

Submission to the Essential Services Commission's Competitiveness Review

20th April 2020

Via <https://engage.vic.gov.au/>

Dear Essential Services Commission,

The Consumer Policy Research Centre (CPRC) welcomes the invitation to comment on the Essential Services Commission's Competitiveness Review.

CPRC is an independent, not-for-profit consumer research organisation. CPRC undertakes interdisciplinary and cross-sectoral consumer research. Our mission is to improve the lives and welfare of consumers by producing evidence-based research that drives policy and practice change. CPRC has a particular focus on consumer wellbeing and welfare in markets for essential services such as energy.

To assist the review, we enclose several CPRC reports that are relevant to the questions being explored by the Commission in its Competitiveness Review, and provide a summary of key relevant findings from our published and forthcoming research. We would be happy to discuss this research further with the Commission.

Assessing the competitiveness of the Victorian Energy Market

Consumer engagement in the energy market

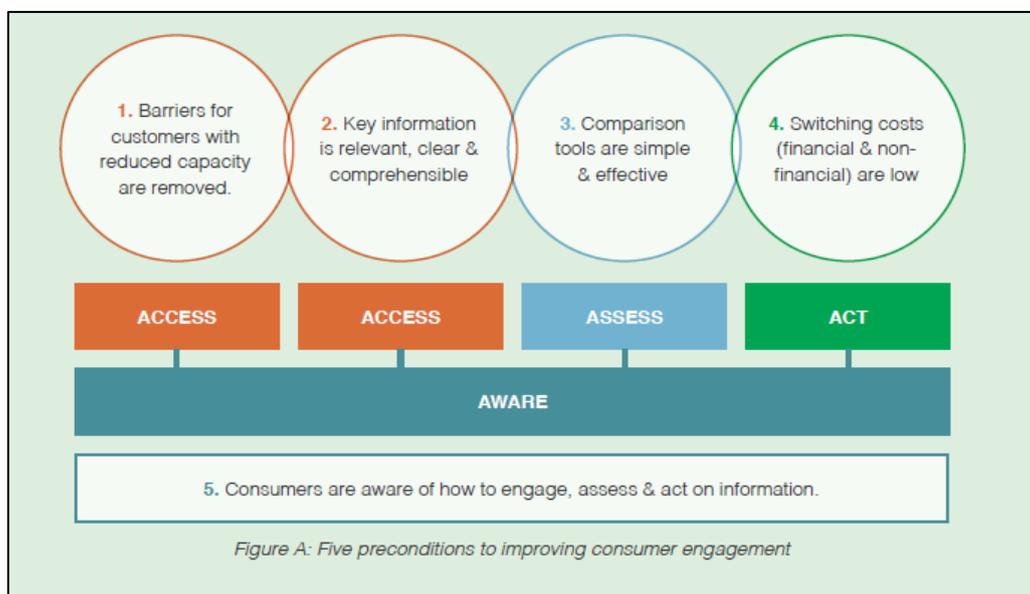
We strongly endorse the Commission's closer consideration of consumer outcomes to assess whether the market is competitive. CPRC developed its *Five Preconditions of Effective Consumer Engagement – A Conceptual Framework* (attached) in response to a range of consultation processes considering various interventions to address 'disengaged consumers' and falling trust in markets to deliver positive outcomes for consumers.¹ This began by identifying the various causes of consumer disengagement in complex markets and considering what conditions might be required to address these different aspects.² The *Five Preconditions* (Figure A) identified in our report are as follows:

- **Precondition 1 - Barriers to access for consumers with reduced capacity or vulnerability are removed** - Fair access to markets requires outreach interventions and direct assistance mechanisms which address barriers for vulnerable consumers experiencing reduced capacity to engage.
- **Precondition 2 - Key product information is disclosed in a relevant, clear and comprehensible manner** - Consumers can easily access key information about price, quality and terms of sale for products and services. However, this precondition goes beyond increased disclosure; the information must be easily accessed *and* comprehensible.

¹ CPRC, *Five preconditions of effective consumer engagement – a conceptual framework*, March 2018, 2.

² *Ibid.*, 13.

- **Precondition 3 - Comparison tools are accurate, simple and effective** - Consumers can easily assess information about different products or services, potentially through comparison tools, to enable simple and accurate comparisons.
- **Precondition 4 - Switching costs (financial and non-financial) are low** - Consumers can easily act on this information, with minimal switching costs or thinking costs that create barriers for consumers to switch from their current provider or product to an alternative that better suits their preferences.
- **Precondition 5 - Consumers are aware of how to access, assess, and act on information** - Consumers need to be made aware of how they can access support and key information, compare offers and switch providers. If consumers are unaware of any of these former preconditions, they may disengage regardless of the quality of interventions to address these elements.



The Commission might consider whether these preconditions – which can be considered market infrastructure – are in place in the Victorian energy market. In our view, these preconditions are required to facilitate consumer engagement, though we would caution they do not address the motivations and capacities of individuals to engage in a market.

Considering vulnerability and its effect on engagement

Our first precondition outlines how those encountering disadvantage or vulnerability may face increased barriers to access. As noted by Mani and others, scarcity of time, money and attention can directly impact people’s decision-making. In particular, ‘preoccupations with pressing budgetary concerns leave fewer cognitive resources available to guide choice’, and their research concluded that there may be a direct causal link between poverty and temporarily reduced cognitive capacity.³

³ Anandi Mani *et al.*, ‘Poverty Impedes Cognitive Function’, *Science* 341, no. 6149 (30 August 2013): 976.

The CPRC report *Exploring regulatory approaches to consumer vulnerability: a report for the Australian Energy Regulator*, outlines key findings, lessons and approaches being taken to address vulnerability across different jurisdictions, sectors and regulators.

The report notes that everyone is likely to experience vulnerable circumstances at some point in their lives, due to common, unavoidable and unpredictable life events such as illness, job loss, financial shocks, the death of a loved one and natural disaster. Life events such as having children, ageing and disability can also contribute to consumer vulnerability. Vulnerability can arise from personal circumstances, but it can also arise as a consequence of market complexity, poor product and service design, deliberate exploitation of people's behavioural biases, information asymmetry and targeted exploitation of particular communities. In considering the extent to which consumers engage in the market, we would encourage the Commission to consider the impact that vulnerability has on decision-making and the ability of individuals to engage.

As a corollary to this, we would encourage consideration of the pro-competitive benefits of consumer vulnerability strategies, particularly where these address product, service and market design. As outlined in our consumer vulnerability report, more regulators in Australia and especially the UK are seeking to prevent or ameliorate consumer vulnerability by pursuing good front-end design that better enables consumer engagement and protects consumers from exploitative or poor value products and services. One key measure in this respect is inclusive design, which involves adjusting the norm and designing products and services to meet the needs of 'edge users' (which may include people with disability or older people), which can produce design features that in fact benefit and better enable engagement by *all* consumers. Inclusive design requires a fundamental shift in regulatory thinking. Designing around the 'mainstream' consumer may be counterproductive – the better approach, it appears, is to design for people with greater barriers to service access, use and engagement, which then facilitates engagement for everyone. In this sense, inclusive design and consumer vulnerability measures are emerging competition strategies and could be considered by the Commission in assessing retailer competitiveness.

In our forthcoming report on the experiences of older consumers, we explore the behavioural economics literature and the limitations of consumer decision-making more generally, as well as how they specifically relate to older Australians. Our report also considers the extent to which people do not engage at all, and the reasons why this is important for regulators to consider. We expect to publish this research in July 2020, and would be happy to explore the report's themes with the Commission in advance of publication.

'Non-price' characteristics of energy retailers

Our second precondition of consumer engagement requires that key information is easily accessible, and that it is clear, comprehensible and comparable. While recent Victorian and national energy reforms have focused on improving consumers' ability to understand and compare pricing, there has been less consideration given to service quality in the energy market.

In 2018, CPRC produced the report, *'But are they any good?'* (attached), which examines the benefits of service quality information disclosure for consumers, and considers the impact of a lack of trusted, transparent information about the service quality consumers can expect from businesses in complex markets. The lack of this information often means consumers may rely on inappropriate proxies such as price, word of mouth or brand name recognition and marketing, which tends to favour incumbents and may in fact inhibit competition to provide good customer service to consumers.

If information asymmetry about service quality of providers creates ambiguity in the market and results in reduced consumer participation, as is suggested by the literature, it may also result in market inefficiencies.⁴ The absence of service quality information provides little incentive for suppliers to compete on changing demands around service quality and improve their service offering, resulting in poor technical and dynamic efficiency.⁵ Where consumers perform only a limited search of the market, firms might compete to be the first to attract consumers, rather than competing to provide the best offer.⁶ As noted by the UK's Office of Fair Trading, this potentially results in overuse of resources for marketing and advertising rather than providing a lower-priced or higher quality product.⁷

This has arguably been a key driver of cost in the retail energy market. The ACCC's Final Report of the Residential Electricity Market Inquiry found evidence that retailers may pay up to \$200 per customer acquired through commercial comparators, attributed to factors such as the cost of commission for different comparison websites, advertising, and call-back activities to retain customers.⁸ Moreover, where product-environment information is ambiguous, consumers may choose not to switch to lower cost providers with equal/greater quality than their current provider, diminishing demand-side competition and ultimately resulting in muted price competition or *X-inefficiency* – whereby firms lack adequate competitive incentives to reduce unit costs of production.⁹

CPRC would like to flag our forthcoming collaborative research with RMIT's Behavioural Business Lab to investigate the opportunities to make meaningful service and quality information available to energy consumers. This project involves a series of iterative qualitative and quantitative research components exploring the non-price attributes that consumers value in the energy retail market. We would also be happy to offer the Commission a briefing on the findings of this report.

Structural considerations

In assessing the competitiveness of the energy market, CPRC would encourage the Commission to consider the accessibility and navigability of the *marketplace* - as distinct from the *market*. We explore these considerations more fully in our forthcoming report on the experiences of older consumers.

Adopting a consumer-centric perspective, a *marketplace* can be defined as a particular location where people can access key information about a range of goods or services, compare this range of suppliers, and choose/purchase a good or service. In this sense a marketplace is the infrastructure that brings into being the abstract concept of a market.¹⁰ This location might be physical (for example, in the case of a supermarket), a digital platform or tool, or even verbally articulated by a broker, advisor or other intermediary.

Where marketplaces are inaccessible, hard to navigate or incomplete (due to limited or imperfect information disclosure), search costs increase which can result in poor consumer outcomes. Difficulties accessing marketplaces may arise for a range of reasons, including low digital access or literacy where marketplaces are online, language barriers where

⁴ Onesun Steve Yoo, Rakesh Sarin, "Consumer Choice and Market Outcomes Under Ambiguity in Product Quality", *Marketing Science*, (Articles in advance) (2018).

⁵ Consumer Affairs Victoria, "Designing Quality Rating Schemes for Service Providers", 2006, 2.

⁶ Office of Fair Trading, *What does Behavioural Economics mean for Competition Policy?*, March 2010, 19.

⁷ *Ibid.*

⁸ ACCC, *Restoring electricity affordability and Australia's competitive advantage - Retail Electricity Pricing Inquiry—Final Report*, 2018, 231.

⁹ CPRC, "But are they any good?", November 2018.

¹⁰ Stahl, F., Schomm, F., Vossen, G. *et al.* A classification framework for data marketplaces. *Vietnam J Comput Sci* **3**, 137–143 (2016). <https://doi.org/10.1007/s40595-016-0064-2>

mechanisms to facilitate access do not provide effective translation, or where marketplaces do not provide adequate support for consumers with disabilities.

Where regulators and policymakers rely on commercial entities to provide the marketplace (e.g. switching sites and digital aggregators), or where these intermediaries arise to address information asymmetries faced by consumers, their incentives may not be aligned with consumers. The incentives of commercial intermediaries may result in their skewing product presentation, the shrouding of particular attributes and characteristics, or the use of strategic complex information to mislead consumers.

Trust and Innovation

We strongly endorse the approach of the Commission to consider the lack of innovation delivered by the retail energy market and the low trust consumers have in energy retailers. Our research with RMIT also suggests much of the pricing 'innovation' created by retailers, such as deceptive conditional discounts, relates to the environment of low trust. In our forthcoming report on the experiences of older consumers, we consider businesses practices such as overly complex information disclosure and exploitation of low consumer engagement to the advantage of businesses and to the detriment of consumers.

In terms of measuring trust, there are number of indices that seek to measure trust across different sectors.¹¹ Measures of trust from attitudinal survey questions remain the most common source of data on trust, however we note that academic studies suggest that some of these measures of trust may be weak predictors of actual trusting behaviour.¹²

Nobel Laureate Onora O'Neill has argued that institutions must first demonstrate their trustworthiness in order to earn consumers' trust.¹³ O'Neill argues that demonstrable measures of competence, reliability and honesty can provide an indicator or proxy for the trustworthiness of an institution.¹⁴ Through our collaborative research on service quality, CPRC and RMIT have sought to understand what characteristics consumers value in choosing between retailers – we anticipate that some of our results likely describe the measures described by O'Neill, and which may provide proxies for trustworthiness. We will submit the findings of this research to the ESC in the coming weeks and we hope this provides a useful evidence base for consideration of additional performance indicators to build long-term trust in Victoria's energy market.

If you have any queries about this submission, please don't hesitate to contact Ben Martin Hobbs on 03 96379 7600 or ben.martinhobbs@cprc.org.au.

Yours sincerely,



Lauren Solomon
Chief Executive Officer
Consumer Policy Research Centre

¹¹ See for example the Edelman Barometer, Roy Morgan Net Trust Score, World Values Survey.

¹² <https://ourworldindata.org/trust>; Johnson, Noel D., and Alexandra Mislin. "How much should we trust the World Values Survey trust question?." *Economics Letters* 116, no. 2 (2012): 210-212.

¹³ Onora O'Neill: What we don't understand about trust (June 2013) [Video file]. Retrieved from https://www.ted.com/talks/onora_o_neill_what_we_don_t_understand_about_trust?language=en

¹⁴ Ibid.