Non-price competition and entry

Summary

1. The market in Great Britain is highly concentrated, with one firm (Calor) accounting for almost half of all domestic bulk LPG sales (by volume and value) and four firms (Calor, Flogas, Shell and BP) accounting for around 90 per cent of sales. The market in Northern Ireland is even more concentrated with only two firms—Calor having around [✂] per cent of the market and Flogas [✂] per cent.

2. In Great Britain market shares and size are stable, although some larger firms have grown through acquisition, and some entry and exit has occurred among smaller

firms. Entrants tend to remain small, or to expand to a point where they are purchased by one of the major suppliers.

3. Almost all domestic bulk LPG suppliers also supply to non-domestic sectors—ie commercial, industrial and agricultural. The cost of entry as a supplier depends on the scale, but small-scale entry is possible at a relatively modest cost, as evidenced by the fact that some small firms have entered in recent years, and remained in the market. However, larger-scale entry or expansion, other than by acquisition, have not taken place. The scope for growing a large customer base ‘organically’ is limited by the lack of market growth (there are few ‘new to market’ customers) and switching costs (described in Appendix G) which limit the scope for winning customers from existing suppliers.

4. On the whole, internal strategy documents tend to emphasize customer retention over business growth, although major suppliers said they were also trying to grow their businesses. The most feasible way of doing this appears to be through winning ‘new to market’ business rather than taking customers from one another. On the basis of the evidence received, we consider that the market for the supply of domestic bulk LPG in Great Britain are characterised by, at most, limited prospects for growth.

5. Major suppliers engage in a range of marketing activities to attract new customers, and incentivize their sales staff to win new customers, to ensure that when the owner of a property changes the new owner does not switch to another supplier, and to enhance the value of existing accounts.

6. Some major suppliers characterised all aspects of (and innovations in) service provision as examples of non-price competition. We accept that the major suppliers

have taken steps to improve their distribution and sales support systems, albeit that some of these improvements were aimed at reducing costs in addition to improving customer services. However, we have seen no evidence that any recent innovation in service quality has caused large numbers of customers to switch to a particular supplier, or a greater proportion of new customers to choose that supplier over another. We can see no reason for any different assessment in relation to Northern Ireland.

Market structure

7. Table 1 shows the shares of the largest suppliers of domestic bulk LPG in Great Britain. Calor is the largest supplier, about twice the size of [✂], which in turn is also about twice the size of [✂]. The four largest suppliers account for about 90 per cent of supply.

8. As for the smaller suppliers, an internal Shell document noted that local competition was present but that ‘no national players were emerging’. The LPGA said that some of the smaller suppliers had grown and continued to grow quite substantially but that, to be large in the industry, a supplier had to provide a national service. However, major suppliers told us that the smaller suppliers imposed a greater competitive constraint than their market shares might suggest. [✂] said that national market shares underestimated the strength of regional and local players which supplied LPG on very competitive terms and many of which had built a strong reputation in that area. Calor told us that competitiveness, not size, was the issue: it faced strong competition from smaller suppliers who were actively contacting its customers by direct mail and offering lower prices.

TABLE 1 **Shares of domestic bulk supplies in Great Britain based on volume (in tonnes) for 2003**

	Market share by volume	*Volume ('000 tonnes)*	*Turnover £m*	*Number of customers ('000)*
Calor GB				
Flogas GB				
BP			✂	
Shell				
Others				
Totals	100.0	(✂)	-	(✂)

Source: The parties, CC calculations.

Note: totals may not sum precisely due to rounding.
*Estimated assuming 'other' suppliers charged the same average price as major suppliers.

9. Table 2 shows that there has been very little change in market structure in Northern Ireland since 1999. Between 1995 and 1998, there were three suppliers in the market. These were Calor Gas NI, Flogas NI and Blugas NI Ltd. In 1998, Calor bought Blugas (which at the time was owned by three Esso oil distributors from the Republic of Ireland). Today, Calor [✂] in Northern Ireland, with approximately [✂] per cent of the market.

TABLE 2 **Market shares for Northern Ireland based on volume (in tonnes)**

	1999	*2000*	*2001*	*2002*	*2003*
Calor NI			✂		
Flogas NI					
Total	100.0	100.0	100.0	100.0	100.0
Market size (tonnes)	(		✂		)

Source: The parties and CC calculations.

10. We have been unable to calculate shares for Great Britain over time due to missing data from a number of suppliers. However, [✂] provided us with its estimates of market shares over time, which showed an increase in concentration between 1995 and 2003 from an already high level in 1995. We note that the supply of domestic bulk LPG is considerably less concentrated than it was in the early 1980s when Calor had an estimated market share in the supply of bulk LPG of over 75 per cent. Calor said that its share was high because it initiated the bulk domestic market.

Past mergers and acquisitions

11. A large part of the more recent changes in market shares appear to be due to acquisitions, in particular Flogas's acquisition of BG. In recent years, [✂] and Calor has acquired Eurogas. [✂].[1] Shell said that there appeared to be a logic in this market—suppliers being either very big or very small as medium-sized players have been bought out over time.

12. We asked the major suppliers to provide us with data on the changes in the number of their customers due to acquisitions and switching.

13. [✂] had to provide estimates of gains and losses due to the unreliability of much of the historic data. [✂]

14. In contrast to [✂].

15. [✂] does not have any reliable historical data in terms of total number of customers.

16. [✂] However, we cannot judge from the data we have received the extent to which this objective was fulfilled.

17. Due to the lack of information from major suppliers, it is hard conclusively to demonstrate the effects of past acquisitions and disposals on market shares.

The importance of vertical integration

18. Only BP and Shell operate at all levels of the distribution chain, ie production, wholesale and retail. Calor and Flogas operate only at the retail level, although we note that [✂].

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[1] [✂]

19. Calor told us that the following factors were advantages of vertical integration in the supply of domestic bulk LPG:

(a) security of supply;

(b) confidence in LPG product quality; brand strength—BP and Shell are invariably well-known and established multinationals with excellent brand reputations; and

(c) already well-versed in safety requirements and associated systems; and economies of scale—including front-office and back-office synergies.

20. Flogas told us that [✂].

21. BP and Shell indicated to us that [✂]. Shell told us that this suggested that vertical integration may actually be a disadvantage. [✂]

22. BP told us that [✂]. Flogas [✂].

23. [✂] told us that there were cost advantages to suppliers that were not vertically integrated. Non-vertically-integrated firms do not have to invest in the infrastructure of distribution and storage facilities. Smaller suppliers can also buy the product downstream without the need to pay for the logistics to transport LPG from refinery to depot.

24. BP [✂].

Entry and expansion

Recent entry and expansion

25. Table 3 shows the suppliers that have started supplying domestic bulk LPG in the last ten years. All these suppliers are small. As noted earlier, major suppliers told us that the competitive strength of the smaller suppliers should not be underestimated

and national coverage was not a requirement for successful entry. Calor told us that a small supplier was able to operate in a tight geographical location and offered a strong service at very competitive prices. [✂] said that the large number of smaller suppliers that had established a viable business with a strong brand reputation within their local area or region demonstrated that national coverage was not necessary.

TABLE 3 **Entrants during last ten years**

Name	*Location*	*Number of customers*
Ace Gas	Halifax	
Altagas*	Nationwide	
Bulk Gas UK Ltd	Staffordshire	
Cardiff Gas	Cardiff	
Castle Gas†	Yorkshire	
Cheshire Gas	NW England and N Wales	
Countrywide Energy	W Midlands & Welsh borders	
Direct Gas	Midlands	
Easigas	North Wales	
Econogas	West Midlands	✂
Extra Gas	Manchester	
LPG Direct	York	
LPG Direct‡	Corby	
Monarch Gas		
Premier Autogas Ltd	NW England	
Rectory Gas Supplies	N and E Yorkshire	
Sefton Gas Ltd	Liverpool	
Travelgas‡	W Midlands & Welsh borders	
Vitagas	Norwich	

Source: Information provided by Calor and the parties.

*Bought by Flogas.
†Bought by Calor.
‡Also known as K G Smith.
§Bought by Supergas which has left the market.

26. BOC, which supplies domestic bulk LPG in other countries but not in the UK, believed (in 1999) that there was an opportunity to enter the domestic bulk LPG market and make acceptable returns but that this could only be done through acquisition. It believed that it would have needed to have entered all categories (ie commercial, domestic, agriculture and industrial) in order to get critical mass.

27. Calor stated that the vast majority of companies currently operating in the domestic bulk LPG market entered the market after initially supplying bulk LPG to commercial and industrial users. These suppliers included Calor, Flogas, Shell and BP (as MacGas and Handygas). The principal exception to this, according to Calor, is

Conoco which only supplies large commercial and industrial users, and is unlikely to enter the domestic market. BP had a similar strategy to Conoco but now operates in the domestic market following its merger with MacGas and Handygas.

28. One major supplier provided a list of 21 smaller suppliers which, it said, had expanded[2]. Ten of these suppliers had provided us with volume sales data. Of the ten, only five had expanded since 1999 or 2000. Three had declined, one neither grew nor declined, and one had provided only recent data. Between 2002 and 2003 five had expanded and five declined, but the net change in their combined volume sales was negative.

29. One possible barrier to expansion is that the market is mature with low demand growth. BP [✂].

30. Calor said that smaller suppliers might not expand for the following reasons:

(a) the availability of capital;

(b) management resources;

(c) family business mentality;

(d) risk (to set up a new depot or buy another vehicle that will operate at less than capacity for a period until new customers are found); and

(e) satisfaction with current business returns.

Entry and expansion strategies

31. We asked the major suppliers to propose feasible entry strategies for a firm planning to enter the domestic bulk supply business. Their proposals covered three main

[2]The examples of expansion were: Altagas, Callow Gas, Cam Gas, Carver Gas, Cheshire Gas, Countrywide Energy, CPS, Direct Gas, Discount Gas, Econogas, Extra Gas, Gaulds Gas Ltd, Gleaner Oils Ltd, Johnston Oils Ltd, Lister Gases, LPG Direct (Northern) Limited, Northern LPG Supplies Limited, Premier Autogas Ltd, Sefton Gas Ltd, Supergas and Vita Gas.

types of entry: completely new entry, entry from related activities and entry through acquisition. Their proposals are summarized in the rest of this section.

Completely new entry

32. Calor told us that a new entrant could start supplying domestic bulk LPG direct from source, ie a refinery. This appears to be the quickest route into the market. The lead time for the procurement of a vehicle and pressure vessel would be around four months so it would take approximately six months for the business to come into operation. A secure site would need to be found. Further costs would depend on the size of the tankers bought and whether they were new or second-hand. For example, Calor told us that [✂].

33. Shell told us that regional market entry was possible by ‘lifting’ LPG from third party depots. This type of supplier interaction appears to be commonplace. For example, we are aware that Calor makes deliveries from Shell depots in Caernarfon and Milford Haven and that Shell also delivers from depots owned by Lister Gases, Flogas and other third parties. The main costs would be for new or second-hand trucks and the driver’s wages bill. Shell estimated that the start-up capital would cost a minimum of [✂] and that it would take up to three years to achieve a stable level of sales, although this could be reduced if the supplier already had contacts within the industry.

34. Calor proposed that a supplier could supply domestic bulk LPG using its own intermediate storage. The cost of the design, installation and commissioning of an [✂] to [✂] tonne LPG storage facility is between £[✂] and £[✂]. The lead time for such a facility would be [✂] to [✂] months. Further costs would depend on the size of the tankers bought.

35. Flogas, Shell and BP suggested that [✂]. The financial cost estimates of a depot varied greatly between major suppliers. [✂]

36. Flogas proposed that [✂].

Entry from related activities

37. BP told us that [✂].

38. Calor told us that [✂].

39. BP and Shell told us that [✂].

40. Calor said that [✂].

41. Calor told us that [✂]

Entry through acquisition

42. Shell told us that access to the market could occur through the acquisition of an existing supplier. We note that acquisition would not reduce market concentration or necessarily introduce a new competitive threat (unless the new management was more efficient and aimed to win customers from its competitors).

Further costs

43. The entrant must be able to comply with the regulatory framework. Flogas told us that adhering to regulatory requirements would cost a few hundred pounds. This would include the cost of applying for operator licences to operate HGV road tankers and the cost of placing the required advertisement in the newspapers. Also, a hazardous substances consent would have to obtained under the Planning

(Hazardous Substances) Regulations 1992: the fee for an application would be £250 and may rise up to £400 for storage above 25 tonnes of LPG. Flogas also told us that a supplier seeking full planning permission for the construction of a bulk terminal would have to pay £150 for the application.

44. On the whole, the fact that entry has occurred in the past suggests that entry is not prohibitively difficult. This market is not characterized by high unrecoverable costs although this will depend on the strategy chosen, eg whether to buy a brand new or second-hand vehicle. Quick entry, albeit with limited growth prospects, could occur if the entrant decides not to invest in storage facilities but to deliver from another supplier's facilities. Quick and less costly entry is also feasible if the supplier chooses to expand an existing cylinder or autogas business.

Exit

45. Table 4 shows the suppliers that have left the market in the last ten years. We have received no indication that the costs of exit are high. As Table 6 shows, most suppliers (large and small) have exited by divesting their business in order to pursue other interests.

TABLE 4 **Suppliers that have left the market in the last ten years**

Supplier	*Reason for leaving*
Supergas	Divested to pursue other interests
Total LPG	Divested to pursue other interests
Altagas	Bankruptcy. Assets purchased by Flogas
British Gas	Divested to pursue other interests
Esso Gas	Divested to pursue other interests
Powell Duffryn (Eurogas/ Corrall Gas)	Divested to pursue other interests
Travelgas	Divested to pursue other interests

Source: Calor.

Barriers to entry and expansion

46. Barriers to entry and expansion may arise from the costs, inconvenience and uncertainty involved in switching suppliers, such as the costs of installing and removing tanks, the time and inconvenience in changing tanks, length of contracts and the length of termination period in contracts. These are covered in Appendix G. In this section we examine other possible barriers to entry and expansion.

Behaviour of incumbents

47. The behaviour of incumbent suppliers may deter entry and expansion. A potential entrant may believe that the incumbent supplier would vigorously defend its market position in the face of new competitors. This is particularly so in a mature market—most suppliers agreed that overall the prospects for market growth were small. Major suppliers argued that there was a degree of churn, although we note that, at around 3 per cent of the customer base[3], the rate of churn can not be characterized as high. BP told us that [✂]. The major suppliers told us that offering keener prices in response to activity from competitors was a natural competitive response. We note, however, that an aggressive short-term price response to market entry may have the effect of deterring entry, leading to higher concentration and higher prices in the longer term. The effects of price defending by incumbent suppliers are considered further in paragraphs 109 to 113 of Appendix G.

48. Shell told us that smaller players had benefits over larger players in their locality. It said that local suppliers would grow relatively more quickly in their localities than national players, even without advertising. Smaller players might deliver a better perceived value for money for some customers because they were local and more responsive. In Shell’s view, these benefits were reflected in the comparable numbers

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[3]As set out in Table 10 of Appendix G, 3 per cent of domestic customers left their LPG supplier in 2003.

of new customers joining smaller and larger players (although it must be noted that we have not been provided with evidence of a shift towards smaller suppliers).

49. ALGED, which predominantly represents smaller suppliers, told us that the major suppliers were at a disadvantage in that they could not be as flexible with their pricing policies as some of the smaller suppliers. The industry was very capital intensive, which may motivate the incumbent supplier to defend its investment, particularly in tanks.

50. A small supplier ([✂]) told us that [✂]. [✂]

51. Another supplier ([✂]) expressed a fear of future conduct by major suppliers if switching costs were reduced. It stated that the major suppliers would resist voluntary cooperation with the industry and might need directing accordingly. [✂] said that this insinuation was without foundation and against the expectations based on current practice: the use of a foreword in COP 26 to define a ‘statement of policy for uplifting LPG vessels’ was first introduced on 7 April 1993 and had been successfully followed since—with the occasional update and restatement.

Mature market

Views of market decline

52. The domestic bulk LPG market is long established and appears to have limited prospects for growth. Shell said that total market demand was in decline (–2 per cent a year), with the domestic bulk segment declining faster than the industrial/ commercial segment, but believed the degree of churn to be ‘considerable’. As we noted earlier, we do not believe that the rate of churn of 3 per cent of the customer base can be characterized as high. [✂] told us of a ‘natural decline’ in the market but that it had led to fierce competition between existing suppliers [✂]. Shell told us that

domestic customers were being lost to other fuels (eg oil and natural gas) and because premises were vacated. Shell expected these trends to continue with the result being an overall total market decline.

53. The two major players in Northern Ireland [✂]. Calor Gas NI told us that the market in Northern Ireland was steadily declining. [✂]

Views of market growth

54. An opposing view was expressed by Calor which expected that the bulk LPG sector (including non-domestic categories) would grow over the next three years. It said that [✂].

55. Flogas told us that [✂].

56. Shell observed that there were new customers entering the market from both the affluent and poorer ends of the spectrum. Such customers included those moving into barn conversions, the elderly/lower-income families living on caravan sites and those living on lower-quality housing estates in rural and semi-rural areas. This meant that a supplier might grow if it won a disproportionately high percentage of ‘new to the market’ customers, as existing customers were satisfied with their existing suppliers (and presumably would not leave).

57. Flogas said that [✂].

Economies of scale, scope and density

Economies of scale

58. Calor said that there were no significant advantages associated with economies of scale that would constitute a barrier to entry. The fact that the smaller regional

players were able to maintain viable and competitive businesses alongside national players like Calor suggested that such economies of scale did not represent a barrier to entry in any meaningful way. We note that larger suppliers may have a cost advantage over smaller suppliers, even if this advantage is not an absolute barrier to entry.

59. Scale advantages were suggested by Shell, which told us that there might be further consolidation in the market (as seen in the last five years), as the need for critical mass would increase.

60. Calor told us that economies of scale may result from three main avenues:

(a) *Distribution.* Suppliers focused on lowering distribution costs, maximum use of tankers, savings from having own depots, larger tanks, [✂].

(b) *Advertising*. Calor uses a range of marketing communication techniques. It said that smaller suppliers would find it more difficult to identify new-to-LPG customers.

(c) *More storage.* Suppliers with the scale to invest in storage capacity are better able to avoid shortages and buy ahead when propane is cheaper. This reduces the supplier's exposure to any unpredictable demand and supply changes and fluctuations in the cost of propane.

61. We have received no firm evidence of cost savings being made as a direct result of operating on a larger scale.

Economies of scope

62. In general, economies of scope arise where efficiencies are achieved by producing two or more products rather than one. [✂] suggested that economies of scope were

possible if a supplier had a presence in different customer categories, ie domestic, industrial, commercial and agricultural.

63. [✂] it was more cost effective to deliver to both domestic and non-domestic customers within a single run. It calculated that the average domestic customer drop was [✂] litres of LPG, and that the average time per delivery was [✂] minutes. In an average ten-hour day, [✂] litres would be delivered, which is well below the average tanker capacity of [✂] litres. [✂] told us that 'substantially cheaper' average delivery costs could be achieved from delivery runs that permitted the emptying of a full mini-bulk tanker, and that this was better achieved from supplying to a mix of customers. [✂] told us that it could compete most efficiently and effectively where it had efficient logistics due to close proximity to its existing depots, or where it had other customer relationships.

Economies of density

64. Economies of density occur in areas where a supplier already has a good concentration of business in a geographic area, which means that the incremental cost of supplying an extra customer is relatively low.

65. These economies were implied in Shell's 2004 UK plan, which stated that geographically the product is mainly available in the North of Great Britain, with most demand being in the South. Therefore, to lower distribution costs, it needed to cooperate more with competitors in southern locations through the use of swaps and the sharing of depot facilities. Shell also told us that the economics of supply and delivery encourage a high density of business by geographic location. This gives suppliers an incentive to expand their customer base as this reduces their average unit cost. Calor said that local depots were used to exploit any economies of customer density that might exist, which meant that smaller suppliers, regardless of

their size, would be able to exploit them. Flogas also said that smaller suppliers with dense local or regional distribution could be more efficient than a widely-stretched national supplier. We have seen no evidence that any of the larger suppliers are more widely stretched than local suppliers.

Identifying new customers

66. Shell told us that as it was costly to identify and convert existing customers due to the low density of such customers in any area, Shell did not consider a strategy of targeting existing customers (ie from its competitors) to be commercially viable. Shell stated that although it was not proactive in this respect, it had a strong reactive policy and would follow up customers who contacted the company. [✂] Flogas and Calor did not agree with the view that it was hard to identify LPG customers and told us that there were numerous ways in which new customers could be identified and targeted.

67. [✂] told us that identifying new customers was not difficult, and [✂] told us that with effective marketing, advertising and direct sales, the identification of customers could be achieved. There were two views to the contrary. [✂] told us that it had tried various types of direct marketing in the past with virtually no success, so it now relied on word of mouth. [✂] told us that identifying potential customers was difficult.

68. ALGED believed customers could easily find out about competing suppliers. The Internet, *Yellow Pages* and the fact that well-liveried vehicles with telephone numbers on were passing through their area all provided extensive advertising. Countrywide Energy told us that it had been contacted by customers of other suppliers as a result of its advertisement in *Yellow Pages*. ALGED said that customers might have a problem in convincing alternative suppliers that it was feasible to supply them with gas, given the costs of providing the customer with a tank, and the response of the existing supplier to retain its customer (for example, to fill up the tank to retain the

customer for a few more months). Calor said that it had no experience of this happening in dealings with other suppliers in the industry, and it would in any case be an aggravation for the customer and ultimately self-defeating for any supplier who tried it.

Northern Ireland

69. Calor Gas NI told us that [✂]. Flogas NI told us that competition from the Republic of Ireland was unlikely (though we did receive evidence of a small amount of cross-border trade may occur at present—see paragraph 23 of Appendix E). It told us that the key issue was the need for storage facilities that were sufficiently close to customers, and it judged LPG populations to be some way from the Irish border, making significant cross-border trade less practicable.

Retention and expansion strategies of suppliers

70. Calor's three-year strategy plan, which commenced in May 2002, states the need to refocus the organization, processes and priorities on keeping rather than winning customers. Calor told us that, [✂]. Its main strategic plan for 2003 to 2005 set out an objective to optimize customer retention in the domestic bulk market by reducing churn by [✂] per cent. However, Calor told us that, due to changes in market conditions and the success of its recent restructuring, Calor had been able to shift the focus of its marketing efforts back to winning business, particularly due to an intensification of competition between suppliers and because there were more opportunities in relation to heating oil users (Calor told us that in 2003 it identified customer dissatisfaction with heating oil and began to market to heating oil users more aggressively). Calor said that it would also continue to focus on improving customer retention through service optimization and increased customer 'intimacy'.

71. Flogas told us that its primary objective over the next few years was to [✂].

72. BP's current strategy in the bulk sector is to [✂].

73. Shell's 2004 plan states that Shell aims to grow the business profitably ([✂]). It believes this is possible by targeting 'new to market' customers (in areas of rural development). Shell also aims to improve customer retention which it believes will be possible by improving customer service. For example, one of its key non-financial targets is that all drivers should undergo customer care training.

74. [✂] Calor said it had recently won [✂] customers from other suppliers following a sales drive in [✂] (see paragraph 96 below, which discusses further the pro-active steps taken by Calor to target the customers of other suppliers).

75. Both Calor NI (which has an [✂] per cent share of the Northern Ireland market) and Flogas NI (which has [✂] per cent) told us that [✂]. [✂] told us that it saw continuing potential for growth in the apartment/townhouse sector, given the ability of LPG to satisfy the key design requirements for such developments.

76. On the whole, internal strategy documents tend to emphasize customer retention over business growth, although major suppliers said they were also trying to grow their businesses. The most feasible way of doing this appears to be through winning 'new to market' business rather than taking customers from one another.

Non-price competition

77. We consider price competition in Appendix I. In this section we examine the extent of non-price competition in the market—ie to what extent suppliers compete against each other, for new and established customers, through means other than price. In this market, suppliers compete for new customers mainly through marketing

campaigns and aim to retain established customers mainly through improvements in service quality. We start with a look at competition for retaining customers.

Non-price competition for customer retention

78. The service offered to existing customers includes a range of features, such as reliability of supply, quality of emergency service, technical and safety expertise, the range of payment options, and special offers on products like boiler replacement and appliances.

79. Calor outlined the following elements of its service as examples of non-price competition:

(a) *Delivery service.* Calor operates an optional automatic top-up delivery service which about [✂] per cent of its bulk domestic customers use. Calor told us that the customer benefits of this system were that there was no need to order gas or to be at home to receive deliveries. Calor told us that it had spent three years and substantial R&D costs developing a telemetry system to streamline this service.

(b) *Emergency service.* Calor told us that it focused a great deal of attention on ensuring that its emergency service was quick and effective. On occasions, Calor has been called on by the emergency services to provide cover where another supplier has been unable to respond to an emergency.

(c) *Technical and safety expertise.* This was an area in which Calor believed it had a clear advantage over its competitors and so was one that was featured in its marketing activity. Calor told us that it played a leading role in the development of the Codes of Practice within the LPGA and within the standards-setting process as a whole. Calor told us that it used this knowledge to help customers by developing its own systems and procedures in compliance with these requirements. However, other suppliers emphasized their own superior safety standards, and at least one other uses safety as a marketing tool. In practice, the

ORC survey results[4] indicated no supplier (including small suppliers) had a significant advantage in terms how their customers rated them on the handling of safety issues, although one supplier [✂] had a lower rating by its own customers on safety. As such, safety does not appear to be an important source of product differentiation.

(d) *Payment options.* Consumers demand flexibility and are familiar with the types of payment options provided by the utilities. Calor has developed a budget plan payment facility which has proven popular with its customers.

(e) *Special offers.* Calor provides extended warranty products, boiler servicing and appliance offers. A great deal of this is communicated through its *Country Views* magazine which is sent to all its central heating customers.

(f) *Security of supply.* Calor told us that it had invested heavily in strategic gas storage facilities to ensure continuity of supply.

(g) *Customer service.* In 2001 Calor devolved its customer service functions for the domestic bulk market from its Warwick Head Office to 12 local distribution depots across Great Britain. Calor said that its intention was to put the physical delivery of the service much closer to the customer and thereby increase the feeling of customer intimacy. In addition, Calor segmented its domestic bulk customers on the basis of their loyalty and instituted a contact programme aimed at less loyal customers—with the aim of identifying any potential service problems at an early stage. Along with its provision of staff training courses such as telephone answering and its WiRe[5] customer relationship management system, Calor believes that the combined effect of these initiatives has been a decline in the number of domestic bulk customer terminations and a reduction in churn. However, Calor was unable to provide us with data on the rate of customer terminations prior to 2003.

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[4]ORC survey report (2005), commissioned by the CC.
[5]'Wi' stands for winning and 'Re' stands for retaining.

80. Calor said that its customer feedback showed that safety was considered to be the most important factor. When customers were asked the question of the 'least wanted deterioration' in the areas of customer service, the top five reasons were: frequency of tank inspection; emergency response time for gas leaks; responsibility for the physical condition of the tank; timeliness of automated delivery; and price level compared with alternative suppliers.

81. However, the ORC survey found that only 5 per cent were dissatisfied with the handling of safety issues by their supplier and only 1 per cent mentioned safety issues as a discouragement to switching supplier. When asked the main factor they would consider if switching supplier, 78 per cent mentioned price while only 15 per cent mentioned customer service, 12 per cent reliability,[6] and 5 per cent mentioned safety.

82. Shell told us that innovation in the industry proved that suppliers were constantly striving to compete. These innovations included: [✂]. Shell also told us that these measures may have a short lifetime as competitors are able to mirror changes relatively quickly.

83. An LPG brand tracking report[7] commissioned by Shell and produced by Synovate found that the choice of supplier was mostly convenience driven. Calor is seen as having the best-known brand. Shell and BP are considered stronger in safety and product quality; whereas Calor and Flogas are considered to deliver better value for money and have a better customer service delivery performance. These results do not correspond to those of the ORC survey, where [✂] was seen as poorer by its own customers on safety and [✂] on value for money. The Synovate report

[6] Some respondents named more than one factor.
[7] LPG Brand Tracking UK (2003), a report prepared by Synovate (unpublished). This survey used a sample of 463 users of LPG, of which 320 were domestic users and 143 where commercial users. In total, 160 customers surveyed were Shell customers.

concludes that despite Calor's large market share, its share of preference is only marginally stronger than its rivals, suggesting that commitment to the Calor brand is relatively weak and could be an area of vulnerability.

84. Some major suppliers characterised all aspects of (and innovations in) service provision as examples of non-price competition. However, we note that changes can also be motivated by cost savings for the supplier. For example a more streamlined delivery system (eg telemetry-based) can lower delivery costs; direct-debit payments can lower administration costs and some suppliers incentivise staff or customers to switch to direct-debit.

Non-price competition for new customers

85. Major suppliers engage in [✂]. Calor provided us with a detailed account of its initiatives and their effects on winning customers. These are dealt with in the following paragraphs.

86. Calor said that each year it spent around £[✂] on a range of non-price initiatives, including more than £[✂] on marketing activity which was aimed specifically at the non-mains gas domestic central heating market. Calor told us that it employed a range of promotional methods—advertising, direct mail, Internet, exhibitions and leaflet distribution, any of which may feature promotional offers of free gas or free tank installation. It also had initiatives such as Calor Village of the Year and Calor Scottish Community of the Year. Calor told us that there were many examples of other suppliers doing mail drops, local press advertisements as well as tankers with supplier's logos and telephone numbers.

87. Calor provided us with information on response rates to its sales and marketing campaigns. These are detailed in Table 5.

TABLE 5 **The effectiveness of Calor's approaches to winning new customers in 2004**

Campaign	*Installer incentive*	*Qtrly door drop*	*Yellow Pages*	*Recommend a friend*	*Boiler replacement*	*Internet*
Total number mailed						
Campaign cost						
Responses/leads				✂		
Cost per lead						
Wins						
Cost per win						

Source: Calor.

88. Calor told us that advertising in *Yellow Pages* was [✂]. Calor also told us that most suppliers advertised in *Yellow Pages*. According to Calor, [✂]. Other campaigns not noted in the table were much less successful. These included: [✂]. Calor told us that it was difficult to assess the success of other campaigns such as its consumer and developer PR campaigns. In the case of the latter, a single developer lead can generate a number of new delivery points now and in the future.

89. The other parties were generally unable to relate marketing activities to their ultimate effect on the number of customers won or lost. BP told us that [✂]; while Shell told us that [✂].

90. Calor said that, in addition to marketing activity, it had employed other non-price initiatives aimed at improving customer acquisition rates and reducing customer losses. It said that research had shown that customers wanted a ‘one-stop shop’ and did not want to have to contact one company to organize a gas supply, another to build a concrete base/dig a trench and yet another to install the central heating system. As a result, Calor launched its central heating ‘New Approach’ in 1998 which had the aim of providing customers with a complete service covering all of the above. Calor told us that this initiative was very popular with consumers—especially as the service was backed up by a reputable national brand. However, Calor had to suspend the service due to problems in establishing and maintaining a nationwide

infrastructure of LPG-qualified gas engineers. It told us that it would consider reviving the service if the opportunity arose.

91. Calor NI told us that it had undertaken radio advertising, [✂]. Flogas NI told us that [✂].

Smaller suppliers

92. Smaller suppliers do not advertise as extensively as the major players. We asked them how many prospective customers they approached in 2003, the results are shown in Table 6.

TABLE 6 **Number of households contacted**

Supplier	*Number of households contacted*
BATA	✂
Bulk Gas UK Ltd	
Callow Oils	
Cam Gas	
Cardiff Gas	
Cheshire Gas	
Countrywide Energy	
CPS Fuels	
Gleaner Oils Ltd	
LPG Direct (Northern) Limited	
Northern LPG Suppliers Limited	
Premier Autogas Ltd	

Source: The parties, CC calculations.

93. [✂] seems to be the exception. In the winter of 2003/04 it sent out [✂] to homes in postal sectors where mains gas penetration was determined to be less than 50 per cent. It assumed that, if the number of households in non-mains areas is 20 per cent, then they approached [✂] customers.

94. In general, smaller suppliers tend to rely on much less expensive forms of advertising and publicity than major suppliers such as *Yellow Pages*, word-of-mouth and mail-dropping national developers and local builders to increase their customer base.

Finding new customers

95. New-to-LPG customers are the principal source of new business (around 3 per cent of suppliers' customer bases started using that supplier in 2003; only around 0.5 per cent had switched from another supplier), but Calor told us that marketing activity also generated responses from competitors' customers.

96. Calor uses standard marketing techniques for finding potential new customers, eg customer analysis, market research, list purchasing, advertising, PR, door drop, direct mail and telemarketing. Calor undertakes sales drives in specific areas to win competitors' business and also to build a database of prospects which are then followed up in sales drives or some form of direct mail/door drop. In addition, Calor monitors web sites, press cuttings and local market intelligence to help identify competitors' customers. Calor said it had recently won [✂] customers from other suppliers following a sales drive in [✂].

97. Calor told us that it developed relationships with appliance manufacturers and particularly installers as they were good sources of new-to-LPG business and competitors' customers. Similarly, Shell told us that it identified potential customers through relationships with 'indicators' which are companies such as heating engineers, builders, architects, developers and equipment manufacturers that are able to provide information on potential customers. Shell offers [✂]. The main objective is to increase the number of leads as opposed to price queries.

98. BP said that [✂].

Incentive schemes for staff

99. We asked the major suppliers what incentives they gave to their sales staff and tanker drivers to report potential customers.

100. Calor told us that its sales force received the following incentives:

(a) signing a new domestic supply contract—£[✂] per [✂] litres over target;

(b) signing a new domestic contract where the property owner has changed—£[✂] for each one; and

(c) signing a direct debit or budget plan agreement for a domestic customer—£[✂] for each one.

101. The average yearly incentive payment to salespeople was approximately £[✂] a year and the average salesperson's salary was approximately £[✂] a year.

102. Flogas [✂]. The variable elements of pay of the sales staff of Shell constitute about [✂] per cent of overall pay. Shell's sales staff receive [✂]. BP [✂].

103. Flogas told us that [✂]. Shell said that it had no formal mechanism for incentivizing its tanker drivers. [✂] BP told us that [✂]. Calor does not incentivize tanker drivers to report potential customers, although from [✂] it did incentivize its drivers to report competitors' tanks under a scheme called 'Frontline'. According to Calor, this type of strategy is constantly under review and it is possible that such a scheme could be reinstated in the future.

104. Calor NI told us that it employed a points-based system based on the number of new customers gained and the cost of that new business. Flogas NI [✂].

105. Despite the efforts of the smaller and major suppliers, the ORC survey results indicated a lack of awareness of other suppliers. Nine out of ten users (91 per cent) said that they had never been approached by another supplier. Three-quarters (75 per cent) could not name or did not know any other suppliers. This indicated a lack of effectiveness of non-price competition. Major suppliers told us that [✂] and also indicated that a more personalized interaction with customers (eg through more sales staff or direct mail) would leave a greater impression on users but would not be cost-effective. Another possible reason given by Calor is that customers only think about LPG at particular points in time, in which they are 'in the market'[8] (ie they become more aware of LPG as a product and its potential substitutes). This is normally when they are dissatisfied with service or when they are considering changing their heating system. Therefore, if customers are not looking for a supplier they may receive advertising messages but pay no attention to them.

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[8] [✂]