

## Competition and innovation in the energy market

**14 October 2014 – Ian Peters, Managing Director for Residential Energy at British Gas spoke at Utility Week Congress**

Good morning, and thank you to Utility Week for inviting me to speak today.

I'm here to talk about competition and innovation – there are few issues of such importance to my business. I'm going to make the case that competition and innovation are interlinked. They drive each other.

I believe the market is competitive, and that's benefiting consumers. Though I acknowledge, some will disagree with me. The definitive verdict will come from the CMA – and we welcome its independent review, which is vital to help rebuild trust in the sector.

Utility Week recently asked me what the market might look like in 2, 5 or 10 years' time. My answer was that it would look significantly different, even were the CMA inquiry not happening.

Over the last 18 months, the energy market has changed dynamically and at a speed never seen before. These dramatic changes are irreversible. They demonstrate that the market is working -- and they also force it to respond and continue evolving.

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Let me first explain how the UK energy market is competing intensively for business.

Competition between the traditional players has always been very diverse. We compete on very different brand propositions and with very different competitive pricing strategies.

There is no fixed 'pecking order' among the large suppliers. We all compete hard to win customers and grow our businesses.

You'll see proof of that if you look at where we all rank in price on the dual fuel market: the large suppliers' relative positions – by fuel and on a combined basis -- are changing the whole time. British Gas is currently mid-table, but in recent years we've been both the cheapest and also the most expensive. It's constantly shifting, as we compete with each other.

Beyond the way the large suppliers behave, there are other factors driving the competitive market – for example the growth of online switching, and the rapid arrival and growth of new entrants.

It's true that overall switching numbers fell in 2012 and for most of 2013, reflecting the end of doorstep selling and the decline of telephone sales, both in response to changing consumer preferences.

But what we saw at the end of last year was a surge in customer switching. More than half of this was done over the internet, and that trend has continued. We now operate more in a world of customer "pull" rather than supplier "push" sales.

Customers increasingly tell us that's how they want to interact with us. The customer is always right – and we're responding.

This surge is boosted by an array of third party switching sites which are themselves very commercial and competitive businesses. They put all their energy into driving up switching between suppliers.

But what about the new players in the energy sector? What role have they played? Their varied business models also demonstrate a competitive market. The small suppliers are clearly growing – we now have an "Intermediate 4," which would question whether they are barriers to growth - and I see no reason why this won't continue over the coming years.

The trend is swift and dramatic.

At Easter last year, small and intermediate suppliers made up around 2.5% of the market. Today that's already up to nearly 8%. By the end of the year, I expect the figure to have climbed to 10%! That's around 5 million customer accounts supplied by these largely new, start-up, companies.

What helps the growth, of course, is the fact that until recently most of our smaller rivals have been wholly or partially exempt from government obligations and, as acknowledged by First Utility, they have been helped by falls in wholesale energy prices.

I now have 26 competitors, including Oink Energy, whose launch you may have seen recently -- a low price brand from Good Energy – and Extra Energy, a UK entrant from a German parent. Challengers like Oink and Extra show that this clearly isn't a market with high barriers to entry. It's one that gives customers more choice than ever before, fuelled by the switching sites and, increasingly, by collective switching schemes as well. There is an iChoosr collective switch taking place today.

OK then, if the market's that dynamic and intensely competitive, do the British Gas customer numbers bear that out? Yes they do – they're moving about, on a massive scale.

In the last year 2.5 million accounts have switched either to, or away from, British Gas. Every one we lost was a cause for pain, and every new customer who came to us was a cause for celebration. This market is not "static". It's a battlefield!

And if we zoom out, the national picture shows that switching rates in the UK are one of the highest in Europe.

On one specific point: it's a common misconception that my company has lots of customers who've never switched.

If you can cast your mind back to before the market was opened up, British Gas was a monopoly which had 100% of all gas supply customers in Britain.

Today, that figure stands at 38%. In itself, that's an indication that competition has worked in Britain. And, of course, the 38% includes many customers who've benefited financially from competition -- either by switching away and returning, or by switching tariff or payment method while remaining with us.

At the time of its privatisation, remember, British Gas didn't sell any electricity - the electricity firms had regional monopolies on that.

Today, 80% of British Gas customers receive electricity as well as gas from us. Most customers these days buy their energy as dual fuel. We've had to go out and win every single one of those electricity accounts in this competitive market.

So in the battle for customers we've won business from the former electricity suppliers, just as they've won gas business from us.

We don't have vast amounts of so-called 'legacy customers' who took gas from us before privatisation and have just got stuck in limbo, never engaging with the market. Let's get straight on this.

Five years ago we had about 4.5 million gas-only customers; but the number has been declining rapidly as customers opt for dual fuel or switch away.

The figure's gone down to 2.6 million. Not "inert" customers – but customers making choices. 1.8 million of these made an active choice to be with British Gas when they moved into a property we were previously supplying, or took us with them when they moved home. Another 400,000 have chosen to change their tariff or payment type.

Active customers – like my mother. She's 80 and has bought her gas from British Gas since 1956 (but despite my best efforts, never her electricity). She'd be offended to be called an "inert" customer – she has a fixed term, fixed price contract; she reviews her direct debits on our online dashboard; and she manages her account off a smart phone. A thoroughly modern and engaged customer, I'd say!

That leaves just 400,000 customers some might label "inert" - 2% of the original total. Yet two thirds of these customers have engaged with us in other ways – for example by managing their account online, by joining Nectar, or by taking a product from British Gas Services.

If you compare our industry to many others, and other geographic markets, you'll find that the rate at which customers switch tariffs while remaining with their supplier is also very high. Internal switching, we call it.

A couple of years ago very few British Gas customers sought alternative British Gas products. These days, each year around a quarter of my customers move to a different tariff, prompted in part by our Tariff Checker service. And just because a customer doesn't move, it doesn't mean they're unhappy, or that they can't understand the market.

Many customers, then, are making an active choice to stay with us - they trust us, they like our service, and they know that we write to them if we have a cheaper deal for them.

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So we're operating in an environment of intense competition. Before I show you how this competition has driven innovation in my business, I want to deal briefly with the issue of consumer trust and the role of regulation.

Firstly on trust -- I recognise that trust in our industry has fallen in recent years. What's driven that is quite complex. Rising prices and bills, inflated ever more by three very cold winters in the last five years, falling incomes, high profile examples of poor behaviour by suppliers, and suspicions around lack of transparency and rising profits being behind higher prices.

We've done a lot to improve our service. We've significantly lowered our complaints numbers, for instance. I'm going to ensure this continues. And we'll be first out of the blocks on accelerated switching.

Price is a major concern, but the competitive pressure in our market has actually resulted in the UK having some of the lowest energy prices in Europe. It may not feel like it, as we pick ourselves up from a recession, but it's true.

In my business over the last 5 years, our profits have actually fallen, while our operating costs have increased by only 1% pa. The drivers of increasing prices have been chiefly the rising wholesale market, a rise in the costs of environmental and social policies, and a 27% increase in the cost of delivering energy to your home.

We've invested heavily in service and innovation. To fund that, we've made £150 million of savings through restructuring, new processes and system investments as well as a £50 million reduction in our annual bad debt charges. We've got our overall bad debt charge down to 1%, with 20% fewer [customers] in debt than last year -- that's very competitive and good for customers, as well as for the business.

We've channelled those savings into innovating and improving our service, giving customers more information and control over their own energy consumption and therefore their bills. More on this later.

Lack of transparency can also breed mistrust. It's an area where we continue to improve. We've gone further to explain prices and openly publish breakdowns of our bills. At British Gas there are no "hidden millions". We go much further than others in reporting how much our parent company Centrica makes generating energy, and how much we make in trading it.

And we don't sell energy to ourselves to make a profit - only 7% of the gas and 14% of the electricity sold to British Gas customers came from Centrica last year. The little we did buy from Centrica was all at market rates and independently audited.

I do accept that, as an industry, we haven't been clear enough in explaining energy prices, and our service hasn't always been as consistently good as it should be. We've got further to go; but things have been significantly improving.

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Regulation, of course, also shapes a competitive market. In 5 years we have had at least six major regulatory changes that have impacted the way we compete. Each has followed almost immediately on the heels of the other: the RMR was launched within a year of the Supply Probe. And the regulator referred the energy market to the CMA just as RMR changes were starting to come into effect.

It is not that we don't welcome an active regulator – we do, but I would make a plea for more regulatory stability. I think one important point here is getting the balance right between fairness, which can drive a trend towards narrowing of differences in service and price, and the competitive dynamic. We need to work with our regulator and the CMA to get that balance right.

In addition, we - and the regulator - need to continue to work together on clearly explaining some of the facts around hedging, pricing, and profits. Misunderstandings can lead to inflammatory headlines that build mistrust and don't help customers understand and engage with our competitive market. The onus is on all of us - companies, consumer groups, politicians, regulators - to work harder to enhance understanding and rebuild trust.

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The competitive nature of that market means that I need to work really hard to keep my customers. Improve their service, keep things simple and give them more control. This fight for customers drives innovation in my business.

Creating innovative products and services to help our customers understand and control their gas and electricity use is the focus of British Gas' residential business today. Innovation is at the very core of our business model, our offer to customers, and our mindset. I could talk about what we're doing in distributed generation, renewables, communities - and indeed the B2B sector - but I will focus on three specifics.

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Take smart meters, for example -- an area of innovation where British Gas is taking the lead.

Smart meters will transform the industry in the years to come. We're delivering smart meters earlier and on a much larger scale than anyone else, and have already installed more than 1.5 million in Britain's homes and businesses.

Our customers with smart meters are much happier than those without: they have fewer queries and complaints because they now get accurate bills and can see exactly where they're using energy and understand -- in real-time -- how that's reflected in their bills. Our smart-enabled customers are also already making average savings of 3% on their energy use.

That saving will increase significantly as we expand the uses and connectivity of smart. We're giving customers more information on how to save energy -- such as through our monthly smart energy report, which itemises household energy usage, and compares your usage with similar properties.

We're able to tell people what they are spending in pounds and pence. Rather than expressing their usage in kWh, which suddenly hits them like hieroglyphics on their bill. Customers don't understand kWhs -- it's like demanding payment in a foreign currency.

We want our customers to experience the full range of benefits that smart meters have to offer. We're trialling smart pay-as-you-go meters, so our customers will no longer need to trudge to the shop in the rain to top up their meter, but will be able to do so online, by smart phone, or over the phone. They'll also get text alerts as their credit drops. As smart meters rollout, the cost savings will enable me to reduce progressively the price of prepayment, towards that of direct debits.

British Gas is also pressing ahead with time-of-use tariffs that will help our customers have even greater control and flexibility -- like tariffs for electric vehicles and one's offering free electricity on Saturdays or Sundays. These tariffs are only possible with smart meters, so the two go hand-in-hand.

Competitive tariffs, in a competitive market, enabled through innovative use of technology.

Smart appliances will eventually enable the internet of the home - such as freezers, dishwashers and washing machines that switch on when it's cheaper. They'll also warn you in advance if they're about to break down, enabling early detection and a first time fix by the engineer.

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Ultimately, we're reinventing ourselves, and our mission. British Gas won't just sell you the gas and electricity you need -- we'll use state-of-the-art technology to help you consume less of it, and bring your bills down, without impairing your quality of life.

Customers increasingly want to deal with us online, so we're enabling that -- two thirds of all of our customer interactions are now digital. More remarkably, nearly half of those now start from a smart phone. Our website and suite of smart phone apps are leading the industry, with a million customers regularly using them.

Let me briefly highlight one of those products, that's had great early success -- Hive Active Heating. This product lets you remotely control your energy -- your hot water as well as your central heating.

You can use Hive from your mobile, tablet or laptop. And from your desk, the train, your sofa -- or, most popularly so far with our customers, from your bed!

100,000 households now use Hive and on average they use it twice a day. To put that figure in perspective, most people adjust their thermostat just twice a year.

Our Hive customers tell us they're already reducing their bills by not heating their home when it's empty. We estimate around £150 is wasted on average each year on heating an empty home. They also say they're more comfortable, and enjoy the convenience of never returning home to a cold house when the temperature suddenly dips. Better still, Hive is available for anyone, British Gas customer or not.

There's no question in my mind that Hive Active Heating, and products like it, will revolutionise how people are controlling their energy use and bills, and in turn revolutionise the way we interact with our customers.

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But will it be just the early adopters or the tech-savvy who benefit from the innovation that's being driven in my business by competition? Absolutely not -- all of my customers will benefit from the improved service. They'll get paper versions of smart energy reports, for instance, and will get accurate billing from their smart meter sending in regular readings.

To conclude: in the UK, I see an energy market that delivers some of the cheapest prices in Europe, some of the highest levels of energy security, and some of the highest levels of switching by increasingly savvy and connected customers.

I'll be the first to admit that energy suppliers haven't always got things right for our customers, but I've described how British Gas is fully playing its part in an active competitive market, how it's innovating for its customers, and how it's giving people informed choice and hugely increased control.

I'm proud to be here today representing a great British company that's supplied energy to homes and businesses for 202 years -- and one that I've shown you is evolving and innovating hard, to earn the right to serve its customers for the next century as well.

Thank you.