Household Customers Choice of Electricity Contract and Retailer

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Background

Decoupling of electricity market due to the new Energy Act introduced in 1991:

- Production
- Transmission
- Distribution
- Retailing
- Trading
Motivation

- We observe substantial price dispersion

- Electricity prices offered by retailers can be compared online

  - There is a lot of information on prices and contracts out there – this information is available at a search cost
Electricity Contract Allocation for Households

Source: Statistics Norway
Main Objectives

- We are interested in learning more about consumer’s switching costs

- Can differences in switching costs among consumers explain the observed price dispersion?

- What differences in preferences do we find among switchers and non-switchers?

  - Does retail competition function as intended by the Energy Act?
Data

- Collected for the Norwegian Water Resources and Energy Directorate (NVE) in 2013

- Questionnaire answered by 1108 respondents

  - household electricity consumption
  - choice of electricity contract
  - switching costs related to switching electricity contract
Economic theory suggest

Diamond (1971) showed:
- If all consumers have positive search costs, oligopolistic firms will set price equal to the monopoly price

Salop and Stiglitz (1977) showed:
- Uninformed consumers can only become perfectly informed at a cost
- This leads to a monopolistically competitive equilibrium and price dispersion, even though the commodity produced is identical
Have you ever Switched Retailer?

[PROSEN T] Non-Switchers

[PROSEN T] Switchers
Consumer Behavior

- While **42 percent** of households have not changed electricity retailer
- **66 percent** of non-switchers have not changed contract
- **20 percent** of households have not changed retailer nor contract
Switchers

- 80 percent respond that price was «very important» or «quite important» as a factor motivating a switch of retailer

- 32 percent agree or totally agree that it is important to receive a single invoice covering both grid-costs and electricity

- 80 percent of switchers respond that they have switched retailer 1-3 times since 1991

- Main sources of information before making switch decision:
  - Directly contacted by retailer with an offer (the most important!)
  - Online price listings “clearinghouse” provided by the Competition Authority
  - Visit retailer webpage
Non-Switchers are Asked: Do you Know how to Change Electricity Contract?

[PROSENG] totally agree or agree

[PROSENG] do not know or not sure
Factors of Importance for Non-Switching Behavior

- 46 percent agree or strongly agree that it is important to buy electricity from a local retailer

- 73 percent of non-switchers have not considered switching retailer

- The remaining 27 percent list main reasons for not switching to be:
  - saving were not high enough,
  - lack of information
  - forgot about it

- 55 percent agree or totally agree that it is important to receive a single invoice covering both grid-costs and electricity
We find two groups of non-switchers

- Group # 1: They have the know-how
- Group # 2: Lack the know-how, and are «locked-in»
Planned Future Research

• Do statistical testing

• Look into product differentiation, and find how this affects consumers choices
Conclusion

• One segment of consumers have very large switching costs

• One segment of consumers have low switching costs

• One segment of consumers are not switching despite low search costs

• According to theoretical models on price dispersion, this segmentation of consumers will support existence of substantial price dispersion in the market
Thank you for your attention.

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