Transpower recently articulated in the White Paper '*Te Mauri Hiko, Energy Futures*' new technology is changing the nature and economics of the electricity industry.

The Electricity Authority has a responsibility to promote competition for the long term benefit of customers. In fulfilling this responsibility, Flick's experience has been that the Electricity Authority has done an excellent job at facilitating the practical aspects of entry to the market including with the useful information. However, we are concerned by the superficial view of effective competition and rules that impact it.

The Electricity Authority seems to conclude competition is effective by skimming the surface and parading the numbers of entrants to the market and switching statistics. There is no acknowledgement that sustainable independent expansion/growth in this market is extremely challenging because of the dominance of vertically integrated incumbent retailers. As a result of the Electricity Authority's comfort with the status quo the market rules impacting key competitive processes, such as customer transfers, have barely evolved, and the long term interest of consumers are not being sufficiently addressed.

Why is price discrimination ok?

Flick hold serious concerns about the current design of the customer transfer process - particularly because it provides a mechanism to price discriminate and predate competition. This has not been given enough attention in the issues paper.

The Electricity Authority is evidently inappropriately comfortable with high levels of price discrimination in the market. 'Economic theory' is often used by the Electricity Authority to conveniently justify its prevalence with comments like this one from the Issues Paper *"...price discrimination...can be beneficial for consumers overall if customers who pay lower prices are, on average, more price sensitive than those who pay higher prices"*.

Statements like the above are incredibly concerning. Those customers who are currently paying significantly more would obviously be better off by paying less (for the 40% of customers that have never switched this will equate to about \$300M annually). There is also plenty of evidence that those that can least afford it are often paying the highest prices and are unable to switch provider.

When there is a statutory objective to act in the long term interests of consumers it is not tenable that the Electricity Authority is comfortable with producers, in particular incumbent retailers, using price discrimination to capture all the surplus in this market.

Independent thinking

The lack of focus and progress on promoting competition may be explained by the heavy influence of incumbent players in an area where there is obvious vested interest in maintaining the status quo.

We acknowledge the importance of technical and operational input into the regulatory process, but an independent regulator must maintain an objective lens.

We note that the MDAG is dominated by incumbent perspectives and that recent submissions from new entrants have been given limited regard. We believe a more objective view of issues with the customer

transfer process, and its important influence on competition, would also consider the level of price discrimination in the market and the impact on sustainable entry.

A combination of issues

The customer transfer process favours incumbents because of this combination of factors:

- A limited proportion of the market is switching - As highlighted in your issues paper about 40% of ICP's have never switched and a further 31% of customer have a less than 0.29 probability of switching annually;
- Search costs are high compared to margin (for pure retail);
- Contract lock-in creates a further barrier to customers switching;
- Incumbent (integrated) players cross- subsidise and price discriminate across their customer base;
- The industry rules create advantages for the outgoing retailer who holds and can use customer information;

These factors need to be considered together. From Flick's perspective poor regulatory design (from rules developed by incumbents) has created an opportunity to price discriminate and a distinct advantage for incumbents with large customer bases.

The customer transfer process allows the outgoing retailer to save/ win-back the customer with a more competitive offer. This is damaging to competition because of the substantial disproportionate impact this has on new entrant retailers - who are investing in acquisition. New entrants who have successfully convinced a customer to switch, and who have invested in substantial search costs, are then trumped. This is reactive rather than proactive retention, in most markets this opportunity doesn't exist. This activity drives high customer acquisition costs, which creates a barrier to entry, limits the sustainability of new entrants and minimises the threat of disruption to incumbents. This ultimately impacts consumers as it dampens competitive pressure, which is reflected in rising electricity costs for consumers.

If the electricity market followed the same transfer process as the NZ broadband market, the outgoing retailer would be prevented from using customer information to 'winback' the customer. This would encourage incumbent retailers to work harder/ offer more competitive prices in order to retain customers, so they do not decide to switch. It would also put all retailers on an equal footing when it comes to acquiring a new customer and is likely to reduce customer acquisition costs - this in turn will increase competitive pressure in the market.

Steve O'Connor
CEO
Flick Energy Limited

Questions

Do some retailers have a distinct win-back advantage which others do not have and cannot ever have?

Incumbent retailers have a distinct advantage because of the following factors:

- *Size of base*
- *Low switching participation - 40% of the market haven't switched so on average 40% of incumbent bases haven't switched*
- *They price discriminate and cross subsidise, non-switchers pay for switchers.*

i What sorts of strategies do acquiring retailers have to defend against winbacks and how cost-effective are they?

- *Contract terms - but these are not appropriate for new/ innovative models as this would discourage people 'trying' a new model or new brand.*
- *Throwing cash.....given this is in the order of \$500 (~ an extra 10% discount plus, \$300 cash on the spot) it is not sustainable for new entrants that operate in the 'switching' portion of the market.*

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?

Contractual terms are not appropriate for new types of business models/ customer experiences as it will make it harder to acquire customers. As a new entrant one of the most compelling messages we can push is to 'come and try our excellent service, customer experience and new model, if you don't like it you can switch'. We believe that if we required customers to enter into fixed term contracts we would reduce acquisition by more than 50%, so yes, it's absolutely a commercial decision not to. But, If the Electricity Authority believes this is a realistic defensive strategy then they'll failing to appreciate the challenges (and cost) of sustainable entry and growth in this market. We note that Carl Hansen² dismissed Electric Kiwi's lack of contracting as 'targeting flighty customers', we're concerned that this attitude pervades the Electricity Authority, it demonstrates a lack of understanding of customer decision making dynamics, and the challenges of customer acquisition.

iii Does early switch notification give an undue advantage to retailers seeking to win-back customers?

Yes, obviously, but it's the combination of the switch notification and being allowed to use the customer contact details.

² <https://www.radionz.co.nz/national/programmes/ninetoon/audio/2018650930/power-struggles-unfair-sweeteners-to-switch-back>

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?

Anecdotally we know that save/ win-back calls can be very pushy and espouse the benefits of the outgoing retailer while undermining the credibility of the retailer the customer has chosen to move to.

If win-back activity is allowed to continue there should be a requirement to make an accurate comparison.

ii Is there any evidence that retailers have engaged systematically in proscribed marketing behaviours?

We think there is probably a good chance many winback calls are misleading, by inaccurately comparing offers. These are generally recorded so the EA could request to listen to some.

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?

Yes, we believe win-backs and saves are essentially the same. The issue is about the outgoing retailer being able to use customer data to attempt a winback.

iv What are the implications (if any) for consumers of saves and win-backs?

They can miss out on an improved service and savings that come with our offering. For customers as a whole we believe the saves/ winbacks rules entrench the dominance of the incumbents who can price discriminate and predate competition to the detriment of consumers.

Are there any further issues related to saves and win-backs that we have not considered?

Yes, price discrimination and its detrimental impact on competition.