The Road to Confusopoly

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Confusopoly

- Adams: “a group of companies with similar products who intentionally confuse customers instead of competing on price.”
- Examples: telecommunications, insurance, mortgages, credit cards, etc.
- But what about energy retailing?

Search Model

- Consider an industry with several producers of an homogenous product
- A consumer considering switching suppliers will switch if:

$$P^{old} + D > P^{new}$$

  - where D are switching costs including any disconnection fees
- A consumer will only search for a new supplier if:

$$\text{Prob}[P^{old} + D > P^{new}] > S$$

  - where S are search costs

Diamond Paradox

- With many suppliers, why would you expect to get a better deal?
  - If all highly competitive, then can’t do better
  - Only if you think firms will offer you a customer specific deal; but will they?
- According to Diamond (1971): each firm won’t lose many customers by charging a slightly higher price than other firms
  - In equilibrium: all charge the monopoly price and no search occurs.

‘Sleepy Incumbent’ Model

- Customers may expect to get a better deal if switching from an incumbent
  - Implication: entrant’s should advertise pricing deals
  - Incumbent may accommodate this by charging higher prices (Guilietti, Waddams-Price, Waterson, 2005)
- Should see incumbent retailers charge a higher price than entrants in an area

Which Model? Sample of One

- Which model applies in Victoria? Diamond Paradox or Sleepy Incumbent
- With this in mind, I decided to revisit my own gas retailing choice in Victoria
  - I was aware I had choices
  - I had never researched options before
  - I utilised the Essential Services Commission Energy Comparator

Behavioural Economics

- New economic approaches for dealing with consumer irrationality
- Basic idea:
  - When faced with an upfront cost and future options, consumers with over-weight option value and spend too much upfront
  - When faced with an upfront benefits and future avoidable costs, consumers will under-weight ability avoid costs and spend too little upfront

Implications for Switching

- Consumers will under-weight importance of disconnection fees
- Consumers will under-weight ability to opt out of automated payments to switch in the future
- Consumers will under-weight future switching costs
- Consumers will fail to invest in information to make choices transparent
  – And firms will not have an incentive to provide transparency as consumers will demand more upfront to compensate for switching costs later on.

Policy Responses?

- Likelihood of consumer choice providing a locus for effective competition is bleak
  - Energy retailing looks like a confusopoly
- Would a regulated pricing structure that forced simplicity and transparency be better?
- Would a consumer choice regime that required a choice be effective?
  - E.g., an audit of individual choices or an annual auction for customers?