

Full Retail Contestability in Singapore's Electricity Market: What to Expect for Residential and Small Business Consumers

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SYNOPSIS

Singapore is gearing up towards Full Retail Contestability (FRC) for its electricity market in the second half of 2018. This will enable both residential consumers and small business owners to select from a variety of electricity providers and pricing arrangements. In order to gain market share, the retailers will no doubt soon begin to try to get the attention of consumers through a plethora of branding and pricing strategies, and catchy advertisements. Consumers may find it quite challenging to fully understand the differences among the various options made available to them. The purpose of this policy brief is to elucidate what consumers should expect when FRC commences.

KEY POINTS

- A multitude of pricing innovations will be made available for heterogeneous consumer preferences, many of which will include products not directly connected to energy use.
- There is a need for consistent and effective monitoring of electricity retail market competitiveness, with measures to encourage innovative tariffs and, if necessary, facilitate the comparability of electricity prices introduced.
- Important factors that will affect the success of FRC are unbiased information about what the various retailers plan to offer and measures that could reduce switching costs.
- As small electricity users are new to retail choice, inertia may be a factor that limits the potential welfare improvements brought about by FRC.

INTRODUCTION

The move towards full retail competition (FRC) for Singapore's electricity market in the second half of 2018 marks the final step towards consumer empowerment and competitiveness amongst electricity suppliers. This means that small users of electricity will no longer be constrained by a de-facto administratively designed tariff. For the first time, there will be a selection of electricity retailers from which consumers can choose the one that best suits their individual needs.

Currently, less than 20 per cent of electricity users still pay regulated tariffs. These users include 1.4 million households, as well as several small business owners whose monthly electricity usage does not exceed 2000 kWh,

equivalent to S\$406 in bill costs based on low-tension tariffs at 20.30 cents per kWh as of the last quarter of 2017. Many of these electricity account holders do not have experience in retail choice, and will have to rely on information presented to them in order to make optimal decisions about retailers and pricing options.

As of October 2017 there were 27 registered electricity service providers listed. This is a threefold increase from three years ago when there were only eight. As competition for market share will be intense, various innovative marketing strategies and billing structures will be devised to entice consumers to switch from Singapore Power (SP) Services to the new electricity providers.

A potentially large number of new price plans will be made available, including time-of-use and fixed pricing, integrated billing design, as well as other non-price bundled attributes. This makes it imperative for consumers to actively learn about all the plans on offer in order to benefit from their first switch in the liberalised market.

ANALYSIS

Although electricity is a homogeneous commodity, there is a tremendous range in consumer preferences. Thus the retailers must learn about the particular sets of preferences held by the smaller consumers, notably the residential and small business consumers, for whom the potential cost savings from lower prices may not be significant enough to spur them to switch to a new provider. More than 10 new entrants have joined the retail market in the past three years, some of which may have limited experience in electricity retailing. These retailers must hence differentiate themselves and build trust with consumers via branding efforts that cater to particular groups of the newly contestable consumers.

Product Differentiation and Branding

Newer retailers, such as MyElectricity have already started to brand themselves as an electricity service provider (ESP) that focuses on 'state-of-the-art' technology to provide electricity for both commercial and industrial (C&I) consumers, as well as household consumers in Singapore. They plan to continuously upgrade their software solutions and to leverage on collaborative opportunities with other service providers to offer integrated billing solutions for consumers.

There are also some retailers targeting demand response solutions for end-consumers. Red Dot Power is one such company, aiming to help consumers save electricity by finding efficient ways to reassign and reduce power usage so as to reduce both costs and damage to the environment. Others are offering clean electricity. For example, Sun Electric and Sunseap Energy will focus exclusively on solar energy-related services, whilst Environmental Solutions (Asia) will offer 100 per cent carbon neutral power to the small consumers of electricity.

These strategies ensure some form of product differentiation, hence potentially shaping the market into a monopolistically competitive one, with differentiated groups of consumer loyalties emanating from the uniqueness of each supplier "brand".

Diversity of Price and Non-price Bundled Attributes.

Experiences in other countries, as well as the information offered on the websites of retailers in Singapore, show that there are many ways that tariffs can be structured, sometimes with a combination of both price and non-price attributes. There are already many well-established pricing mechanisms in use around the world. Currently, Singapore residents purchase electricity from a variable standing offer, where tariffs are administered by a single service provider. Such tariffs are also known as legacy offers. When retail competition commences, consumers will be presented pricing choices that are typically categorised into three main types: fixed, dynamic, and threshold-based prices.

Fixed price plans allow consumers to purchase electricity at one standard rate regardless of changes in the cost of producing and delivering electricity. While these completely protect consumers from large volatilities in fuel price movements, the average rates for such prices are relatively higher compared to other price structures.

Dynamic tariffs allow prices to change depending on the nature of the pricing contract. The range of contractual arrangements under this category is very diverse, catering to consumers with a wide range of risk tolerances. A time-of-use (TOU) arrangement could allow consumers to enjoy lower prices during pre-specified periods, such as weekday evenings or weekends and public holidays, while penalising electricity use through higher prices during other times of the day or week. These dynamic plans could also come in the form of guaranteed discount rates, where promises are made to peg prices to pre-specified percentage discounts off the wholesale prices. More adventurous consumers could even try plans indexed to volatile fuel prices.

Finally, threshold-based tariffs are related to charges that allocate limits on demand, beyond which prices could increase greatly. One example is demand charges where consumers are penalised with higher prices if they use a large amount of electricity in a short period of time (i.e. 5 minute period). Another example is a capacity charge, where fixed prices are paid for pre-specified amounts of consumption on a weekly or monthly basis, beyond which higher rates start to kick in. Such tariffs are related to demand-management where costs are saved by reducing or shifting consumption of electricity.

The flexibility offered by pure-price mechanisms may not be sufficient to convince consumers to switch to another price plan or retailer. This is where bundling strategies come in, whereby incentives are designed for spill-over benefits into other markets of interest to consumers. Such incentives are customised to consumer needs and vary widely from insurance plans, membership schemes and even discounts off purchases of other durable goods. Green products associated with clean energy such as solar-based offers are also an integral part of some plans. Such offers are only possible from the formation of strategic alliances with other companies which could further enhance the branding effect, potentially leading to greater market share as the market consolidates in the longer term.

For consumers who are not interested in switching plans after liberalisation, there should ideally be a default supplier offering variable standing offers that they can continue to rely on.

Consumer Inertia towards Retail Choices

It is likely that consumer inertia towards retail choice will be a challenging obstacle to overcome during the first few years following FRC. Small businesses and residential consumers in Singapore will likely be averse to venture into the unknown territory of retail choice for electricity, and may not attempt to learn anything about the new pricing plans on offer. This is hardly surprising due to a lack of prior experience in retail choice. In order to judge whether it is worthwhile switching from default prices, consumers will have to depend

on whatever information they are exposed to, and their own personal preferences.

The availability of information about the new suppliers and the costs of switching will be crucial. In the Norwegian electricity market, households did not switch to the lower cost spot pricing products for 14 years from 1991 to 2004. During this period, consumers were levied switching fees, and were constrained to switching only at the end of each quarter. In addition, spot price information was not made publicly available until 2004. In the subsequent three years with reforms removing the switching fees, 34 per cent of households put themselves on spot-price products, which was a threefold increase from before 2004. A smart home field experiment in Germany in 2013 also suggested that benefits from dynamic pricing plans are not obvious to consumers, with 69 per cent of participants preferring standard tariffs. Also, the time taken to switch may become a barrier as it increases with the complexity of the switching process. Experience in the Nord Pool suggests that for an annual switching rate of 10-15 per cent, the time taken to switch should be a maximum of 14 days.

Even with sufficient information available and switching hassle minimised, there are other barriers that could prevent consumers from switching. The expected gains from switching may be lower than the actual gains, amounting to a gap between perception and reality, as shown by a 2016 research report by the Council of European Energy Regulators (CEER) for the Netherlands and Spain. According to this report, there was a 70 per cent gap between the expected and actual gains, and the switching rates were very low. Evidently, the consumers were not yet ready to trust new retailers in the industry.

To facilitate the switching process, *Electrify.sg*, an independent organisation that serves as an online marketplace for users to shop for power service providers, has an interactive online portal (electrify.sg) to help consumers compare and purchase electricity price plans and services. SP Services has also set up an online portal (www.openelectricitymarket.sg) to provide information on Singapore's electricity market. The information available

via these portals will contribute to negating the effects of consumer inertia.

Consumer Welfare and the Need for Effective Monitoring of Retail Competition

Questions about consumer welfare will likely be addressed in the future, which may lead to the re-assessment of retail choices in Singapore. Will there be a need to lay down rules for tariff re-structuring if the packages offered are not sufficiently coherent for consumers to make fully-informed decisions? Will consumers really benefit from deregulation?

According to a report on the Australian market released by the Grattan Institute in 2017, retail prices in Victoria increased between 2011 and 2014 with retailers charging higher mark-ups than before. This could be due to increased customer engagement costs arising from competition, which are in turn passed down to consumers.

In response to the price increases that occurred following retail competition, the UK tried to introduce constraints on market competitiveness to protect vulnerable consumers. Limits on tariff innovation, such as banning complex tariff types and limiting consumer choices on bundling services, were imposed. However, these measures were later found to be ineffective because suppliers had to remove some innovative bundling strategies from the market, a few of which were beneficial to lower-income families.

Instead of imposing constraints on the market when problems arise, retail competitiveness should be regularly monitored as it evolves. Information on retailers' cost structures and retail margins should be gathered so as to detect any barriers that could prevent the realization of potential benefits accruing from FRC. Subsequent intervention could come in the form of regulations that ensure the availability of sufficient tariff options for consumers of differing risk profiles, as well as regular updates on electricity market information whenever the need arises.

CONCLUSION

The concept of retail choice for the smaller consumers of electricity in Singapore is novel. It presents a steep learning curve for

consumers who lack prior experience but are willing to consider alternative retail choices. Given that markets may not operate efficiently without measured intervention, the government and retailers should work together to prepare adequately for the challenges that follow deregulation.

In summary, the conditions for FRC are based on the following key factors, namely: abundant public information for consumer engagement, adequate retail choices, and sufficient integrated technological and process infrastructure to facilitate switching. When these conditions are met, FRC has great potential to reduce average energy costs for consumers, decrease their power consumption which in turn benefits the environment, and enhance home and business experiences to a new level with more integrated and personalised solutions.

WHAT TO LOOK OUT FOR

- The number of consumers who switch to new electricity service providers in the first 12 months following the commencement of FRC.
- The branding and pricing strategies of the retailers seeking to draw consumers.
- Whether the switch to new service providers and pricing plans will lead to sizeable energy and price savings or other benefits for consumers.

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