

# CMA impact assessment 2014/15

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# 1. Summary

- 1.1 The Competition and Markets Authority (CMA) is the UK's lead competition and consumer authority and its primary duty is to promote competition, both within and outside the UK for the benefit of consumers. It is an independent non-ministerial government department which, from 1 April 2014, brought together and took on the functions of the Competition Commission (CC) and many of the functions of the Office of Fair Trading (OFT). The CMA has a wide range of tools to use in addressing competition and consumer problems including carrying out investigations into mergers and markets, enforcing competition and consumer law and working with sector regulators. It also has certain other functions – in particular, considering regulatory references and appeals.
- 1.2 As part of its performance framework agreement with the Department for Business, Innovation and Skills (BIS)<sup>1</sup> the CMA is required to report annually on:
- (a) the delivery of a target of direct financial benefits to consumers of at least ten times its relevant costs to the taxpayer (measured over a rolling three year period); and
  - (b) the ratio of direct financial benefits to consumers and costs for its principal tools.
- 1.3 In this first CMA impact assessment (IA) we report on performance against this target for the financial year 2014/15.
- 1.4 As the target is measured as a three year rolling average, for 2014/15 the calculation is based on the performance of the final two years of the OFT and CC and the first year of the CMA. The assessment is undertaken by the CMA itself and is reviewed by an external academic. This year the academic was Professor Amelia Fletcher of the University of East Anglia. The methodology is based on that developed over recent years by the OFT, validated by successive independent academic reviewers and consistent with approaches now regarded by the OECD as international good practice.<sup>2,3,4</sup>
- 1.5 For the period 2012 to 2015 the estimated average direct financial benefit to consumers was £745 million per annum and the ratio of direct benefits to cost

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<sup>1</sup> BIS (January 2014), [CMA Performance Management Framework](#).

<sup>2</sup> The OFT used Professor Stephen Davies as a reviewer for a number of years. Professor Davies was closely involved with the development of the OECD guidance.

<sup>3</sup> OFT (July 2010), [Guide to the OFT's impact estimation methods](#).

<sup>4</sup> OECD (April 2014), [Guide for assessing the impact of competition authorities' activities](#).

was 11.2. The breakdown of the financial benefit by tool is set out in Table 1, below.

**Table 1: Estimated annual CMA/OFT/CC consumer savings and costs for 2012–15**

	<i>£m</i>
<i>Area of CMA work</i>	<i>Savings</i>
Competition enforcement	65
Consumer protection enforcement	79.2
Merger control <sup>5</sup>	23.7
Market studies and market investigations	576.6
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<b>Total benefits</b>	£744.5 million
<b>Total costs (averaged over 2012–15)</b>	£66.5 million <sup>6</sup>
<b>Benefit/total CMA costs</b>	11.2:1

1.6 Although necessarily relying in part on assumptions<sup>7</sup>, we regard our estimates of direct financial benefit as being on the conservative side. In general relatively cautious assumptions are applied to the estimates and they exclude estimates of benefits from a number of cases where the impact was difficult to quantify in a sufficiently robust manner. In addition the focus on direct financial benefits excludes many important wider impacts of the competition regime including, for example, the deterrence of anti-competitive mergers and other types of anti-competitive behaviour and the CMA’s wider impact on productivity and growth.

1.7 The CMA is undertaking work jointly with the European Commission and the Netherlands Competition Authority to gain a better understanding of the deterrence effect of competition enforcement and in due course the longer term indirect impact of our work.

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<sup>5</sup> The CMA has a duty to investigate mergers that legally qualify for scrutiny. This means that CMA merger control work is demand-led and not discretionary, unlike most other areas of the CMA’s work. Given that the number of qualifying mergers can vary considerably from year-to-year (because of fluctuations in the economic cycle for example), the consumer benefits of the CMA’s merger control work can also vary significantly from year-to-year.

<sup>6</sup> This is total CMA costs (actual spend) minus costs of the CMA work on regulatory appeals.

<sup>7</sup> Impact estimations are conducted immediately after cases are completed and are therefore based only on information available during the case and on assumptions regarding the expected impact of our interventions. On this basis the estimates are considered to be ‘ex ante’ evaluations.

## 2. Overview of our methodology

- 2.1 The estimates we present in this report are largely consistent with those previously presented by the OFT in its annual positive impact assessments.<sup>8</sup> However, there are some areas of difference. One difference is that, unlike the OFT positive impact report, the CMA IA estimates include benefits from cases where the outcome is under appeal at the time of publication of the report. We have included these benefits as we consider this will ensure the IA is the best estimate of the likely impact of the CMA cases at the time of this report's publication. In addition this approach also ensures that the benefit estimates are included in the IA at roughly the same time as the costs the CMA incurred in carrying out the case.<sup>9</sup> This approach requires that subsequent IA's may need to be revised to take into account the outcome<sup>10</sup> of any appeals.
- 2.2 Another difference from the OFT positive impact assessment is that there is no longer any need for an allocation of benefits between phase 1 (the OFT) and phase 2 (the CC) Authorities as both phases are now performed by the CMA. In past years benefits for the OFT and CC were estimated and then allocated to each organisation on an 80/20 basis depending on which was the 'main actor' organisation.<sup>11</sup>
- 2.3 Given the CMA's primary duty to promote competition, both within and outside the UK for the benefit of consumers, the impact estimations included within this report focus on the direct financial benefits to consumers of the CMA's work. The direct financial benefits to consumers may include, for example, the direct reduction in prices to consumers or the value to consumers of improvements in quality, service or information provision following an intervention.
- 2.4 Many of the beneficial outcomes of the CMA's work are not easily quantifiable and are not included in the total benefits shown in Table 1. For example, these figures do not attempt to measure the impact on consumers of any psychological detriment averted by our actions, the deterrence effect of our competition and consumer enforcement work, or the impact of increased competition on innovation, productivity or economic growth. Each of these can

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<sup>8</sup> Past OFT assessments can be found on [The National Archives' website](#).

<sup>9</sup> It can be several years before appeals are concluded leading to a significant lag between the inclusion of the benefits and costs of certain cases.

<sup>10</sup> For this year's IA we have excluded the benefits from the three year average for at least one OFT case where the proposed remedies were quashed on appeal.

<sup>11</sup> The split was based largely on costs incurred. For example where a merger was referred to the CC by the OFT the split was 80/20 in favour of the CC.

be significant. In addition, the estimate of benefit does not encompass the full extent of the CMA's work.<sup>12</sup>

- 2.5 The CMA conducts both impact estimates (ex-ante evaluations) and detailed long-term evaluations (ex-post evaluations) to estimate the impact of our work. Ex-ante estimates of impact are based on the best information available at the time of estimation – which is typically when the decision or recommendations have been made or implemented but the full impact is not yet observable. Ex-post evaluations are more robust and are based on information gathered after the recommendations/remedies have been implemented and the resulting impact realised, often several years after the case has been completed. Ex-post evaluations are only conducted for a small subset of cases – at least two a year. The figures presented in Table 1 are derived from ex-ante impact estimates made shortly after the completion of cases.
- 2.6 We use the Consumer Price Index to take account of inflation. All figures for the ex-ante estimates are presented in April 2015 prices.<sup>13</sup>

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<sup>12</sup> The estimate of benefits does not include activities such as criminal enforcement, compliance work, international/EU work, advocacy because the benefits of these, whilst substantial, can be difficult to quantify due to the nature of the work. We also do not include regulatory appeals as our role is an appellate one rather than being the primary regulator.

<sup>13</sup> In line with central government techniques for discounting future accruals of benefits or costs, we discount future consumer savings by the HMT endorsed Social Time Preference Rate (3.5%). See HMT, [The Green Book: Appraisal and Evaluation in Central Government](#).

## 3. Consumer savings by area

### Introduction

- 3.1 This section presents estimates of the impact of our work for each of the following areas: enforcement of competition law, enforcement of consumer protection legislation, merger control and markets work.
- 3.2 For merger control and markets work, the CMA is both the phase 1 and phase 2 authority in a two stage process (phase 1 cases being referred where there are sufficient competition concerns for a further, more in depth, phase 2 investigation). Although the decision makers at phase 2 comprise a CMA panel of independent members (to ensure a transparent and distinct process) the CMA has responsibility for both phases including their resourcing. Where cases have been referred to phase 2 benefit estimates are only made once the phase 2 process has been completed although both phase 1 and phase 2 costs are part of the IA.
- 3.3 We do not publish impact estimations for individual cases. Case estimates have been independently reviewed by Professor Amelia Fletcher<sup>14</sup> to ensure that our benefit estimates are reasonable and robust.

### Competition enforcement

- 3.4 The CMA engages in a range of activities aimed at ensuring compliance with the Competition Act 1998 (CA98), including formally investigating and taking enforcement action against anti-competitive practices and using ‘softer’ tools such as providing guidance and targeted compliance initiatives.<sup>15</sup> Under the Enterprise Act 2002 (EA02) we can also investigate and prosecute individuals who have committed the cartel offence.
- 3.5 We estimate that the CMA’s (and previously the OFT’s) interventions saved consumers at least £195.1 million in aggregate between the financial years 2012 and 2015 representing annual average consumer savings of £65 million.
- 3.6 The estimate does not include the significant deterrent effect of our competition enforcement actions. In 2011 the OFT published deterrence ratios for its competition enforcement work, produced by London Economics.<sup>16</sup> The

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<sup>14</sup> Amelia Fletcher is Professor of Competition Policy at the University of East Anglia.

<sup>15</sup> The benefits from these softer tools are not typically included in the quantified estimate of benefits.

<sup>16</sup> See *The impact of competition interventions on compliance and deterrence, OFT1391*. The research identifies and quantifies the wider benefits and costs associated with deterrence resulting from enforcement activities undertaken by the CMA and previously by the OFT.

research estimated that for each cartel case investigated by the OFT, 28 others were deterred. For investigations into abuse of dominance and other commercial agreements, the figures were 12 and 40 cases deterred respectively. The overall magnitude of the CMA's impact is therefore expected to be significantly higher than the estimated direct financial benefits.

## Consumer protection enforcement

- 3.7 The CMA's consumer protection enforcement work seeks to change trader behaviour that appears to contravene consumer protection legislation using a range of interventions such as publishing guidance, issuing informal warnings, accepting undertakings under the EA02, or obtaining Court Orders.<sup>17</sup> All interventions are aimed at protecting consumers, particularly vulnerable consumers, from rogue trading, unfair commercial practices and other breaches of consumer protection legislation. The CMA has taken over some, but not all, aspects of the consumer protection work of the OFT. The main powers which transferred to other agencies are those conferred by the Consumer Credit Act 1974<sup>18</sup> and the Estate Agents Act 1979<sup>19</sup>. OFT powers under anti-money laundering legislation have transferred along with these statutory functions.<sup>20</sup>
- 3.8 For the period 2012 to 2015, the total consumer benefits in aggregate from relevant consumer enforcement work are estimated to be £237.5 million, giving an average of £79.2 million per year.

## Merger control

- 3.9 The CMA operates both stages of the UK two stage merger regime. Businesses can (voluntarily) notify a merger to the CMA and, in addition, the CMA has a duty keep merger activity under review and can investigate mergers that have not been notified to it. At phase 1 it reviews merger situations falling within its jurisdiction<sup>21</sup> and refers for more detailed scrutiny (at phase 2) any cases where there is a realistic prospect of a substantial lessening of competition (SLC) in a UK market. The CMA has the power to accept undertakings in lieu (of reference to phase 2) (UiL) from the merging

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<sup>17</sup> Trading Standards are also responsible for consumer protection enforcement and tackling unfair trading practices. This section only considers the consumer savings resulting from CMA and OFT enforcement action. See OFT (June 2009), *An evaluation of the impact of the fair trading work of local authority Trading Standards Services in the UK*, OFT1085.

<sup>18</sup> To the Financial Conduct Authority.

<sup>19</sup> To the National Trading Standards Estate Agency Team.

<sup>20</sup> The CMA's role in consumer protection is set out in more detail in our *Consumer Protection Guidance*.

<sup>21</sup> Mergers of businesses with EU and global turnover above a certain size fall within the jurisdiction of the European Commission.

parties, if these are deemed to address potential concerns identified in the course of its investigations.

- 3.10 At phase 2, a CMA panel of independent Members conducts an in-depth investigation to assess if a merger is expected to result in an SLC. If an SLC is expected, the CMA decides upon the remedies required and can impose remedies by order if it is not able to agree them with the businesses.
- 3.11 Our estimates of consumer savings in this area include mergers amended through UiLs, mergers that are abandoned on referral to the phase 2 (abandoned mergers), and mergers amended or prohibited by the CMA at phase 2.
- 3.12 Table 2 presents the average annual estimates of consumer savings from the merger regime for the years 2012 to 2015. The estimates for abandoned mergers and UiLs have been scaled down by the 'SLC rate'. The SLC rate is the proportion of the mergers over the period 1 April 2012 to 31 March 2015 examined at phase 2 where an SLC finding was made; it is currently 40%. The application of this scaling down factor is to account for the uncertainty of the outcome of a phase 2 reference.

**Table 2: Average annual consumer savings from the merger regime, 2012–15**

<i>CMA merger phase</i>	<i>Estimated average annual consumer savings</i>	<i>£m</i>
Phase 1		8.9
Phase 2		14.8
<b>Total (joint merger regime)</b>		<b>23.7</b>

- 3.13 During the past three financial years (2012 to 2015), the merger regime has saved consumers £23.7 million per year on average.
- 3.14 The benefits from the merger regime are dependent on the cases that come to the CMA for assessment and are therefore driven, in part, by the economic climate and can vary significantly from year to year. They are also dependent on the composition of the merger being assessed. If anti-competitive mergers are proposed and prohibited or altered then the estimated direct benefits of the merger regime will be greater.
- 3.15 Benefit figures for mergers do not include the wider benefits, such as deterrence, of its mergers work and the wider merger regime, which we would expect to be significant. In 2007 the OFT published deterrence ratios for our

mergers work, produced by Deloitte.<sup>22</sup> The survey suggested that at least five proposed mergers were abandoned or modified on competition grounds before the OFT became aware of them for each one merger blocked or modified following intervention by the UK competition authorities.

## **Market studies, reviews of orders and undertakings, and market investigations**

- 3.16 Market studies are examinations into the causes of why particular markets appear not to be working well for consumers and may lead to proposals as to how they might be made to work better. They take an overview of regulatory and other economic drivers in a market and patterns of consumer and business behaviour.
- 3.17 Markets may be referred for a market investigation for further investigation where there are reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK is preventing, restricting, or distorting competition. In estimating consumer savings therefore, we consider the impact of both market studies where they have not resulted in a market investigation and completed market investigations.
- 3.18 Where the market study or review has led to action by other government departments or industry stakeholders following our recommendations, we only attribute a proportion of the impact to the CMA. For example, where CMA recommendations are implemented by another government department, the impact estimates are apportioned between the CMA and the relevant government department.
- 3.19 We estimate that the savings from the markets regime are £576.6 million per annum between the financial years 2012 and 2015.

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<sup>22</sup> See OFT (November 2007), *The deterrent effect of competition enforcement by the OFT*. Note that this analysis is not directly comparable with the more recent deterrence work conducted for the OFT by London Economics (published December 2011).

## 4. Costs

- 4.1 Cost figures may fluctuate from year to year and as such will impact on the benefit to cost ratios reported in CMA IA. To smooth out any such fluctuations, we use a three year moving average for total costs. This is consistent with the way in which we report estimated benefits.
- 4.2 For the purposes of calculating the benefit to cost ratio, the total costs of the CMA for the financial year 2014 excludes the costs incurred in fulfilling the CMA's function with regard to the determination of regulatory appeals as we do not include any benefits from these in the IA. For the financial years 2012 and 2013 the costs are those of the OFT and the CC.<sup>23</sup> The CC costs are the total net CC cost as reported in the annual accounts.<sup>24</sup>
- 4.3 On this basis, the average annual CMA/CC/OFT costs over the financial years 2012–15 is estimated at £66.5 million.<sup>25</sup>

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<sup>23</sup> The OFT costs exclude those related to Consumer Credit Licensing and related anti-money laundering activity because the OFT was not required to conduct impact estimation.

<sup>24</sup> This will tend to have a downward impact on the benefit cost ratio as we have not removed cost for activities for which we do not estimate corresponding benefits, such as regulatory appeals.

<sup>25</sup> Figure in March 2015 prices.