How can consumer power be harnessed to improve market outcomes?

A briefing on the use of “demand-side remedies” that seek to improve consumer engagement in markets

7th November 2016

Which?

Executive Summary

At Which?, we know that the power of consumers can shape markets and give businesses the incentives to deliver excellent products and services at competitive prices, and provide high-quality after-sales service. However, in many markets consumers seem to have the opportunity to engage but do not do so in sufficient numbers to drive good outcomes. This is likely due to a variety of reasons, from a simple lack of information to barriers that companies might put in place that discourage customers from switching.

Competition authorities and regulators have tried to tackle these issues in a variety of ways. Over the last 15 years we have seen several attempts to improve the "demand-side" of many markets, ranging from providing information (sometimes in standardised formats) to auto-enrolment of consumers in workplace pensions. Some of these interventions have been successful but in other cases have been simply ineffective and costly for businesses to implement. In the worst cases interventions have even been harmful, sometimes in surprising ways.

We therefore decided to look at the evidence on remedies which have worked and which haven't to see what we could learn. Alongside this briefing we publish a Review by Professor Amelia Fletcher that considers the empirical evidence. Professor Fletcher looked for a wide range of evaluation evidence on the impacts of intervention on consumer outcomes in order to help us build a picture of how well these remedies have worked since the turn of the Millennium. We have identified the following core findings from Professor Fletcher's piece:

- Supplying more information to consumers can help to tackle consumer detriment, but in many cases it is not enough
- It is hard to increase consumer switching behaviour unless a remedy removes a clear contractual restriction. In particular we have found it is hard to increase how much consumers search for better deals simply through providing more information
- Remedies sometimes fail because of the way they are implemented by market participants
- Remedies can make things worse for a variety of reasons. For example:
    - Counter-intuitively some types of remedies may worsen consumer decision making; for example consumers may trust their current provider more if the current provider is forced to provide information about alternative options
    - Previously engaged and savvy consumers may lose out from the implementation of remedies which limit what suppliers can do
    - Poorly-designed remedies can provide the consumer with too much information or too many options
    - The design of remedies using behavioural insights has improved notably over the last decade, although a successful remedy also needs to account for supplier reaction
    - There may be limits to what can realistically be achieved in markets through demand-side remedies, especially when one considers reactions of both firms and consumers to such remedies and the risk of unintended negative consequences.

In this piece, we give our view on the implications of the evidence. This is a Which? view only, and does not necessarily represent Professor Fletcher's views. In summary we argue that regulators and competition authorities should:

- **Treat testing and evaluation more seriously, and not use cost or difficulty as an excuse to not carry this out.** Regulators have been guilty of introducing a number of ineffective and even harmful remedies. We want to see regulators starting to think about remedies earlier in the inquiry process, devoting adequate time and effort to design and testing of remedies, including engaging with consumers themselves to test effectiveness. The largest cost to consumers is ineffective remedies, not testing and evaluation.
- **Establish clear outcome measures of a successful intervention**, so that they can monitor and evaluate the success of the remedies, and adjust their regulatory approach based on consumer outcomes.
- **Ensure that they explicitly plan reviews of remedies, and commit to carry out evaluations**, in particular when testing before introduction is impossible.
- **Use a wide range of techniques to identify more innovative remedies**, avoiding remedies which sound good in a committee room but don't improve consumer outcomes. This could include opening up the process of finding solutions to allow private actors and independent intermediaries to design solutions.
- **Ensure that supply-side remedies based on competition policy are not prematurely ruled-out.**
- **Recognise the limits of demand-side remedies that seek to change consumer behaviour** and be prepared to say that either direct consumer protection is needed, or that nothing can be done that would improve the situation.

We recognise that establishing a more rigorous approach for demand-side remedies may result in fewer remedies being implemented; however those that are implemented should be more effective.

Introduction

At Which?, we know that the power of consumers can shape markets and give businesses the incentives to deliver excellent products and services at competitive prices, and provide high quality after-sales service. However, we also know that this is likely to be the case only where consumers can and do exert that power. The first pre-requisite for this to happen is that consumers have the choice to go to a range of other suppliers. However, in many markets consumers seem to have the opportunity to engage but do not do so in sufficient numbers to drive good outcomes. This is likely due to a variety of reasons, from a simple lack of information to barriers that companies might put in place that discourage customers from switching.

Competition authorities and regulators have tried to tackle these issues in a variety of ways. Over the last 15 years we have seen several attempts to improve the "demand-side" of many markets, ranging from providing information (sometimes in standardised formats) to auto-enrolment of consumers in workplace pensions. Some of these interventions have been successful but in other cases have been simply ineffective and costly for businesses to implement. In the worst cases interventions have even been harmful; sometimes in surprising ways. An Office of Fair Trading (OFT) evaluation of remedies to doorstep selling found that improving rights and information available to consumers did appear to increase consumer confidence in the market, but at the same time the proportion of consumers shopping around had actually fallen. Confidence in the market had not caused increased competitive pressure. It is not easy to predict how a new regulation on firms will translate into change in a market.

We therefore decided to look at the evidence on which remedies have worked and which haven't, to see what we could learn. Alongside this opinion piece we publish a Review by Professor Amelia Fletcher (who was Chief Economist of the OFT from 2001-2013) that considers the empirical evidence. Professor Fletcher looked for a wide range of evaluation evidence on the impacts of intervention on consumer outcomes in order to help us build a picture of how well these remedies have worked since the turn of the Millennium.

Consumer outcomes: How well have previous interventions worked?

In a dynamic market environment, engaged consumers play a key role in driving companies to provide the right products at competitive prices. Consumers making active choices mean that a market can react to a diverse range of preferences, bringing together what consumers are willing to pay for different quality products with technical feasibility. Active consumers also provide incentives for companies to innovate in the hope of opening new markets.

However, there are many instances of markets where consumers appear to be relatively inactive but also report low satisfaction. Both retail banking and energy have recently been subject to market investigations and identified the lack of consumer engagement as a problem. This is about more than consumer switching however; there are also many markets where consumers may be misled into the purchase of products and services they would not otherwise have bought. For example consumers may end up with inappropriate insurance, expensive extended warranties or other purchases that they subsequently regret. Competition authorities and regulators have tried to tackle these types of problems in a variety of ways, as the accompanying Review shows.

In summary the findings show that:

- Supplying more information can work, but in many cases is not enough: More information can be beneficial for consumer confidence, for aiding rational consumer behaviour, and for driving up quality (e.g. requirement for a warning on storecards with APR above 25% led to a dramatic reduction in proportion of such cards) but enhancing information can also have no significant impact (e.g. personalised interest rate information in cash ISA statements appears to have actually reduced consumer awareness of interest rates; although this may be because interest rates are so low).

Case study

Evaluation of information remedies in the store card market

In March 2004, the OFT referred the store cards market to the Competition Commission (CC) for investigation. The CC found that store card providers' incentives were unambiguously to charge higher interest rates, partly because consumers were insensitive to the annual percentage rate (APR), late payment fees and insurance costs. It found that store card providers did not include sufficient information on APRs and interest charges on their store card statements which contributed to or reinforced consumers' lack of sensitivity to APRs. The CC imposed remedies focused on information, including:

- All store card account statements were required to a display certain information prominently.
- Cards with an APR of 25 per cent or more were required to display a warning in statements.

An **evaluation of these remedies** published in 2011 found that:

- With regard to the CC's APR warning remedy, the proportion of store cards with APRs below the warning threshold of 25 per cent increased from 30 per cent in 2005 to 57 per cent in 2008. Interestingly, their econometric analysis found that the CC's provisional decision on remedies in December 2005 had a small but statistically insignificant effect in reducing the APRs, and the implementation of the remedy package appears to have sustained and enhanced this effect. The evaluation states that this is consistent with the view that the publicity during the investigation led to customer demand changing and store card providers making a competitive response that anticipated the CC's remedies.

- **It is hard to increase how much consumers search for better deals simply through providing more information:** Some information remedies focused on search may have had some impact (e.g. a one-stop shop remedy for care homes seems to have provided some benefits in an evaluation by the Cambridge Centre for Housing & Planning Research) but it can be hard to increase search behaviour to a level that really drives competition (e.g. information remedies in the extended warranties market increased the proportion of consumers who considered alternative offers from 4% to 15%, which whilst a substantial increase still means the vast majority of consumers did not consider alternatives).
- **Enhancing switching behaviour is hard unless a remedy removes a clear contractual restriction:** Switching remedies can be powerful in cases where switching had been limited by a clear contractual restriction, which the intervention removes (e.g. breaking the link between purchase of an original product and a complementary product such as purchasing a car and a warranty for that car, or a printer and the ink required for the printer) but more generally it can be hard to enhance switching behaviour (e.g. the OFT evaluation of interventions in the cash ISA market found that remedies led to real improvements in transparency and ease, speed and reliability of switching, but there was no evidence of improved consumer awareness or of actual increased switching).
- **Remedies sometimes fail because of the way they are implemented by market participants:** It can be hard to gain compliance for remedies or remedies can be stymied by market participants (e.g. a personal current account remedy to allow opt-out of unauthorised overdraft charges was made available only on a subset of accounts, usually those charged for).

Remedies can make things worse, so regulators should take testing and evaluating them seriously

The Review shows how remedies have the potential to make things worse in a range of ways, such as:

- **Imposing cost for no (or little) benefit.**
- **Curtailing opportunities for small companies to challenge incumbents** (thereby harming consumers).
- **Suppliers reacting in ways that worsen consumer outcomes**: For example, the Review highlights an example of a study by Grubb and Osborne (2015) looking at the introduction in the US of a requirement to send text alerts to consumers who are about to go over their free text/call limits. Their model suggests that suppliers lower charges for going over the limit, but increase standard charges to such a degree that consumers actually end up worse off.
- **Making consumer decision-making worse**: An interesting example is shown in the case study box below, where giving consumers more information through sellers did not lead to an increase in consumers shopping around; although causality hasn't been established, it is notable that shopping around through PCWs decreased.[1]

This means that implementing remedies without testing or detailed monitoring is high-risk for consumers. This leads us to our first conclusion: demand-side remedies can make things worse, so regulators should take testing and evaluating them seriously, and consider packages of remedies carefully.

1. This type of effect has also been found in a study by GfK for the Department for Business, Innovation and Skills: Evidence Review of Trigger Points in Regulated Markets, which found that "If consumers have a sense of belonging or attachment to the supplier, for example feeling like a valued customer, they are less likely to switch in order to maintain this relationship for fear of losing benefits of the relationship".

Case study

Evaluation of remedies in the doorstep selling market

Following a 2004 OFT market study into the UK doorstep selling market, a number of changes were made to improve the rights and information available to consumers. For example, the OFT encouraged greater transparency on prices and willingness to provide written quotes through industry self-regulation, by encouraging traders to operate under approved Codes of Practice or (for the building and construction trades) through participation in TrustMark.

The 2012 OFT evaluation showed that the package of measures did significantly increase consumer confidence, as intended: "In 2004, 70 per cent of consumers were 'fairly' or 'very' satisfied with the sales process and this had increased to 83 per cent by 2010".

However, it found that the proportion of customers making price comparisons before purchasing on the doorstep had actually fallen. The evaluation did not find a direct link to the OFT remedies, but it does give rise to the possibility that enhanced consumer confidence in doorstep sellers may actually have reduced search behaviour and thus competition.

We believe that testing and evaluation are both very important to ensure that interventions in markets improve consumer outcomes.

Testing: The Review highlights that an important form of evidence in support of particular remedies can be lab experiments or randomised controlled trials (RCTs). Testing should be considered for all significant remedies, with the Financial Conduct Authority leading the way on this type of testing.[2] The Review notes that in recent years there has been a much greater focus than previously on real consumer behaviour, and on drawing upon all potentially available evidence to design remedies. However RCTs require buy-in from companies and can be time-consuming and expensive. Therefore, there is a potential problem with the current timetable for remedies, which effectively makes RCTs unrealistic for the Competition and Markets Authority (CMA). When the CMA proposes that regulators utilise RCTs to test out interventions, they should consider placing an order on the relevant firms that they engage appropriately in the trials. Other forms of testing may be appropriate where an RCT is impossible or disproportionate. Such evidence can be important in demonstrating the problem in the first place – and this in turn can help demonstrate the likely impact of the remedy (e.g. Ofcom research demonstrated that consumers who were subject to auto-rollover contracts were less likely to switch and therefore we should certainly expect a ban on such contracts to enhance switching).

Evaluation: High-quality, independent evaluation is also needed because testing cannot tell us everything we need to know about whether a remedy will improve consumer outcomes. We also need to know how suppliers will respond before any such conclusions can be drawn. Where the impact of remedies is uncertain, regulators and competition authorities should consider using a review point or sunset clause combined with evaluation in order to explore the full market impact and whether outcomes are improving for consumers.

Sometimes it is suggested that testing and evaluation are expensive and can only be done for a few remedies. We think this only applies in a small minority of cases, because the evidence in the Review shows remedies can be significantly harmful to consumer outcomes and the **largest cost to consumers is the introduction of ineffective remedies, not testing and evaluation**.

2. For example Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour and How does selling insurance as an add-on affect consumer decisions?

For a small minority of cases a remedy may be a “hygiene factor” which is known to have little risk of harmful consequences or imposing significant costs, and can therefore be introduced without testing or evaluation. These are likely to be the case where either the remedy concerns compliance with current consumer protection law, or where previous evidence exists that gives a strong indication the remedy is likely to be effective. However, significant care needs to be exercised over assuming that this is the case, as the rest of this Briefing makes clear that there are varied examples of apparently straightforward interventions that have been ineffective or harmful. Particularly where previous evidence is used, this needs to be highly specific to the remedy proposed, as consumer behaviour can vary significantly depending on small changes to context.

Regulators should clearly establish success measures based on consumer outcomes

Regulators are ultimately responsible for the consumer outcomes in the markets they regulate, although the route to tackle consumer detriment may be through competitive processes or more direct consumer protection. However, we have observed many cases where there is a lack of clarity over which consumer outcomes a regulator expects to change. These may be direct measures of consumer outcomes (such as value for money, quality or customer service indicators) or it may be a measure of core elements of the competitive process (such as consumer understanding of offers, switching rates or consumer satisfaction).

Establishing clear outcome measures:

- **Sets a benchmark by which to evaluate success of interventions:** Regulators should be ultimately accountable for the success of their interventions, and to do this there need to be clear success measures. There may be other relevant indicators of beneficial impact that were not identified at remedy stage, but these can be set in context against the success measures identified at the time.
- **Gives regulators the right incentives to develop remedies in the most effective ways:** Ensuring that there is a focus on consumer outcomes means that regulators will focus on what measures will work. This may incentivise regulators to conduct greater testing beforehand, to consider a full-range of remedies (including supply-side) or to be more innovative in designing and delivering remedies. We discuss this last point in more detail below.

Innovation in remedies

Whilst there are honourable exceptions, we have seen little evidence of enough innovation in the types of remedies which are proposed. The process of designing remedies appears to rely too much on internal thinking at regulators and competition authorities, supplemented by input to consultations and reviews of academic evidence. We think that regulators can do better.

Regulators and competition authorities should consider the following approaches to identifying more innovative remedies:

- **Establish outcome measures clearly, but open up the process of finding solutions**: Regulators need to establish what the outcome of a successful intervention would be but should not fall in to the trap of thinking that they are the only ones who can design an appropriate technical solution. Where success criteria can be clearly identified, regulators could consider using prize funds such as the Nesta Challenge Prize fund, or payment by results. In particular, where firms are taking forward the design of a solution, a regulator can use the identification of the outcomes that need to improve as an incentive to drive innovative approaches from industry. In some cases it may be appropriate to attempt a demand-side remedy first, and then consider stronger regulation if outcomes do not improve.
- **Give the market the tools to help consumers engage:** Open data and APIs[3] for consumer information allow companies and independent organisations to design a range of solutions. Where there is significant consumer detriment due to a lack of helpfully presented information, intermediary companies are likely to be able to make money out of solving the problem. However, in some markets they may be blocked from doing so by the lack of available data and hence there is an important role for a regulator to tackle the availability and format of data. Solutions achieved through this route are likely to be more innovative, as it can incentivise the generation of a broad range of ideas which will then be sifted by market forces to leave only those that are effective.
- **Ensure that supply-side remedies are not prematurely ruled out:** Regulators should be careful not to conceptualise a disengaged consumer as the problem. In active markets, consumers are engaged through company incentives to advertise. Regulators and competition authorities must ensure they have questioned why the supply-side of a market does not have that incentive if consumers are not engaged.

Fewer, more effective remedies

Our arguments here increase the expectations on regulators and competition authorities when designing remedy packages. We recognise that this has cost and resource implications, and acknowledge that this may mean that fewer remedies will be imposed. We think this is a necessary trade-off, given the potential harm and wasted resources that can be caused by ineffective remedies. The case study we give below on extended warranties provides a sobering tale. There has been limited compliance with the remedies, and repeated interventions and undertakings appear to have not significantly changed the market. The CMA and regulators need to ask themselves whether further testing of remedies could have been done beforehand, and consider whether they are putting enough resources towards enforcing the orders which they consider important.

3. Application Programming Interface, which are one of the most common ways technology companies integrate with each other.

Case study

Evaluations of interventions in the extended warranty market

Extended warranties for domestic electrical goods cover consumers against break down or accidental damage. An OFT inquiry in 2001 concluded the market was not working effectively and referred the market to the CC. The CC imposed four remedies through an Order in 2005:

i. a requirement for retailers to display prominently freely-available leaflets containing specified information to consumers

ii. a requirement for retailers to display price and duration information about extended warranties adjacent to the price of the electrical good

iii. a requirement for retailers, upon request, to provide a written quotation that guarantees that the extended warranty will be available on the same terms for 30 days if the consumer chooses not to buy it at that time

iv. increased rights for consumers to cancel a purchased extended warranty

In 2008 **the OFT evaluated the impact of the remedies** and found they had limited impact as a result of inadequate compliance, including:

- A lack of 'prominently displayed' leaflets
- Around 45% of the retailers visited in a mystery shop were not displaying the required information next to any of the relevant products and a further 20% had the information available next to only some products
- Up to a third of sales assistants giving the wrong information on consumers' rights

There were some positive impacts, with the evaluation finding an increase from 4% to 15% in the proportion of consumers who considered alternative offers from those offered at the point of sale, and that fewer people were under the impression that they had to make an instant decision on an extended warranty.

Overall the evaluation estimated a reduction in consumer detriment of around £19 million per year, compared to an annual detriment of £366 million. The overall one-off costs were £4.6 million for the investigation and around £4.9 million for the industry.

The OFT then returned to this subject in 2012, because of a persisting advantage for selling extended warranties at the point-of-sale and limited shopping around. The OFT decided not to make a Market Investigation Reference this time, instead accepting Undertakings In Lieu from major players in the market. These undertakings required the companies to establish, maintain and participate in a comparison website and publicise it in prominent positions. The OFT considered that this would "enhance the ease and effectiveness of shopping around by consumers, thereby leading to increased numbers of consumers who shop around and more consumers considering alternative, non-POS (point-of-sale) providers".

However, Professor Fletcher reviewed this comparison site for her Review and found that while the retailers may have stuck to the letter of the undertaking, the **resulting** website is not in line with the spirit of what was intended: "Only four suppliers are included on the site, three of which are retailers. All three retailers only supply extended warranties if sold alongside the domestic electrical good. There is only one insurer on the site selling stand-alone extended warranty cover. As such, the website would seem to be of limited use, and no use at all for searching between providers of stand-alone extended warranty cover".