Picking peaches

Service Quality in the Victorian Energy Market – a summary report

August 2020

Executive Summary

Regulatory inquiries and Royal Commissions continue to identify poor practices by firms delivering essential and complex services, resulting in consumer detriment. Yet in many of these markets there is little information available to consumers to enable them to differentiate companies by the quality of their service, reflecting a key *information asymmetry*. Where consumers cannot pick 'lemons' from 'peaches', firms do not face competitive pressure to improve their service offering.

This report provides a summary of the findings from a collaborative research project between RMIT's Behavioural Business Lab and the Consumer Policy Research Centre. This research has produced unique empirical data about the value of service quality and how it affects consumer choice in the context of the Victorian retail energy market.*

This project adopted a multi-stage, iterative and self-validating approach to first develop a prototype measure of service quality, and then to test whether service quality information affects consumer choice in an experimental setting and if so, *how* it affects choices.

*The views and recommendations expressed in this report reflect those of CPRC.

Project Aims

This collaborative research project with RMIT's Behavioural Business Lab sought to understand what aspects of customer service consumers considered most important in the context of the Victorian energy market. From these insights, we develop and then tested a prototype measure of service quality.

We aimed to identify whether:
- Consumers consider aspects other than price are important when assessing energy companies, and to examine how valuable consumers consider these non-price aspects.
- Consumers with different decision-making styles seek different kinds of information and respond differently to that information.
- Consumers make different choices about energy providers when service quality information is made available.
- Consumers are more likely to choose companies with a higher service quality rating when service quality information is made available.
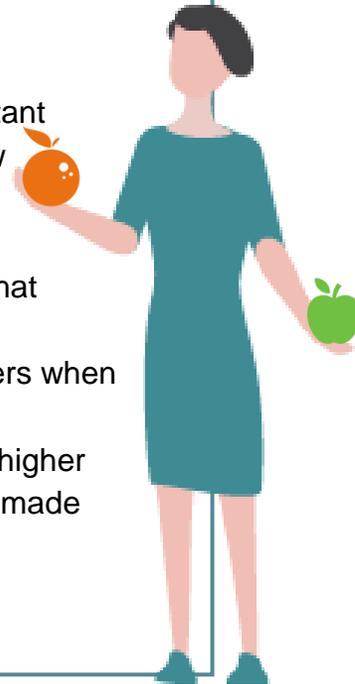
Executive Summary

Developing a measure of service quality

The behavioural research uncovered evidence of key service quality attributes Victorian consumers value when comparing energy retailers, namely: **transparency**, **authenticity**, **agency** and **convenience**. Information about these attributes is largely absent from the information disclosure regime – representing a clear information asymmetry.

The research produced empirical evidence that consumers are willing to pay for energy retail plans that rate higher against these attributes. Through two validating studies, we identified key aspects of each attribute that consumers consider important, and the preferred presentation of this information.

Our research also identified and validated two key decision-making styles: **opinion seeking** and **rational information seeking**. This new segmentation framework cuts across traditional demographic segmentation – which poses both opportunities and challenges for policymakers.

Executive Summary

Testing our prototype measure of service quality

We tested our prototype of a service quality measure in an experimental setting, mimicking how consumers might make a choice through a comparison website. We identified publicly available data to populate our prototype measure of service quality, as well as real energy tariffs and annual costs derived from *Victorian Energy Compare* for each of the energy retailers included in the choice set. Those in the control group were shown the comparator interface with branding and price, while those in the treatment group were shown a comparator interface with the service quality information in addition to annual cost and retailer branding.

In the control group, participants primarily chose the cheapest energy offer (Alinta) followed by a tariff from the most well-known energy retailer (AGL). In the treatment group, participants primarily chose the provider with the highest service quality rating (Tango), despite low awareness of the brand among participants and a higher price than Alinta.

While much of this research entails stated preferences, our findings are statistically significant and suggest that consumers make different choices when provided with information about service quality, and that they choose retailers with higher service quality – even if the brand is less well known or even if the cost is higher.

Control Group
(interface displays annual cost & branding)

Consumers choose retailer with lowest cost & highest brand recognition

Treatment Group
(interface displays annual cost, branding **& service quality**)

Consumers choose retailer with highest quality, followed by lowest cost & highest brand recognition

Recommendations

CPRC recommends market stewards (such as DELWP and the ESC):

Recommendation 1 – Develop public facing measures of service quality in energy and other complex and essential services markets to address information asymmetries – particularly in markets where poor consumer outcomes have been repeatedly identified in regulatory inquires and reviews.

Recommendation 2 – Improve the collection and rigour of regulatory performance data to inform a measure of service quality.

Recommendation 3 – Undertake ongoing consumer research to inform relevant aspects of the service quality measure.

Recommendation 4 – Adopt ongoing evaluation of market and consumer outcomes to determine consumer wellbeing, and research into consumer preferences of important aspects of service quality.

Recommendation 5 – Ensure the measure of service quality is easily accessible at the point of decision-making.

Recommendation 6 – Consider decision-making segmentation approaches to better understand barriers consumers face, as well as tailoring communications accordingly.

Background: the importance of service quality information

Effective markets rely on the premise that consumers actively participate by choosing between different products and services according to their preferences about price, quality and features. Where key information is absent, consumers cannot make fully informed decisions, limiting their ability to choose according to their preferences, and in doing so, drive competitive pressure to reduce cost, improve quality and develop new features.

Akerlof (1970) first highlighted the issue of *information asymmetry* – where sellers have significantly more information than buyers about a product or service – in the market for second-hand vehicles. Akerlof observed buyers face significant difficulty in differentiating a 'lemon' (a dud vehicle) from a 'peach' (a well-working/good quality vehicle) without a reliable indicator of quality.

This same principle can be applied to essential and complex services where consumers often can only fully understand the quality of service after purchase - be it technical aspects like broadband speed or customer care. Where consumers cannot evaluate the quality of service before purchase, high quality providers cannot differentiate themselves on this basis, while lower quality firms avoid competitive pressure to improve quality (Martin Hobbs, 2019).

Research suggests consumers may stick with their current provider when faced with uncertainty in the absence of this information – reflecting *status quo bias* (Yoo and Sarin, 2018; Hortaçsu et al, 2017).

The additional costs of poor service are borne by consumers. Resolving problems in essential services sectors – energy, banking and finance, internet and telecommunications – is estimated to cost Australian consumers an additional $6.26 billion each year (Martin Hobbs, 2018, p. 3).

Research has found Australians have low trust in these essential service sectors, which may partly be a consequence of poor service quality (Edelman, 2020; O'Neill, 2013). As noted by The Ethics Centre, 'individuals and organisations will find it difficult (if not impossible) to operate effectively if they do not enjoy the trust and confidence of the community in which they are located' (The Ethics Centre, 2018, p. 4).

How are regulators responding?

The use of 'sunlight remedies' – i.e. ensuring public information about strengths and weaknesses in firms' service quality is available– has been strongly endorsed by British regulators, as seen in the UK Department for Business, Energy & Industrial Strategy's *Modernising consumer markets: green paper* (2018), directing regulators of water, energy, banking and insurance, and telecommunications to develop and implement a variety of customer-facing measures of service quality.

More recently, Australian regulators have begun to follow suit. In 2018 the Australian Competition and Consumer Commission (ACCC) introduced a public facing measure of broadband speed (2018). The program relies on thousands of Australians volunteering to have 'Whiteboxes' installed in their homes to provide reliable data about their internet speed – effectively providing an ongoing audit of this quality of service.

In March 2019, Australian Securities and Investments Commission and Australian Prudential Regulation Authority launched a consumer-facing Life Insurance Claims comparison tool on MoneySmart, which includes data about consumer complaints (Moneysmart, n.d.).

In December 2019, Australian Financial Conduct Authority (AFCA) launched the 'AFCA Datacube', which provides financial services complaints data by firm, location and product (AFCA, 2019).

However, there are few – if any - comparison sites across essential services markets that include a measure of service quality alongside price, as well as a whole of market view.

Developing a measure of service quality

Project stages: an iterative approach

Stage 1

16 qualitative interviews to identify key attributes of service quality (customer care) when considering energy companies

Stage 2

A 'discrete choice experiment' – an online survey enabling us to identify to what extent consumers are willing to confirm willingness to pay for these attributes

Stage 3

A survey to build an understanding of the different aspects of these attributes and the importance of different aspects

Stage 4

A survey to test consumers' preferences around the presentation of service quality information + validate decision-making segments

Stage 5

Experimental survey to test whether preferred presentations (stage 4) result in consumers making 'better choices'

Stage 1: key attributes of service quality

The first stage entailed 16 qualitative interviews with consumers to identify the aspects of an energy retailer's service they considered important when making decisions about switching providers. These semi-structured interviews used a 'why-how' laddering technique to uncover the underlying reasons why consumers considered these aspects important. Analysis then identified key thematic attributes of service quality for validation at the next stage.

Transparency

One of the key themes identified was a lack of trust in energy retailers; a view that retailers were primarily interested in profit-seeking rather than providing good service. Interviewees suggested retailers could be more forthright about 'hidden' charges in their contracts, answering honestly rather than avoiding questions or obfuscating key details about pricing, or alerting customers about rate changes.

Agency

Interviewees felt that they were disempowered to make decisions about their energy supply, often as a result of push marketing and cold-calling which prompted individuals into making decisions. Interviewees also felt that they were not provided with the information they needed in order to make fully informed decisions.

Convenience

Interviewees raised a range of aspects of convenience relating to the ease with which they could have issues resolved and make decisions on their own terms. This often referred to simplicity rather than the speed necessarily – single call resolution was highlighted as opposed to re-starting or repeating conversations with a different staff member at a later point through a call-back service.

Authenticity

Interviewees expressed a desire to build a relationship with their retailer, to be able to talk with call centre staff like an account manager, to be treated with respect, and for retailers to understand a consumer's own local context. Interviewees talked about being rewarded for loyalty rather than penalised.

Decision-making style

These interviews also identified different decision-making styles. Some consumers indicated a clear preference for seeking out information themselves, working methodically to make decisions based on a more 'rational' basis. By comparison, others preferred to rely on the opinions of trusted individuals. A more nuanced view of "engagement" in the energy market was also identified – that some consumers closely monitor their usage and tariff but do not necessarily switch retailers, while others may switch retailers periodically but otherwise pay little to no attention to their bill.

These decision-making construct was also taken forward for validation in subsequent research stages.*

*Note, while other themes were identified at this stage, they were not validated at subsequent stages of the research or fell beyond the immediate scope of the research (e.g. fair pricing for others).
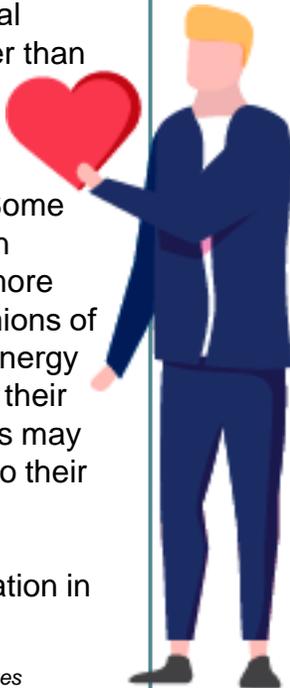
Stage 2: willingness to pay for service quality

In this stage of the research, we used a 'discrete choice' experiment to test consumers' willingness-to-pay for the attributes identified in the qualitative interviews. Discrete choice experiments are a well-established, widely used empirical methodology to understand the choices people make between goods or services with multiple attributes. This approach enabled us to both validate the four non-price attributes identified in the qualitative research stage with a statistically significant sample (N=1002) and determine people's willingness-to-pay for these attributes *relative* to price – rather than rating each attribute independently.

Participants were first required to rate their own energy provider on each attribute (high, medium, low) and nearest approximate cost per quarter ($545, $615 or $730) as a reference.* Participants then chose between different hypothetical energy retail plans (Plan A, Plan B and their current plan – see the table below), with different levels of each attribute and a corresponding price.

This experiment was delivered via an online questionnaire, capturing socio-economic indicators and elicited psychographic indicators. We were able to validate the decision-making styles identified in the qualitative research and run a segmentation analysis to identify whether there were differences in how respondents with different decision-making styles value the different attributes.
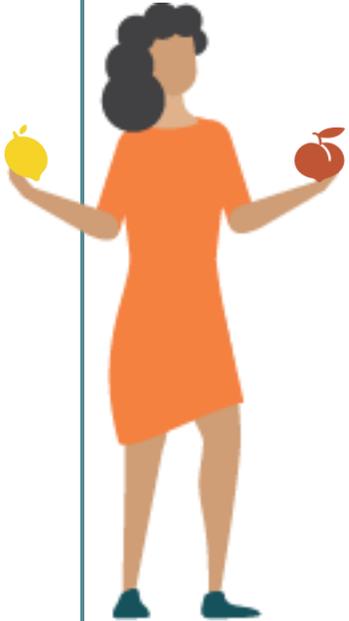
	Plan A	**Plan B**	**Your current plan**
Price	High ($715)	Low ($545)	Your current plan
Transparency	Medium	Medium	
Agency	High	Low	
Convenience	Medium	Medium	
Authenticity	High	Medium	

*The price brackets were derived from an average from the cheapest offers from retailers available though Victorian Energy Compare using a 4000kwh per year usage profile.

Stage 2: willingness to pay for service quality

The 'discrete choice experiment' found price was the most important factor in participants' choices – this graph shows a lower priced plan is 80% more likely to be chosen (each point (co-efficient) represents the best estimate of the average effect of each attribute).

But importantly, the remaining four non-price attributes are also considered important and affect consumers' choices. We can infer that an energy plan with greater transparency is about 40% more likely to be chosen, a plan offering greater agency is 29% more likely to be chosen, a plan with higher convenience is 30% more likely to be chosen, and a plan with higher authenticity 26% more likely to be chosen.

From this we can infer that Victorian consumers are most willing to pay for transparency ($42), followed by convenience ($32), agency ($30) and authenticity ($27) **per quarter** for a 3-person household.*

Overall, these findings both validate our attributes and the initial hypothesis of the project – that Victorian consumers consider service quality information valuable and are willing to pay for an energy provider with higher service quality.
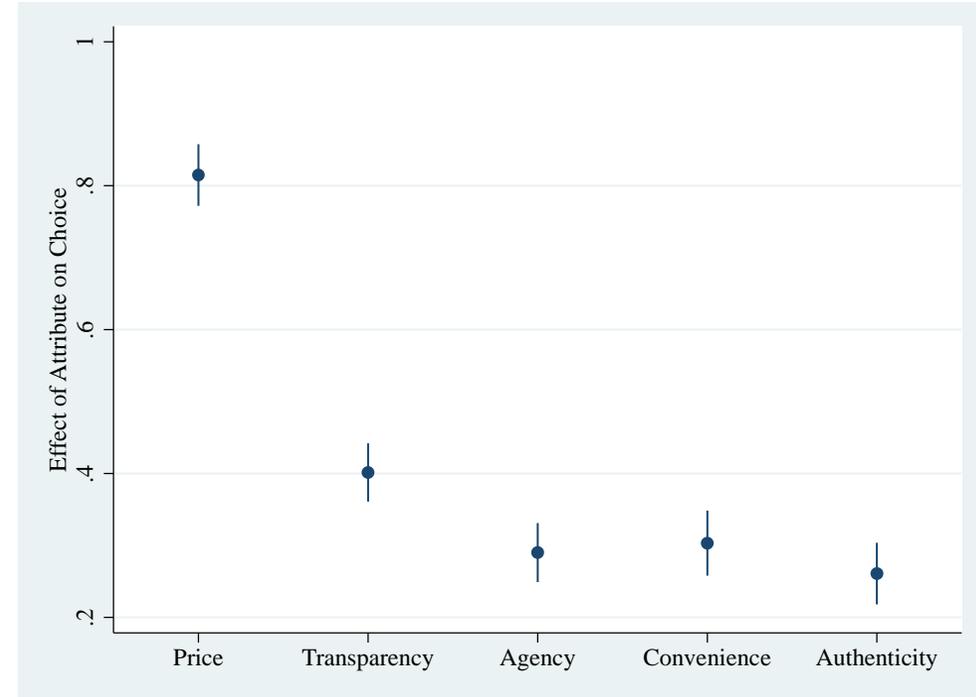
*The researchers obtain the marginal rate of substitution between price and other attributes by dividing the coefficient of each non-monetary attribute by the normalised coefficient of price as $\frac{\beta_{attribute}}{\beta_{price}/85}$. It is necessary to first divide the coefficient of price by 85, since the step change between our low, medium and high price levels is $85 (the levels are $545, $615, and $730 respectively).

Stage 3: aspects of service quality attributes

In this stage, we sought to validate the aspects of service quality raised in the qualitative interviews with a statistically significant sample (N=1002). Respondents rated various information components in assessing retailers on each of the four validated attributes (transparency, agency, convenience and authenticity), on a seven-point scale. This list of components was drawn from aspects identified by respondents in the qualitative interviews, and added to by CPRC, RMIT and stakeholders. Through a statistical process called exploratory factor analysis, we then identified information components consumers consider most relevant to each attribute.

This table outlines the most relevant/information components in order of importance and across our total sample. The results indicate a wide array of information consumers consider important when considering retailers, which is largely absent from the market. The absence of publicly available data around many of these aspects had implications for our measure of service quality. We were able to identify publicly available data for those components in italics, which meant we did not necessarily use the most relevant component in our measure of service quality.

The research was conducted during a period of energy market reforms, with many of the components identified the subject of reform. For example, Victorian energy retailers are now required to clearly articulate fees and charges with new energy offers and notify customers of the best available offer (Essential Services Commission, 2018). Performance data for these new regulations could be a useful input into service quality measures.

Attribute	Information component
1 Transparency (first aspect)	• Pricing before and after discounts • All fees and charges are clearly communicated (not hidden in complex wording in the Terms and Conditions /contract) • *Bills are generally clear and simple to understand* • Energy companies alert all customers to the best available tariff/offer
1 Transparency (second aspect)	• Disclosure of top executives' salaries • Number of retailers' customers
2 Agency	• *Call-centre staff can provide all the support and information required to enable customers to make informed decisions* • Call-centre staff are knowledgeable and consistent in the way they treat customers • Energy company delivers on what they advertise and promise • *Energy companies provide you clear information about your energy usage so you can take action if you want*
3 Convenience	• Call-centre staff provide you with all the help you need without hesitation • Energy company can resolve your issue or enquiry quickly • Energy company resolves your issue or enquiry within one phone-call • *Ability to switch energy companies without errors (e.g. correct address, correct tariff)*
4 Authenticity	• *Energy company responds well to complaints* • Call-centre staff are knowledgeable and consistent in the way they treat customers • Energy company delivers on what they advertise and promise

Stages 3 and 4: different decision-making styles

Across the two validation studies (stage 3 and 4) we empirically tested a decision-making construct developed from the qualitative interviews. Analysis found the following segments were validated in our data as distinct:

- Rational Information Seeker (high/low)
- Opinion Seeker (high/low)
- Active Engagement with Energy Market (high/low)

Analysis found a correlation between Actively Engaged and Rational Information Seekers, and Actively Engaged and Opinion Seekers. This means that when people score high on information seeker (whether rational information or opinions), they are more likely to also be actively engaged.

It is important to note that people can be *both* a high rational information seeker and a high opinion seeker – consider whether someone only relies on hard data found online or whether they might also ask friends and family their opinions when making a choice about a new product or service, sense checking or triangulating different sources of information. Likewise, they might be *neither*.

This characterisation isn't to say these individuals don't make decisions, but rather they might be more inclined to make on-the-spot decisions ('go with their gut') rather than seeking any further information. This means they might be more susceptible to behavioural biases or rely on heuristics, such as *status quo bias* or implicit defaults (Frederiks *et al*, 2015).

Segments

The breakdown of the different segments demonstrates a reasonably balanced spread across each of the segments – see the mean average of the two segmentation analyses below. Across the different decision-making styles, 49% of the sample can be characterised as 'high engagement' while the other 51% can be characterised as 'low engagement'.

Our findings identified only a quarter can be characterised as both highly engaged and rational information seekers – a decision-making style that most closely represents the archetype consumer expected in textbooks. Conversely, our results identified approximately a third (33%) of respondents can be categorised as both low rational information seekers and low opinion seekers (when disregarding engagement characteristics), suggesting some people do not seek out additional information when making decisions.

This has significant implications for broader questions of information disclosure in market contexts – it highlights the problems for policymakers in developing a one-size-fits-all approach for information disclosure, advice and guidance. These findings suggest a need for tailored messaging, and attention to decision-making styles when identifying and developing messages for target groups.

Validation A	Opinion High	Opinion High	Opinion Low	Opinion Low
N=989	Low Engagement	High Engagement	Low Engagement	High Engagement
Low Rational Info	10.72%	8.90%	17.80%	14.56%
High Rational Info	12.44%	13.85%	10.52%	11.22%
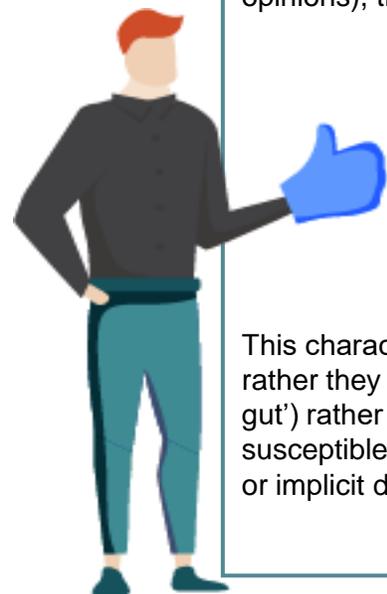
Stage 4: presentation of service quality information

This stage of the research sought to determine whether consumers prefer different visual presentations of the service quality attributes, using a quantitative survey (N=552). This stage also sought to determine whether the validated decision-style segments preferred different information presentations. This built on the qualitative interviews, where disengaged consumers referred to star ratings while more engaged consumers sought to find the data and develop their own spreadsheets for example.

Participants were presented with definitions of each attribute and visual examples of the four different presentation types:

1. Detailed raw data and facts about the energy retailer
2. Data about energy retailers presented in a bar graph or a pie chart
3. Detailed written accounts from experts (such as the energy regulator/ombudsman) or detailed reviews from other energy consumers
4. A rating, ranking or a 'stamp of approval'. This might be a star rating or tick given by the energy regulator/ombudsman or a thumbs up based on consumer reviews.

Participants were asked to choose their preferred presentation for each information component of the different attributes.

Findings

Across all four attributes we found respondents significantly prefer information to be presented as a rating, ranking or stamp of approval, followed by detailed written accounts from experts or consumers. They least prefer information to be presented as a bar graph or pie chart. This finding held even when comparing different decision-making segments – contrary to expectations.

When analysed by attribute, respondents preferred raw data, followed by a rating, ranking or stamp of approval for transparency. For the remaining attributes, a rating, ranking or stamp of approval was the preferred presentation.

We also asked respondents about the source of the information. We found that in the energy market context, roughly two thirds of respondents prefer advice and information from experts/regulators (N=371) compared with a third who prefer opinions from other consumers (N=181).* This has implications for the source of data of a service quality measure, and the agencies best placed to collect this data.

*Qn: *[Thinking] about your preferences when assessing and choosing energy companies… if you had to choose between the following two sources of information, which would you prefer: A) "advice and information from experts/regulators" or B) "opinions from other consumers"?*
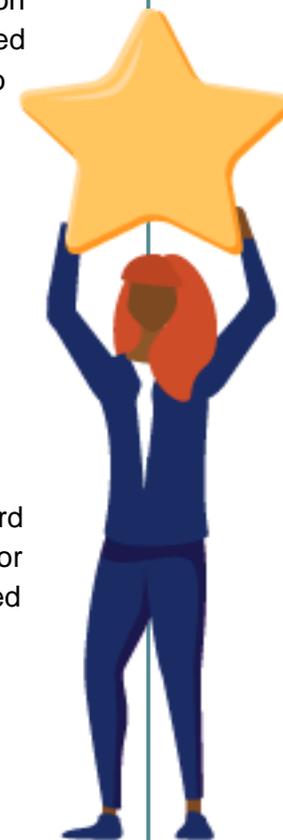
Stage 5: does this information lead to 'better' choices?

In this field experiment, we tested whether the visual presentation preferences identified in the previous survey (stage 4) result in a 'better' choice of energy provider.

Adopting a two-treatment approach, respondents were either allocated the most preferred presentation from stage 4 – a rating, ranking or a stamp of approval (treatment 1: N=220) or allocated the least preferred presentation – information to be presented as bar graph or pie chart (treatment 2: N=212).

Participants were asked to consider three hypothetical energy companies – each with pre-determined levels of each of our attributes (transparency, agency, convenience and authenticity) – either high, medium or low.

Participants were then asked to identify the company with a particular level (either high, medium or low) of each of the four attributes, as well as the 'best' company – i.e. rated most highly for all four attributes. Participants were incentivised to try to improve selection and received a bonus payment if they managed to identify the 'correct' company with the prescribed level of a particular attribute.

Findings

Participants in Treatment 1 (83.3%) were better able to identify the company that was 'best' overall in terms of all four attributes, compared with those in Treatment 2 (67.9%) – and this difference reached statistical significance.

Treatment 1 presentation vs Treatment 2 presentation

COMPANY A

TRANSPARENCY

Number of customers
(Source: Essential Services Commission)
☐ Total number of customers: 420,103
☐ Total number of households in Victoria: 2,520,620

Pricing before and after discounts
This Company
☐ Monthly price without discount: $1,975
☐ Monthly price with discount: $1,925
Industry average:
☐ Monthly price without discount: $2,340
☐ Monthly price with discount: $1,975

AGENCY

Provides useful information and support to help you make choices (Source: Energy and Water Ombudsman)

CONVENIENCE

Helpfulness of call-centre staff
(Source: Essential Services Commission)

AUTHENTICITY

Responds well to complaints
(Source: Essential Services Commission)

COMPANY B

"This company does not give us the exact number of customers they have, but provides us with information on whether it has a large or small share of the total number of Victorian households. This gives us some idea about the size of the company".

Essential Services Commission

"This company only provides prices after discounts. This makes it rather difficult for us to compare prices against the industry average".

Provides useful information and support to help you make choices (Source: Energy and Water Ombudsman)

Helpfulness of call-centre staff
(Source: Essential Services Commission)

Responds well to complaints
(Source: Essential Services Commission)

26%
74%
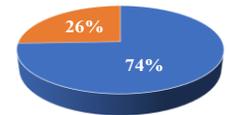
■ Number of complaints
■ Number of complaints escalated to the Ombudsman

Extended lab experiment – testing a measure of service quality

Methodology

Our final experiment tested a prototype of a measure of service quality, measuring whether this information affected consumers' choices.

We recruited a representative sample of the Victorian population Qualtrics Online Panel (N= 510). In an online experiment, participants were asked to imagine they were in the market for a new energy provider and choose their preferred retailer from the 11 retailers presented in an interface based on the *Victorian Energy Compare* website.

The control group (N=287) were shown the interface with estimated annual cost and retailers' branding. The treatment group (N=232) were shown this same information as well as the prototype service quality measure (see left – service quality information highlighted).* This design allowed us to explore two questions:

1. Do consumers make different choices about energy companies when service quality information is made available?

2. When service quality information is made available, are companies with a higher service quality rating more likely to be chosen?

*This particular measure of service quality was developed from the cumulative behavioural insights of previous research stages, but limited by a range of factors including the availability of data. It should be considered a **prototype** developed for the sole purpose of this experimental study only and should not be relied upon for any other purpose.

Methodology

The experiment sought to emulate a real-world comparison and choice process as closely as possible. To this end, we included retailers' branding along with their lowest priced offer available (as of December 2019) through *Victorian Energy Compare*. To ensure pricing was directly comparable, we included only flat tariffs based on an annual consumption of 4000kwh, without contract lock-ins or incentives.

The design of the measure of service quality drew on the cumulative validated findings of the five previous research stages, however it was also partly determined by the availability and rigour of publicly available data. We identified public data relevant to an important aspect of each attribute, though due to the data available, this was not necessarily the *most* relevant aspect. Publicly available data also limited the number of retailers in the experiment.

We used both regulatory and survey data sources to populate our measures:
• Essential Services Commission (ESC) – Victorian Energy Market Report 2018-19
• Energy and Water Ombudsman Victoria (EWOV) – Annual Report 2018-19
• Canstar Blue – Victorian Electricity Providers Annual Review

For each aspect of the four different attributes we drew on more than one dataset where possible to improve the rigour of each measure. The data was then transformed to provide a relative ranking for each attribute and across all attributes.

We departed slightly from the findings at stage 4, in that all attributes were presented as ratings in order to simplify presentation through the interface. We chose a graphic for each attribute (this was not empirically tested) that we considered mostly closely related to the information being conveyed. We also asked participants additional questions about awareness of different providers, trust in their own provider and about their engagement in the market.

| Attribute	Derived information component and relevant data
Transparency	"clarity of billing and pricing" • ESC data – the billing complaints data (per 100 customers) and • Canstar Blue rating - Bill and cost clarity
Convenience	"ease of sign-up and switching" • ESC data – the number of complaints about transfer and switching errors per 100 customers, and • Canstar Blue rating - Ease of Sign up
Agency	"responsive call centre, useful online tools and advice" • ESC data - the average call response times (seconds) per retailer, • ESC data - the percentage of calls answered within 30 seconds per retailer and, • Canstar Blue rating - Online tools and services.
Authenticity	"responds well to complaints" • EWOV data - investigations as a proportion of complaints, and • ESC data - the number of complaints per 100 customers.

Service quality information influences choice

Our results show the effect of service quality information on consumers choices.

In our control group (*no* service quality info)

- 32% (N=88) chose Alinta, the retailer that had the cheapest offer in the choice set, but eighth in brand awareness.
- 18% (N=51) chose AGL, the retailer with the highest brand awareness among participants, but the sixth most expensive.
- 10% (N=28) chose EnergyAustralia, the most expensive retailer in the choice set. This results may reflect the strength of brand awareness - EnergyAustralia had the third highest brand awareness.

In our treatment group (*with* service quality info)

- 36% (N=75) chose Tango compared to 1% in the control group. Tango had the highest service quality rating and the third cheapest price in the choice set. However, Tango had the lowest brand awareness of all retailers among participants.
- In the treatment group only 13% (N=29) chose AGL and 25% (N=57) chose Alinta, the two most chosen retailers in the control group.
- 6% (N=14) chose EnergyAustralia, despite price and ranking poorly on aspects of service quality.

Choice of retailer – control vs treatment

N=510
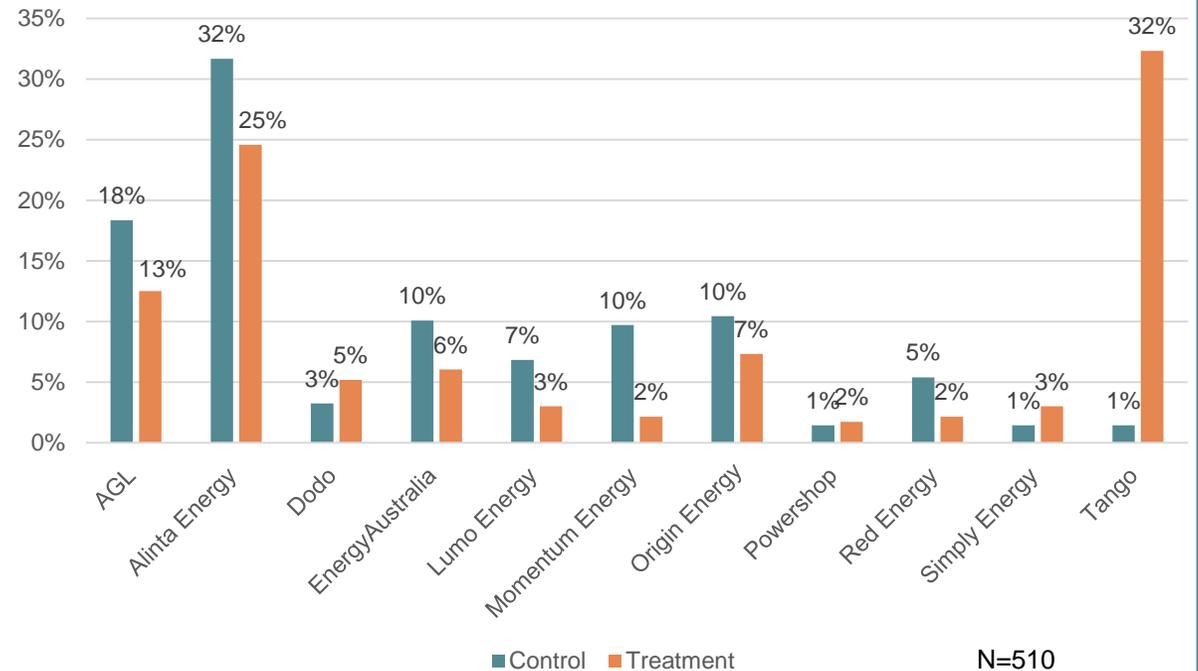
Switching more likely with service quality information

In our experiment, we found a high rate of 'switching' retailers – where respondents chose a retailer other than their own current retailer (reported as part of the survey).

The rate of switching retailers was 10% higher among those who received service quality information compared with the control group.

When analysed by retailer, this trend was largely replicated across the 'big three' providers, though the number switching increased from 45% (control) to 65% (treatment) for current AGL customers.

In the control group, respondents who are current Alinta Energy customers had a significantly lower switching rate (21%) than average – likely because Alinta was the cheapest tariff in the choice set. Notably, 47% of Alinta customers in the treatment group chose another provider, again suggesting consumers are willing to pay for higher service quality.

We note there was a high rate of switching in our experiment overall. Respondents may be more likely to indicate an inclination to switch provider in an experimental setting than when faced with a real-world choice. This may reflect the *intent-action gap* (Frederiks et al., 2015) or the real switching costs involved (Deller et al., 2017).

Switching rate by current provider
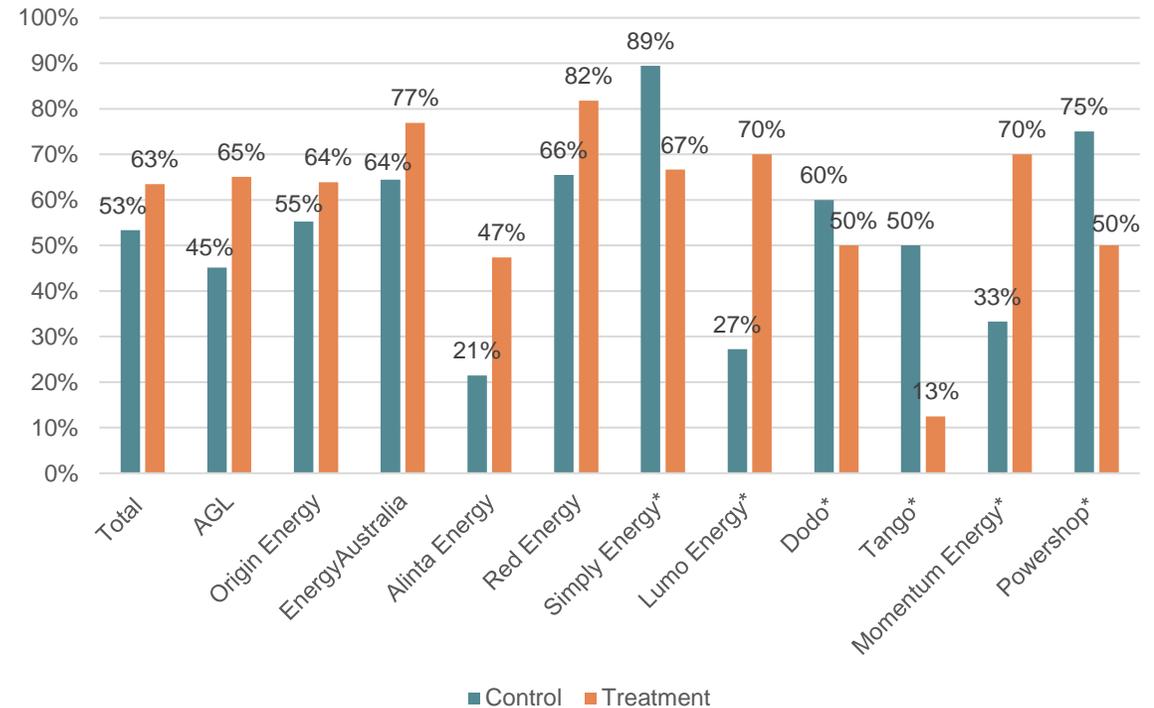
N=463

*The results for retailers with less than 40 respondents are not statistically reliable and should be treated with caution.

Is bigger better?

As part of the experimental survey, participants were asked questions about their awareness of different providers and trust in energy providers. This allowed us to test relationships between trust and different behaviours or attitudes.

We asked all respondents a series of questions about their brand awareness of the retailers included in the choice set. Unsurprisingly, the smaller retailers had low brand awareness compared to the "big 3" retailers.

However, our research found marginal difference in perceived trustworthiness between retailers of *any* size (see left). This suggests consumers are open to choosing new entrants and smaller retailers.

Where consumers have information about service quality, newer firms may be able to grow market share through higher quality of service. In turn, this may drive competitive pressure to increase quality across the industry.

Trust in energy retailer by size
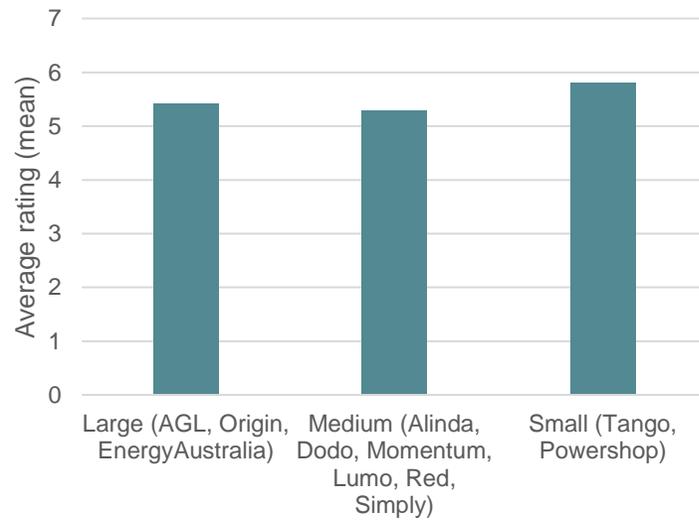
Qnt: *On a scale of 1 (Strongly disagree) to 7 (Strongly agree), please tell us how trustworthy you consider [Large/medium/small] energy companies in general.*

Brand Awareness & Market Share

Brand Awareness (out of 5) — Market Share (electricity)

A matter of trust?

Trust in own retailer and inclination to switch
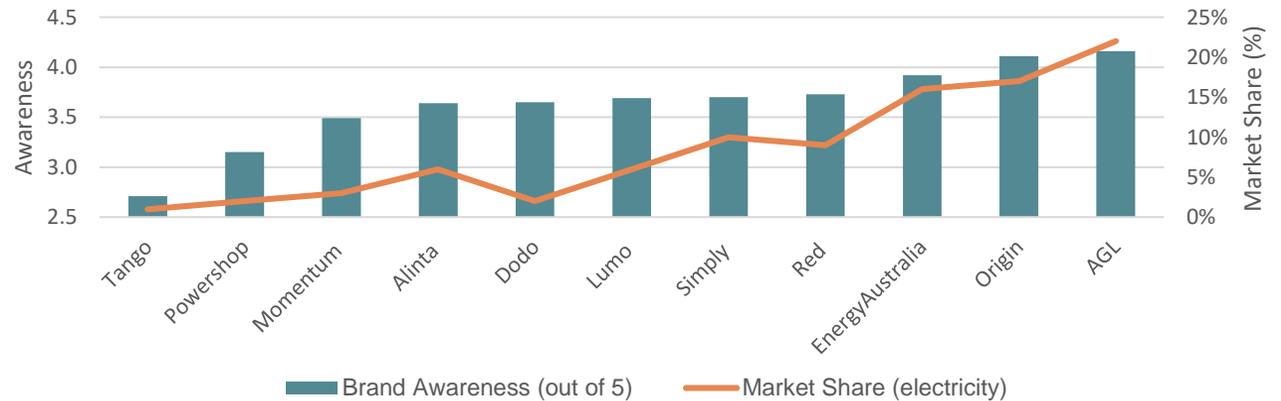
We found a relationship between trust and higher inclination to 'switch' provider. In both our treatment and control groups, those with lower trust in their current provider were more likely to switch to one of the firms listed in our experimental choice set.

A regression analysis of our results found an increase of 1 point (on a scale of 7) in trust in a participant's current retailer is associated with a 10 percentage point decrease in likelihood of switching (controlling for current energy provider).

For firms, providing consumers with higher quality service may help them retain customers – a finding reflected in the literature (Carrillat et al., 2009). Research into the Dutch health care insurance market found consumers are more inclined to switch providers if their current health insurance provider has a lower service quality rating (Boonan et al., 2016).

For policymakers, this suggests providing consumers with information about service quality is important to facilitate an effective market – where distrusting consumers switching from their current provider cannot identify a higher quality alternative, they may disengage entirely.

Conclusions and key insights from the lab experiment

Our experiment sought to test two key hypotheses:

- **Hypothesis 1** – Consumers choose different energy retailers when presented with service quality information.

- **Hypothesis 2** – More consumers choose energy retailers with high service quality when this information is provided.

A two-sided χ^2 test (to test for statistical significance) found that the two distributions of choices across the treatment and control groups were statistically significant, which **confirms our first hypothesis**.

A two-sided t-test found the choice of Tango was statistically significant across the treatment and control groups (p-value < 0.001), which **validates our second hypothesis**.

For policymakers and regulators, the lab experiment shows that:

- In the absence of service quality information, consumers are most likely to choose energy companies that offer the lowest cost (e.g. Alinta) and have the highest brand recognition (e.g. AGL).

- Conversely, providing service quality information leads consumers to make different choices – namely, they choose providers with higher service quality ratings.

- Service quality information may result in consumers choosing lesser known, higher quality retailers.

- Consumers may be prepared to pay more for retailers with higher service quality.

- Brand drives choice for some, even where information about price and quality are available.

Information about service quality may facilitate competitive pressure – if service quality information leads consumers to choose higher quality firms rather than relying on well-known brands or lowest cost, firms may seek to compete on quality.

Recommendations

The findings summarised in this report provide a strong empirical basis for developing public-facing measures of service quality to help consumers differentiate between companies.

Service quality information affects consumer choice, with respondents choosing higher quality providers even where this provider is less well known or more expensive.

Moreover, consumers appear more inclined to switch away from their own retailer when provided with service quality information. This 'sunlight remedy' may therefore have the effect of driving competitive pressure among firms to improve quality.

CPRC's recommendations for market stewards (such as DELWP and the ESC) are outlined on the following pages.
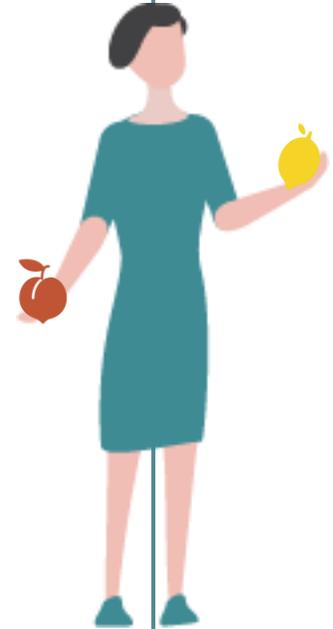
Recommendation 1 – Develop public facing measures of service quality in energy and other complex and essential service markets to address information asymmetries, particularly in markets where poor consumer outcomes have been repeatedly identified in regulatory inquires and reviews.

For information about aspects of quality to be useful to consumer decision-making, it needs to be comprehensible, comparable, and (ideally) market-wide. But as Spiegler notes, even where firms produce 'good' products or services they may have an interest in weakening consumer decision-making if they can thereby reduce market competition and increase profits (Spiegler, 2006).

Consequently, there may be no incentive to develop comparable information about aspects of quality with competitors – and anti-collusion regulations may even inhibit businesses determining processes for collecting and publishing internal data.

Moreover, consumers may perceive information supplied by businesses themselves to lack independence. And where businesses voluntarily fund third parties to produce quality comparison ratings, non-participating businesses have no obligation to participate, reducing the comparability of the entire market (Consumer Affairs Victoria, 2006). For these reasons, we suggest market stewards need to ensure that comparable information about the quality of products and services is provided.

Recommendation 2 – Improve the collection and rigour of regulatory performance data to inform a measure of service quality.

The Consumer Affairs Victoria report *Designing quality rating schemes for service providers* (2006) suggests there are two key approaches to measuring service quality:

1. Measure 'actual service quality by sampling or testing the service and/or surveying consumers – an approach that works well for most standardised services'.

2. 'Identify the characteristics of the service provider that affect service quality and develop indicators for measuring those characteristics'.

The findings from this project suggest that the data required to fully populate the measure of service quality would require **both** approaches in order to develop the kinds of information identified by consumers. In developing the prototype measure of service quality, we found a limited range of data available to populate our measure. Though we were able to draw on regulatory performance data from the ESC and data about complaints from EWOV, many of the aspects identified as important by consumers are not currently measured as part of performance reporting requirements.

In developing a measure of service quality, market stewards would need to consider extending these performance reporting requirements to collect this data where possible. We also encourage government agencies and regulatory bodies to share relevant data from publicly funded research where this in the public interest, consistent with the recommendations of the Productivity Commission's *Data Availability and Use* report (2017).

Recommendation 3 – Undertake ongoing consumer research to inform relevant aspects of the service quality measure.

Populating some aspects of quality identified in our research requires data derived from aggregated subjective consumer views about their experiences with energy retailers – for example, the 'ease of sign up'. In developing this measure of service quality, we relied on publicly available data from Canstar Blue's consumer survey. We suggest there is a need for a consumer survey large enough to capture robust data about consumers' experiences dealing with each retailer in the market to provide meaningful comparability.

Recommendation 4 – Adopt ongoing evaluation of market and consumer outcomes to determine consumer wellbeing, and research into consumer preferences of important aspects of service quality.

This research project was conducted during a significant period of reform in the energy market. Many of the aspects of service quality identified and validated over the course of our research have been implemented as new regulatory requirements.

Beyond regulatory compliance, this means retailers may not be able to develop competitive advantage for some components identified by the present research, while other elements of the reform processes may become key points of differentiation. Other aspects of service quality identified as important would require significant change to the energy regulations – and develop as points of competitive advantage if the rules and market design changes. Understanding what is important to consumers as the market evolves will be essential to ensure the measure remains relevant, which will likely require periodic consumer research to confirm or update aspects of the measure.

Recommendation 5 – Ensure the measure of service quality is easily accessible at the point of decision-making.

For a measure of service quality to be useful, it needs to be available where consumers make comparisons and choose providers. In the case of energy, this is often through online comparison sites, but may extend to other channels – such as direct phone calls. In the UK, commercial comparator websites are required to use the service quality rating developed by Citizens Advice (derived from regulatory data provided on a statutory basis) or submit their own methodology to the regulator for consideration should they wish to develop their own (Martin Hobbs, 2019, p. 20) This approach might ensure ratings are not gamed by less scrupulous operators.

Recommendation 6 – Consider decision-making segmentation approaches to better understand barriers consumers face, as well as tailoring communications accordingly.

Our research identified and validated a decision-styles segmentation framework. Analysing our findings through this framework highlighted the differences in understanding of the energy market among respondents and the different kinds of information that different segments sought. We encourage market stewards to consider segmentation approaches that consider how consumers make decisions to barriers consumers face and to inform communication strategies.

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