
A competition framework for the household retail market

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1. Introduction

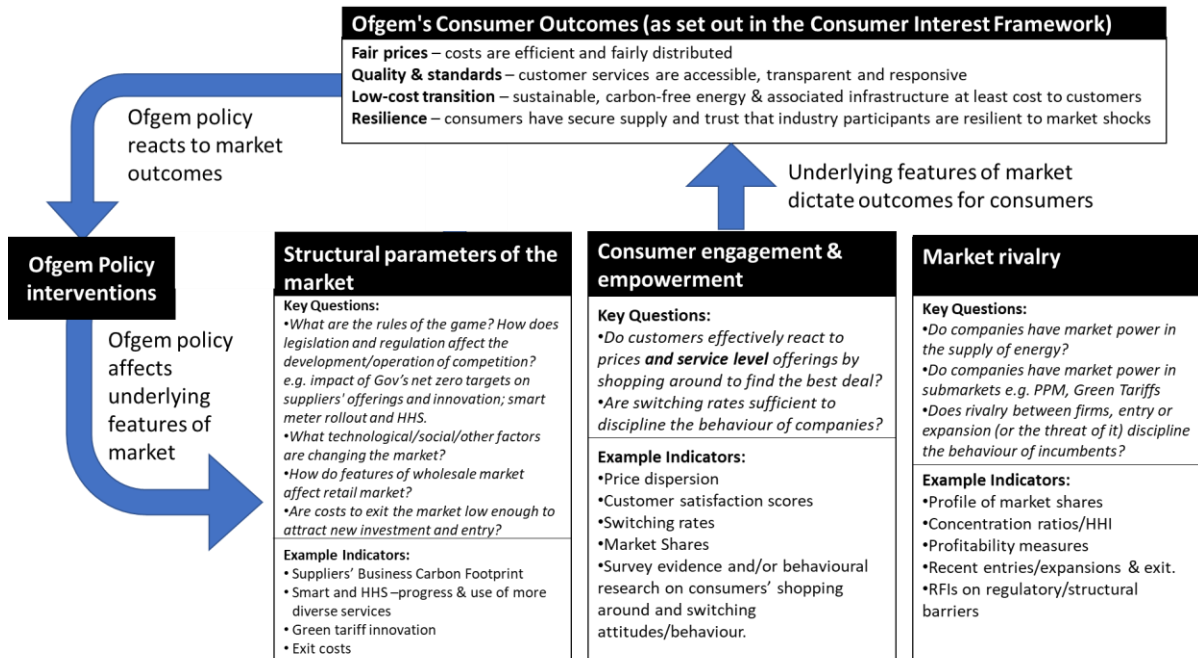
- 1.1 Ofgem is the economic regulator of the energy sector. Our role is to regulate the markets with the principal objective of protecting the interests of current and future consumers. One of the ways we do this is to promote effective competition wherever we consider this to be the best means of achieving the primary duty.
- 1.2 In its May 2022 report into Ofgem’s regulation of the energy market, Oxera recommended that Ofgem (i) put in place a consumer interest framework; (ii) develop a framework for how effective competition is defined and measured; and (iii) when making regulatory decisions, that Ofgem use both the consumer interest and effective competition frameworks to make decisions on future market design options.
- 1.3 In August 2023 we published a Call for Input to seek feedback on the development and implementation of our proposed competition framework.¹ As set out in that document we view the competition framework as a means to monitor the extent to which competition is achieving consumer outcomes as laid out in our Consumer Interest Framework, and for flagging areas where regulatory intervention (either policy or compliance action) may be required.
- 1.4 It is our intention that the framework be future looking and adaptable to the different forms of competition (both price and non-price) which may emerge. The ultimate aim is to (i) recognise what good in the market; and (ii) identify risks and what needs to change.
- 1.5 Figure 1 below summarises the key themes of the competition framework and the interlinkages between them, our Consumer Interest framework and Ofgem policy making more generally.
- 1.6 When we are making decisions that may include trade-offs between different aspects of competition, such as between short-term price effects and longer-term dynamic benefits, or when make decisions that trade-off effects on competition with other parts of the consumer interest framework, such as resilience, we propose to use the competition framework to ensure we take a consistent and consumer-led approach.
- 1.7 In the remainder of this document we provide a summary of stakeholder feedback and our response. We also we provide a copy of the finalised competition framework following amendments as a result of the continued evolution of our thinking and in

¹ [The development of a competition framework for the domestic retail market | Ofgem](#)

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response to stakeholder feedback. It is this version of the framework that we will apply going forwards to analyse the competition impacts and key trade-offs in Ofgem policy making.

Figure 1. Overview of the Competition Framework and its interlinkages



Accessible format: The picture contains a flow chart depicting the following steps:

(1) Ofgem’s consumer outcomes (as set out in the Consumer Interest Framework)

- Fair prices – etc.
- Quality and assurances
- Low cost transition
- Resilience

Then Ofgem reacts to market outcomes

(2) Ofgem Policy interventions

Then, Ofgem policy affects underlying features of market:

(3) Structural parameters of the market

(4) Consumer engagement and empowerment

(5) Underlying features of market dictate outcomes for consumers

Then underlying features of the market dictate outcomes for consumers

Return to step 1

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2. Responses to Call for Input

- 2.1 In total we received over twenty responses to our call for input from a variety of stakeholders including suppliers, charities and consumer groups, and consumers. Below we provide a summary of the feedback and our response, grouped by themes.

Weighting of indicators

- 2.2 Some stakeholders (SO Energy, Energy Systems Catapult, and Over50smoney) suggested we assign weightings of importance to the specific indicators within each theme of the framework. It was argued that in the absence of such weightings the framework provides too much freedom to apply arbitrary and potentially contradictory weightings to each policy decision.
- 2.3 While we see some benefits of specifying in more detail which indicators are of greater or lesser importance, we consider it would be outweighed by a loss of flexibility. In particular, the purpose of a framework is to provide guidelines that are flexible enough to be relevant in all circumstances. As such the framework is supposed to be applied on a case-by case basis and the relative importance of indicators will be context specific. We note that such an approach is in line with other competition assessment guidelines such as the CMA’s Guidelines for Market Investigations.²
- 2.4 Secondly, we consider that the indicators should be interpreted in-the-round with the exercise of expert judgement, rather than mechanistically or in an algorithmic manner.

Financial sustainability indicators

- 2.5 SO Energy suggested there was too much focus on indicators of switching, profitability and pricing and that there should be more focus on financial resilience and sustainability measures. Centrica considered past decisions had placed undue weight on delivering what it considered were short term benefits of competition, whereas more weight should have been placed on delivering sustainable competition.
- 2.6 Our primary focus on financial resilience in this competition framework is the effect of regulations as a potential barrier to entry and expansion. However, given our objective is to facilitate sustainable competition between suppliers we have amended

² [Guidelines for Market Investigations | Competition Commission](#)

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the interpretation of the 'Profitability analysis/ price-cost margins' indicator in the framework to also consider the effect of unsustainable pricing and/or generally low levels of profitability in the sector. We note that, more broadly than the competition framework, resilience is a standalone pillar of our Consumer Interest Framework with the objective of ensuring consumers have secure supply and participants are resilient to market shocks.

Additional indicators

- 2.7 Octopus, Citizens Advice and Energy Systems Catapult suggested that the set of indicators should be expanded to include further indicators of innovation. In particular, stakeholders suggested that we should monitor the take-up of new products and services.
- 2.8 We agree that innovation is an important non-price outcome of the competitive process and the Competition Framework already contains indicators such as the take-up of bundled energy services (such as EVs, solar panels and heat pumps) and the roll out of smart meters as measures of the extent of product innovation within the market. We have also amended the list of potential indicators under the Consumer Engagement and Empowerment theme to include the new tariff launches as a measure of innovation outcomes.

3. Finalised list of potential indicators

3.1 The table below sets out the list of potential indicators we will use to apply the competition framework. We note that this is not an exhaustive list and as the market evolves we may re-consider the indicators.

Theme	Indicator/evidence	Rationale
Consumer engagement & empowerment	Price dispersion	A large gap between prices offered by different suppliers may be indicative of search or switching frictions resulting in weak customer response or the existence of price discrimination.
	Customer satisfaction scores	Important indicator of non-price market outcomes
	New tariff launches	Important indicator of innovation outcomes.
	Switching rates	Indicator of the extent to which consumer behaviour is disciplining suppliers in the market.
	Internal customer engagement measures	Indicator of the extent to which customers who don't switch are engaged with their supplier.
	Market/behavioural research	Provides insights into consumers' shopping around and switching attitudes/behaviour.
Market Rivalry	Market Shares	Where persistently high market shares are held by one or more firms this may be indicative of high barriers to entry or unilateral market power
	Concentration ratios/HHI	

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Theme	Indicator/evidence	Rationale
	Profitability analysis/ price-cost margins	Pricing in excess of cost or profitability exceeding cost of capital over a sustained period may be indicative of firms earning excessive rents (subject to suppliers' level of efficiency). On the other hand pricing below a sustainable level could lead to profits being too low in the sector, undermining the outcome of sustainable competition.
	Recent entries and expansions	May be indicative of high barriers to entry and expansion to the extent that entry, expansion or the threat of it do not constrain the behaviour of incumbent suppliers.
Structural parameters of the market	Interest rates/ availability of capital	Cheaper finance will enable potential new entrants to get funding more easily, and will affect the level of expected returns from the market.
	Opportunity costs to exit the market	High exit costs i.e. unrecoverable sunk costs may act as a disincentive to market entry and its ability to attract new investment
	Capital requirements/other regulatory barriers to entry/expansion	Regulatory barriers may act as a disincentive to entry, expansion or innovation.
	Provision of bundled energy services such	We expect that development of green technologies will drive demand for smart,

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Theme	Indicator/evidence	Rationale
	as energy efficiency, solar panels, heat pumps	flexible, and EV specific tariffs, and that retailers would have a role in supporting customers in the transition.
	Take-up of EVs, heat pumps and other technologies affecting structure and level of energy demand	
	Take-up of smart meters	Will drive demand for smart and flexible tariffs.

4. Application of the framework and next steps

- 4.1 We applied a competition assessment consistent with the competition framework in our recent review into the future of the Market Stabilisation Charge ('MSC').³ In this review we announced our intention not to extend MSC beyond its expiry date of March 2024. The reasons for our decision are set out in our letter of 12 October 2023. We considered a range of factors which were, in general terms:
- reduced market-wide stability risk, with Value at Risk projections having fallen markedly in the latter half of 2023 as prices have continued to fall and stabilise;
 - increased supplier resilience and capitalisation with measures introduced by Ofgem to bolster resilience to market instability;
 - MSC had been found to exert a dampening effect on competition, reducing incentives for established market participants to compete to acquire new customers and acting as a barrier to entry for potential new entrants.
- 4.2 In particular, we found that there was a marked fall in new tariff offerings since Q2 2022. Although other factors will have also had an effect, we noted that this was the time period when MSC and the Ban on Acquisition Only Tariffs ('BAT') were introduced, suggesting a significant direct impact.
- 4.3 Our competition assessment also indicated that there had been poor innovation amongst suppliers and weak customer service during the competitive conditions accompanying the MSC.
- 4.4 This publication finalises the competition framework for the domestic retail market. We will apply this framework going forward to future policy decisions that have a potential competition impact, including the recently announced review of whether to retain the ban on acquisition-only ('BAT') tariffs beyond its current expiry date of March 2024.⁴
- 4.5 We are currently reviewing our data collections as we emerge from the height of the energy price crisis and are assessing these against both the competition framework and consumer interest framework to ensure alignment between our data collection and the key outcomes of importance to consumers.

³ [Future of Market Stabilisation Charge after March 2024 | Ofgem](#)

⁴ [Call for Input on the future of the BAT post-March 2024 | Ofgem](#)

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- 4.6 This will allow us to monitor the state of competition in the market on an ongoing basis and also allow us to react rapidly in applying the framework to assess the competitive effects of future policy interventions to enable robust and timely decision-making.
- 4.7 As part of this review process, and with the objective of efficiency in mind, we are also seeking to rationalise and stabilise our data collection, including the methods with which we collect and quality assure data. Our aim is to work collaboratively with suppliers in this process, to ensure that suppliers can provide high quality data inputs as cost-efficiently as possible.