



The Role of Demand-Side Remedies in Driving Effective Competition

A Review for Which?

UKCN seminar on Consumer Remedies
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Disclaimer: These are not necessarily the views of any organisation with which I am associated.

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Summary

These slides were presented by Amelia Fletcher of the University of East Anglia at the launch workshop of the UKCN consumer remedies project held at the Competition and Markets Authority on 20 September 2016. The theme of this workshop was 'linkages between consumer behaviour and remedies'.

This presentation formed part of a joint presentation that was given together with James Edgar of Which?. These presentations related to the joint work carried out by Which? and Amelia on demand-side remedies.

The presentation begins by describing the issues that may cause the demand side in a given market not to function well, with particular focus given to informational issues and certain key behavioural biases. It then describes the potential downsides of remedies aimed at correcting these issues.

Next, the presentation identifies three overarching categories of demand-side remedies: disclosure remedies, shopping around remedies and switching remedies. For each category of remedy, historical examples, evidence of effectiveness and conclusions concerning their future use are provided.

The presentation concludes with a series of general conclusions that relate to the substance and process of selecting, testing and delivering demand-side remedies.

Introduction

- ❖ Review commissioned by Which? to examine the available evidence on the role and impact of demand-side remedies (DSRs).
- ❖ Seeks to answer the following questions:
 - What is the rationale for DSRs?
 - What types of DSRs do we observe in practice?
 - What do we know about their effectiveness?
 - What lessons/conclusions can we draw?
- ❖ DSRs drawn widely to include a variety of relevant interventions by sector regulators, competition authorities, Government and even some interventions under competition and consumer legislation.
- ❖ Evidence is mostly UK: From *ex post* evaluations and follow-on reviews, as well as academic research and *ex ante* remedy-testing evidence.

The interactive role of the D-side and S-side in competitive markets – possible imperfections

SUPPLY SIDE



Suppliers compete vigorously to win customers

Active, informed customers buy the products which offer them the best VFM

DEMAND SIDE



Key demand-side problems for the 3 'A's

- ❖ Asymmetric information
 - Implies simple disclosure remedies
- ❖ Real costs of information acquisition (search) and switching
 - Can be financial or involve time, energy and potentially frustration
 - Implies remedies which making search and switching less costly.
- ❖ Thinking costs....
 - Eg 1 in 1,000 people click onto T&Cs when buying/downloading software online (Bakos et al, 2014)
 - Implies simple disclosure may not be enough and can even make things worse. DSRs need to make allowance.
- ❖which give rise to behavioural biases.
 - Can have a range of different implications for DSRs.

Key relevant consumer behavioural biases

- ❖ *Status quo bias and loss aversion*
 - May exacerbate real costs of switching
- ❖ *Present bias, myopia and hyperbolic discounting*
 - May explain e.g. consumer failure to allow fully for future fees and charges.
- ❖ *Default bias, saliency bias and other forms of framing bias*
 - May explain e.g. over-focus on price, incentivise shrouding, pre-ticked boxes
- ❖ *Over-confidence*
 - May explain e.g. low sensitivity to high default cancellation fees
- ❖ *Limited memory*
 - May explain e.g. failure to cancel contracts. May also limit learning.
- ❖ *Influence of other people*
 - May explain e.g. unquestioning reliance on advisers

DSRs can enhance consumer decision-making, but what are their potential downsides?

- ❖ *DSRs may be unnecessary*
 - Consumers may learn, or the market may solve the problem
- ❖ *DSRs may be ineffective or only partially effective*
 - If implemented badly, if non-compliance or if badly designed
 - Or may inherently be only partially effective, especially in markets characterised by price discrimination.
- ❖ *DSRs may be disproportionately costly*
 - Can include costs to firms but also to consumers or Government.
- ❖ *Supply-side reactions can make DSRs less effective or even harmful*
 - Tick-box approach to compliance or more subtle price effects
- ❖ *DSRs can create losers as well as winners*
 - E.g. a change in default that reduces over-purchase by some can lead to under-purchase by others. Supply-side reactions also relevant.

Key types of demand-side remedies – and the impact of Behavioural Economics

1. Disclosure remedies

- Pre 2008: focussed on overcoming asymmetric info issues
- BE has changed focus e.g. to ‘smarter consumer communications’

2. Shopping around remedies

- Pre 2008: focussed on bringing together information to overcome search costs
- BE has changed focus e.g. to triggering shopping around and facilitating good decision-making

3. Switching remedies

- Pre 2008: focussed on making switching less costly and time-intensive
- BE has changed focus e.g. to overcoming behavioural barriers to switching

1. Disclosure remedies – Key categories

i. Disclosure to purely address asymmetric information

- Domestic bulk LPG (info on prices)
- Care homes (info on prices/quality)
- Doorstep selling (info on rights)

ii. Disclosure to improve consumer awareness and understanding

- Store cards (font size)
- Cash savings ('one click' to rates)

iii. Disclosure to facilitate comparison across products

- Energy: tariff comparison rates (TCR)
- UOCs: 6 scenarios
- Printer ink: Standard for comparison

iv. Disclosure remedies to stop consumers being misled

- Payment surcharges for airlines
- Energy/telecoms: Restrictions on price variation clauses

v. Disclosure to aid decision-making by existing consumers

- Unarranged overdraft charges (UOCs): Text alerts
- Energy: 'Cheapest Tariff Messaging'

1. Disclosure remedies – Effectiveness

What worked?

- Domestic Bulk LPG: 57% compared prices
- Store cards: usage, balance and APRs all fell. Warnings for APR>25% very effective. NB Some benefit during review!
- Printer ink: Much used in mags (albeit not instore)
- Text alerts for unarranged overdraft charges
- Payment surcharges likely to have worked well

And what didn't?

- Extended warranties: patchy compliance (35%)
- Care homes: Info on quality provided too late
- TCRs: Limited consumer awareness (18%) and lack of clarity about how to use them
- UOCs charging scenarios: Too complex, hard to find
- APRs: Too simple to convey what matters in some cases
- Doorstep selling: Less shopping around!

1. Disclosure remedies - Conclusions

- a) It is important to ensure compliance (with DSRs generally)
- b) In ensuring that disclosure really works, and is comparable, rules may have to be fairly prescriptive
- c) Consumer testing can be valuable in assessing how consumers really use information to make decisions
 - NB CMA recommendations for RCTs in energy/banking, and requirement on firms to cooperate
- d) Consumer awareness of , and attention to, disclosure matters,
- e) This can be affected by *who* does the disclosure, and *where*, and *when*
- f) It can sometimes be helpful to disclose less, not more
- g) It is important to consider the supply-side response to any remedy
- h) Consumer decision-making can sometimes be enhanced by simply investigating

2. Shopping around remedies – Key categories

i. Remedies that collate information to facilitate search/comparison (eg PCWs or other TPIs)

- Home credit/extended warranties: Industry to set up PCW
- Payday: Suppliers to provide data to a PCW
- Rules/accreditation to enhance PCW standards: Energy vs payday
- Heating oil: Coverage claims
- Motor Insurance: Wide MFNs
- Financial advice: Commissions

ii. Remedies that impose access to personalised info to facilitate search

- Home credit: Data sharing with CRAs
- Banking/energy: Midata initiative

iii. Remedies that trigger, de-risk or require shopping around

- New car warranties campaign
- Cash savings: Interest notifications
- Microsoft Internet Explorer
- GAP: POS ban

2. Shopping around remedies – Effectiveness

What worked?

- Financial advice: Significant decline in sales with higher commissions post-RDR
- Extended warranties: 74% realise can shop around; 15% do
- Microsoft Internet Explorer: More substantial drop-off in market share in EU than in US.
- Cash savings notifications likely to work (based on RCTs)

And what didn't?

- Home credit: Low and falling usage, partly due to low awareness and lack of click-through functionality
- Extended warranties: Only has one stand-alone supplier!
- Accreditation: Issues around WOM rule plus coverage
- Heating oil: PCWs still lack transparency and functionality
- Home credit: Limited impact partly due to cost of data
- Midata: Limited impact due to cumbersome process
- New car warranties: Limited reach – only 6% of buyers

2. Shopping around remedies - Conclusions

Remedies that collate information to facilitate search/comparison:

- a) Regulators need strong understanding of relevant technology, and likely developments while remaining humble about ability to predict the future.
- b) It can be better to facilitate or trigger the creation of commercial PCWs than to mandate their existence or for regulators to create them themselves
- c) For mandated PCWs, governance is important
- d) There may be a rationale for regulating PCWs
- e) Accreditation is a useful tool, but only if affects practice across the market,
- f) A requirement that PCWs provide clear info on market coverage is likely to be better than a comprehensive coverage requirement
- g) It may be useful to provide clearer competition law guidance to PCWs around MFNs
- h) PCWs may not be used on a frequent basis (or at all) by some customers, and thus such remedies risk creating winners and losers

2. Shopping around remedies - Conclusions

Remedies that impose access to personalised information to facilitate search:

- a) These remedies are likely to work better when data is provided directly to PCWs, with consumers' permission
- b) Some consumers may engage better with search if it can be done on a mobile device, rather than on a PC
- c) Open APIs are likely to be better than remedies that require data to be given by some supplies to some collators, with no data consistency requirements
- d) It is important that PCWs do not pay a disproportionate fee (if any) for this data

2. Shopping around remedies - Conclusions

Remedies that trigger, de-risk or require shopping around:

- a) Disclosures can be effective as triggers to shopping around but the precise design matters a lot. Timing is especially important. RCTs can be invaluable in getting design right.
- b) Remedies that require consumers to make a positive choice can be effective
- c) Measures which keep issues in the public eye may be more effective over the longer term than one-off consumer awareness campaigns
 - Ofgem/Ofcom consumer complaints data and FCA's sunlight remedy for cash savings may be useful for retaining long term media interest.

3. Switching remedies – Key categories

i. Switching remedies that involve changing contractual provisions

- Energy: Ban on termination fees for default tariffs
- Domestic bulk LPG: Decoupling of LG supply from ownership of tank
- New cars/printer inks: Dropping of warranty restrictions
- Energy/telecoms: Ban on ARCs

ii. Remedies that make switching quicker, easier, more reliable or more attractive

- PCAs: 7-day switching service (CASS)
- Cash savings: 15 day switching
- Telecoms: Gaining provider led switching and mobile number portability (MNP)
- Cash savings/pensions: Move towards ‘aggregators’

3. Switching remedies – Effectiveness

What worked?

- New cars/printers inks: Removal of warranty restrictions very effective.
- Domestic bulk LPG: Initial signs good when reviewed
- Energy: Ban on termination fees for default tariffs presumably positive, since CMA has extended to SMEs!
- Telecoms: Cho et al (2014) find MNP to have reduce prices by around 8%
- ARCs likely to have worked, based on *ex ante* evidence

And what didn't?

- PCAs: Limited awareness and confidence in CASS. CMA has now proposed long-term promotion campaign. Also longer re-direction and provision of transaction history.
- Cash savings: Limited awareness or actual switching. Led FCA to reduce time further but also put in place a further package of remedies

3. Switching remedies - Conclusions

- a) Measures which are designed to overcome financial barriers to switching can be very effective
- b) As can measures which reduce the 'hassle factor' involved in switching
- c) Regulatory intervention can prevent suppliers from exploiting the behavioural biases to limit switching
- d) Barriers to switching can derive from a lack of consumer awareness about the process, misperceptions about the difficulty of switching or other biases towards inaction. In this case, remedies require careful design.
- e) It can take time – and frequent revisiting of the market – to make remedies as effective as possible. This is partly because it can take time to work out what factors are really limiting consumer shopping around and switching.

Further conclusions – Substance

- ❖ Pure information asymmetry and switching costs do matter
- ❖ When behavioural biases *are* important, the BIT's 'EAST' mnemonic is useful.
 - Remedies should be Easy, Attractive, sensitive to Social influences and Timely.
- ❖ Enhancing the role of commercial solutions can be valuable
- ❖ It is important to consider the supply-side responses to interventions.
- ❖ It is important to be aware of the distributional effects of interventions.

Further conclusions - Process

- ❖ Remedy design should be considered early, and with a strong focus on being precise about the issues consumers face. and with an strong awareness of technological developments.
- ❖ Given the complexity of the issues, it is unlikely that any one remedy will provide a complete solution. Rather packages of remedies will be needed.
- ❖ Remedy testing is valuable, especially through RCTs. This can be time-consuming. Where possible, it can be useful to compel firms to cooperate.
- ❖ Remedy implementation requires careful design, good governance and effective ongoing monitoring.
- ❖ Remedy review is also valuable, through sunset clauses, commitment to future review, or a robust programme of *ex post* evaluation.
 - It can be useful to consider the need for later evaluation at the point of remedy design, to enable the right data to be created or made available.
 - Staggered implementation can help.

To conclude

- ❖ DSRs can be very valuable where effective BUT they are not a panacea. Even if they help some consumers, and in so doing enhance competition for them, there may be other consumers who are left behind, or even harmed.
- ❖ As such, there may be an argument for further interventions alongside DSRs to provide additional protections.
 - NB The Review also looks at 'outcome control' remedies.
- ❖ It is, though, important to recognise that we are not in a world of first best solutions. Almost all interventions will have costs as well as benefits – as well as winners and losers.
- ❖ As such, regulators face difficult choices. This report does not seek to provide solutions, but rather to help inform the regulatory decision-making around DSRs.



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