Ofcom: Helping consumers to engage in communication markets – Call for Inputs

---

Consultation response from the

Centre for Competition Policy

University of East Anglia, Norwich Research Park, Norwich NR4 7TJ

Date: 23 August 2017

Author(s):

- Dr David Deller
- Prof Morten Hviid
- Prof Catherine Waddams

This consultation response has been drafted by the named academic members of the Centre, who retain responsibility for its content.

The Centre for Competition Policy (CCP)

CCP is an independent research centre established in 2004. CCP's research programme explores competition policy and regulation from the perspective of economics, law, business and political science. CCP has close links with, but is independent of, regulatory authorities and private sector practitioners. The Centre produces a regular series of Working Papers, policy briefings and publications. An e-bulletin keeps academics and practitioners in touch with publications and events, and a lively programme of conferences, workshops and practitioner seminars takes place throughout the year. Further information about CCP is available at our website: www.competitionpolicy.ac.uk

Response to Ofcom, 'Helping consumers to engage in communications markets – Call for inputs'

Before responding to each question it seems important to contextualise the objective of consumer engagement. Consumer engagement should be treated as an intermediate objective rather than a final objective, in other words consumer engagement is only valuable to the extent that it delivers net benefits to consumers, for example, in terms of lower prices or high quality. Also, it is essential to recognise that consumer engagement involves an opportunity cost for consumers: by spending time engaging with a communications market they are unable to spend time pursuing other activities which might deliver greater benefits.[1] Furthermore, as Deller et al (2016a) discuss, there is an 'observational equivalence' problem around what consumer non-engagement signifies, with there being at least four different possibilities.[2] As a result of these points it is not correct to say that more consumer engagement is always better. Arguably, rather than having an explicit objective of increasing consumer engagement, a more reasonable objective is to remove as many unnecessary impediments to engagement as can be achieved for a reasonable cost. In this spirit we encourage Ofcom to focus on specific contractual terms and/or information deficits when considering the question of increasing consumer engagement.

It needs to be remembered that non-engagement could reflect consumer satisfaction with the product they are receiving or that, however important are communication markets, consumers may have more pressing commitments on their time. For example, Deller et al (2017a)[3] provides evidence that consumers are less likely to switch when they classed the period when an opportunity to switch was offered to them as very busy. More significantly, Deller et al (2017a) highlights that consumers appearing to leave 'cash on the table' by not switching may not be acting in a sub-optimal way once various non-price factors are considered such as: uncertainty in consumption and price, the time and effort required to switch[4], and preferences around the characteristics of suppliers. This last factor is important as it suggests that while 'experts' may consider certain products, in this case energy, to be homogenous, in the eyes of consumers there is variation between suppliers.

Question 1: Do you agree that we should include SMEs in the scope of our work?

---

[1] An example of a cost-benefit analysis which explicitly includes these engagement costs is: Financial Conduct Authority (2015), 'Increasing transparency and the engagement at renewal in general insurance markets', Consultation Paper CP15/41, December 2015, available at: http://www.fca.org.uk/your-fca/documents/consultation-papers/cp-15-41

[2] See pg12 of Deller, D., E. Errington, M. Hviid and C. Waddams (2016), consultation response to the 'House of Lords Select Committee on Economic Affairs: The Economics of UK Energy Policy', available at: http://competitionpolicy.ac.uk/documents/8158338/11690925/8+CCP+Response+to+House+of+Lords+Economics+of+Energy+Inquiry+-+September+2016.pdf/9c2d64eb-81b8-4937-9514-b102e940e089

[3] Deller, D., M. Giulietti, G. Loomes, C. Waddams Price, A. Moniche Bermejo and J.Y. Jeon (2017), 'Switching Energy Suppliers: It's Not All About the Money', CCP working paper 17-5, available at: http://competitionpolicy.ac.uk/documents/8158338/17199160/CCP+WP+17-5+complete.pdf/fdaaed88-56e5-44f9-98db-6cf161bfb0d4

[4] Deller et al (2017b) highlights that centralised mechanisms, such as collective switch auctions, can potentially offer an efficiency gain over the operation of decentralised markets if they remove the costs to individual consumers of searching and switching. See Deller, D., P. Bernal, M. Hviid and C. Waddams (2017), 'Collective Switching and Possible Uses of a Disengaged Consumer Database', CCP report funded by Ofgem, available at: http://competitionpolicy.ac.uk/documents/8158338/19064125/Collective+Switching+Report+-+August+2017.pdf/127c78b6-faad-4496-b198-f56862230896

The CMA's Energy Market Investigation concerning microbusinesses/SMEs suggests it is worth keeping this group of customers in scope initially to identify whether they face particular barriers to engagement that domestic consumers do not face. However, if considering potential remedies it may make sense to separate microbusinesses/SMEs from domestic consumers.

Fletcher et al (2014)[5] highlights the consistently different levels of engagement by firms of differing sizes in a range of markets and highlights the current legal protections in place for SMEs and microbusinesses across these markets. This work suggests that engagement and support for microbusinesses is a clear issue given that their knowledge and bargaining power may be similar to that of a domestic consumer, but they face greater time pressures resulting from running a business. Regarding the scope of Ofcom's work, it seems sensible to consider at what point, in terms of turnover and/or number of employees, one consider SMEs to be sufficiently sophisticated consumers that they can survive with fewer protections than domestic consumers. Fletcher et al (2014) note that there are discrepancies in the size of entities identified as microbusinesses and SMEs etc. When selecting the microbusiness/SME definition to use in any intervention it is important to consider the information available to suppliers and the potential consequences of an intervention requiring suppliers to collect additional information about their customers.

Question 2: What are your views on whether consumers not knowing when to engage is a barrier to their engagement? What impact do you think this has on them and to competition in the various communications markets?

It seems fairly obvious that if a consumer does not know when to engage it is likely to be a barrier to engagement resulting in less competitive pressure and potential frustrations for individual consumers. However, when considering 'knowing when to engage', it seems important to separate: (i) consumers knowledge of contractual impediments to switching, from (ii) consumers knowledge concerning the 'optimal' point at which to switch to minimise costs/maximise benefits. There appears to be a legitimate regulatory role concerning (i), but less of case for regulatory intervention concerning (ii), not least because it is questionable that a regulator can know the 'optimal' point to switch better than individual consumers. As noted above, Deller et al (2017a) shows that in the energy market not switching supplier is often an entirely rational act, even when there appear to be large cash savings available, once a sufficient range of non-price factors are considered by the researcher/policymaker.

It is worth trying to unpack the statistic that 6% of mobile consumers continue to pay handset charges after their initial term. There seems to be important difference between people who continue paying the handset charge for 1 or 2 months before changing tariff/supplier and those paying for more than 6 months. In the former instance it seems likely to be a 'mistake' by an otherwise knowledgeable consumer, i.e. they understand the need to change their contract but perhaps they did not get round to it because they were busy. However, if a consumer is paying the handset charge for a much longer period it is likely to suggest a more fundamental lack of understanding.

Question 3: What are your views on the suggested possible solutions to help address consumers not knowing when to engage? What could be their positive or negative effects? What other possible solutions might there be?

---

[5] Fletcher, A., A. Karatzas and A. Kreutzmann-Gallasch (2014), 'Small Businesses As Consumers: Are They Sufficiently Well Protected', a CCP report for the Federation of Small Businesses, available at: http://competitionpolicy.ac.uk/documents/8158338/8264594/fsb+project_small_businesses_as-consumers.pdf/f1ed4da5-14cf-4b80-a1d8-ff76a0781def

Assuming that they can be delivered at reasonable cost, the general principle of consumers receiving an end of contract notification which highlights the value of shopping around seems to be reasonable. Clear communications around the end of contracts is particularly important if a consumer has only a limited time window when they can switch tariffs/change suppliers. Again, assuming that they can be delivered at reasonable cost, a periodic notification that a consumer may benefit from shopping around when they are on an 'evergreen' tariff seems reasonable. However, experience in the energy markets suggests that there is a balance to be found between over regulatory prescription and allowing supplying companies to bend the message to their own purposes.

For the case of handset charges beyond the period when the cost of the handset has been repaid there may be a case for outright prohibition: consumers are essentially being charged for a product that they have already purchased.

Changes to contract terms which reduce firms' expected follow-on revenue after the end of an initial acquisition contract/tariff may feedback into a higher price for the initial acquisition contract/tariff. In other words, if the expected long-run profitability of a newly acquired consumer is reduced due to regulatory changes to contract terms it may well be reflected in acquisition contracts/tariffs that are less generous. However, in evaluating this potential feedback, Ofcom should assess whether: (a) the initial acquisition tariffs are below cost, and (b) firms possess market power when setting the price of the initial tariffs. If one of (a) or (b) does not hold the risk of upward pressure on initial contract prices is likely to be much reduced. Additionally, one may question whether it is desirable for such aggressive introductory offers to exist in the first place. This is particularly so if one thinks that consumers vary in their propensity to switch, such that those with a low propensity to switch effectively subsidise those with a high propensity to switch, by paying 'high' charges when failing to switch at the end of the initial contract. Although, this may be primarily a distributional issue about 'winners and losers' from a particular change, rather than about how well the market works for consumers on average.

Also, while a regulator can create 'calls to action' that encourage consumers to look around, a regulator cannot ensure that the result of looking around is that a consumer makes a 'good' purchase decision. Wilson and Waddams Price (2010)[6] found that at least 17% of switching consumers in the energy market appeared to *reduce* their monetary surplus after switching. This possibility of 'mistakes' suggests that calls to action are safest in those situations where a consumer's existing tariff is so bad that the probability of switching to an even worse tariff is low. However, positively identifying these situations is still likely to be challenging: a tariff choice that looks like an error ex-post, may not have been an error ex-ante when a consumer remained uncertain about their consumption level.

Question 4: What are your views on whether consumers not understanding their own needs, or having difficulties navigating available information, is a barrier to their engagement? What impact do you think this has on them and on competition in the various communications markets?

Again it is fairly obvious that if a consumer does not understand their own needs they will have problems engaging with a market and will be both less likely to engage and more likely to achieve poor outcomes from engagement.[7] However, except in very tightly defined circumstances, it is potentially dangerous for a regulator/policymaker to think that 'they know better' than a consumer. As discussed

[6] See Wilson, C.M. and C. Waddams Price (2010), 'Do Consumers Switch to the Best Supplier?', Oxford Economic Papers, 62, pp. 647-668

[7] Of course, if a consumer does not know their own needs the ability of an observer to identify what constitutes a good or bad outcome for an individual consumer is likely to be highly questionable.

above, Deller et al (2017a) show that apparently irrational behaviour is rational once the full complexity of consumers' situations is appreciated.

Furthermore, when considering consumers' understanding of their own needs and the options available it is important to recognise the potential for consumers to learn over time and to correct initial 'mistakes'. Ketcham et al (2012)[8] show this potential for learning in relation to health insurance, while Miravete and Palacios-Huerta (2014)[9] show it in relation to the choice of telephone tariffs. Excessive protection is likely to prevent such learning taking place.

There are a small number of citizens who are thought to struggle to take economic and other decisions to such an extent that they are afforded special protection by the law, for example, they may not be able to enter certain forms of loan agreements. This may be particularly the case for decisions with long term implications as would be implied by longer term agreements. However, it is far from obvious that it is the task of a regulator, or a private firms, to identify such individuals, as opposed to the courts.

Question 5: What are your views on the suggested possible solutions to help consumers understand their own needs, and navigate available information? What could be their positive or negative effects? What other possible solutions might there be, and what might be their effects?

First, it should be noted that 'bundled' products are inherently more complex to compare than individual telecoms products as they involve a greater number of components and therefore a greater number of quality/consumption variables. However, it is difficult to see how this particular issue can be addressed. Also, it should be remembered that consumers face the challenge of weighing up multiple different product features in other situations, such as when purchasing consumer durables, without it being thought necessary to have regulatory action, indeed, the market responds to this need for comparison by producing specialist magazines etc.

Before taking any action concerning bundles, it would be sensible for Ofcom to be clear about the arguments for and against bundling. While a bundle may be more complex to compare, thereby helping firms to deter switching in an otherwise commoditised market place, there may also be potential benefits from bundling, such as convenience for the consumer or economies of scale/scope in billing. Also, there might be a technical logic to bundling if TV, broadband, fixed line and mobile telephony are thought to be likely to converge to a single technology in the near future. Indeed, concerns about bundling may a reflect a transitional phase where both unbundled and bundled services are on offer and consumers are learning the benefits/costs of purchasing bundled telecoms products.

More generally, there may be a case for efforts to address situations where there is an imbalance in understanding between a consumer's knowledge of their consumption and the knowledge/information held by a supplier. Assuming that improvements can be made at reasonable cost, two paths which Ofcom may wish to explore are: (i) improving customer communications e.g. information on bills, and/or (ii) improving the portability of consumers' consumption information between suppliers and intermediaries.

A characteristic of broadband, mobile phone and fixed line telephone contracts is that they often have usage allowances where beneath a threshold there is no/a low charge, and above the threshold there

---

[8] See Ketcham, J., C. Lucarelli, E. Miravete, and M. C. Roebuck (2012), 'Sinking, Swimming, or Learning to Swim in Medicare Part D?', American Economic Review, 102 (6), pp. 2639–2673

[9] See Miravete, E. and I. Palacious-Huerta (2014), 'Consumer Inertia, Choice Dependence and Learning from Experience in a Repeated Decision Problem', Review of Economics and Statistics, 96(3), pp. 524-537

is a relatively high price. An apparently simple intervention in the spirit of (i) might be to require bills to show graphically the percentage of a consumption allowance that a consumer had used during the billing period.[10] By having a graphic, such as a coloured bar, a clear visual cue is given to consumers which would hopefully prove accessible to many consumers, including those with limited numeracy skills. The intention would be that a consumer could combine this information with their own knowledge of their individual circumstances to decide if any under/over-consumption was temporary, such that it could be ignored, or frequent/permanent, such that switching tariff would make sense. We recommend that if any intervention of this nature is contemplated, it is tested rigorously through controlled experiments, ideally field experiments. In such experiments outcomes that could indicate a successful intervention might be: (a) increased switching, (b) the consumption of individual consumers moving closer to their maximum allowance, and/or (c) the average per unit cost of consumption falling as a result of (b).

An alternative to prescribing the particular bits of information to be provided to consumers would be to ensure that consumers have the right to transfer their consumption history between suppliers and intermediaries. The suppliers and intermediaries could then potentially experiment with how best to utilise this information to boost engagement, perhaps through individual recommendations of particular tariffs. However, a potential downside of increased consumption data portability is that it could lead to increased price discrimination between customers. This possible downside is worsened by the fact that is unlikely that an individual consumer would know, before handing over their data, whether providing their consumption data would lead to an advantageous or disadvantageous offer. Indeed, if it becomes the norm that consumers provide their consumption history to suppliers/intermediaries, a consumer refusing to do so would reveal information that in itself might be used to price discriminate against them.

Question 6: What are your views on whether these (or other) particular contract terms and conditions, or industry practices, are a barrier to consumer engagement? What impact do you think this has on them and on competition in the various communications markets?

Both the issues of handset unlocking and 'packages' containing multiple contract end dates seem likely to be barriers to engagement. Looking at the retail energy market, Deller et al (2017a), Giulietti et al (2005)[11] and Waddams Price and Zhu (2016)[12] all find that an increase in the difficulty of switching or the time required to complete a switch led to a lower probability of considering searching/switching. However, Flores and Waddams Price (2013)[13] did not find a statistically significant relationship between time/ease of switching and the probability of searching and/or switching amongst well informed/confident consumers.

Having a bundle of telecoms services where each constituent part of the bundle has a different contract end date is likely to reduce engagement and switching due to: the increased time/cognitive

[10] Where a tariff consists of multiple allowances, e.g. for talk minutes, texts and data, a separate chart would be shown for each element. If a consumer consumed above an allowance, the graphic would show the extent of this 'over-consumption'

[11] See Giulietti, M., C. Waddams Price and M. Waterson (2005), 'Consumer Choice and Industrial Policy: a study of UK Energy Markets', The Economic Journal, 115(506), pp. 949–968

[12] See Waddams Price, C. and M. Zhu (2016), 'Empirical Evidence of Consumer Response in Regulated Markets', Journal of Competition Law and Economics, 12(1), pp. 113-149

[13] See Flores, M. and Waddams Price, C. (2013), 'Consumer Behaviour in the British Retail Electricity Market', CCP Working Paper 13-10, available at: http://competitionpolicy.ac.uk/documents/8158338/8235394/CCP+Working+Paper+13-10.pdf/2ee68805470a-4fea-b5f7-7678f52b9971

effort required to extricate oneself from a complex contractual situation, the financial cost of penalties resulting from early contract termination, and any behavioural biases that reinforce these time/effort/financial costs as barriers to action. Deller et al (2017a) demonstrate that, as one would expect, an exit fee reduces the probability of switching by a large amount.[14] A sensible piece of research for Ofcom to conduct would be to establish whether for consumers facing multiple contract end points there is any point in time when they can switch away from their bundle/package without incurring a financial penalty. Also, it would be useful to know if firms can provide any justification for multiple contract end dates; if firms struggle to provide a justification, it is suggestive of multiple end dates being deliberately used to confuse customers. In the absence of multiple incompatible legacy billing systems etc., it is difficult to think of a benefit to firms of having multiple contract end dates.

Question 7: What are your views on the suggested possible solutions to help address the impact on consumer engagement of particular contract terms and conditions, or industry practices? What could be their positive or negative effects? What other possible solutions might there be, and what might be their effects?

In the absence of technical differences between networks, the locking of handsets appears to have little justification. However, this does not necessarily mean that banning the locking of handsets would automatically result in a gain for all consumers. While the ending of locking would make it easier to switch at the end of a mobile contract, this increased ease of switching may be considered by mobile operators when pricing the initial contract which includes the cost of the phone. When pricing the initial contract a rational mobile operator should take into account the expected profits from a consumer remaining with the operator once the initial contract has ended. If the follow-on profits from a consumer are reduced, this may create an incentive for a mobile operator to increase the price of the initial contract (see response to Question 3).

Given the small percentage of bundle consumers (6%) reporting multiple contract end dates, further research on the extent of this issue seems essential before any intervention is considered, to establish whether the benefits of intervention would exceed the costs. This research may also try to tease out whether the issue is with true bundles, i.e. when a range of services are offered for a single total price, or with discount packages where individual services are priced separately and offered as individual standalone products but then additionally the operator offers a 'discount bonus' for purchasing multiple products/services. For true bundles there appears little justification for different contract end dates for different elements of the bundle. If the bundle is being sold as a single combined product, the contract terms should be written to reflect the fact that the bundle is a single (albeit multifaceted) product.

With the case of 'discount bonuses' it is less clear how consumers and firms think of the resulting 'packages', and whether or not different contract end dates offer a degree of flexibility which is useful for some consumers. If, after the receipt of a package discount, consumers continue to think of each package element as a separate product they may like the fact that, for example, they can change their broadband supplier after one year without automatically having to switch mobile phone supplier as well.

Question 8: Are there other barriers to engagement that you think our work should seek to address? What impact do you think these have on consumers and on competition in the various

[14] The size of this reduction in the likelihood of switching may suggest that exit fees have a behavioural effect over and above their financial value in terms of reducing the financial gain from switching.

communications markets? What possible solutions might there be to these barriers, and what might be their effects?

N/A

Question 9: What are your views on the need to trial or test potential solutions? To what extent might you be willing and able to participate in or facilitate field trials or other testing of possible solutions?

In general the trial and testing of potential solutions is an essential element of effective policy design. CCP/UEA has a wide range of skills and experience regarding the assessment of interventions[15] and the conducting of experiments. CCP has strong links to the Centre for Behavioural and Experimental Social Science (CBESS) at UEA and the Network for Integrated Behavioural Science (NIBS).

While generally encouraging the testing and trialling of potential interventions, in particular, through the use of Randomised Controlled Trials, it is worth noting that testing market interventions is likely to be more challenging than some of the examples of success reported by The Behavioural Insights Team in relation to government departments. In experiments involving a government department or an individual company, there is a single actor both designing the experiment and responsible for all engagement with users/consumers. In contrast, Ofcom, the body seeking to run trials/experiments, is reliant on firms' co-operation to access consumers. Furthermore, as noted in Deller et al (2016b)[16], the incentives of Ofcom and firms (especially large incumbents), do not appear to be aligned: Ofcom wants to find out how to increase engagement/switching, while incumbents' profit motive probably involves minimising switching. This at least raises the potential for firms to frustrate or delay experiments in ways that may be difficult to prove as being deliberate obstruction. Indeed, trials run in conjunction with firms that 'volunteer' may not be representative of the consumer behaviour as a whole if particular firms only deal with particular types of consumers.

Also, there is the need to monitor the effectiveness of an intervention after it has been fully implemented, i.e. to test whether the experimental results are matched by large scale reality. Here again a regulator faces additional challenges over an individual firm/government department. While an intervention, holding everything else equal, may prove to be effective in a trial, a market is a process and the roll out of an intervention at full-scale may lead to changes in the behaviour of market actors, especially firms. For example, while an intervention itself might be effective, firms might choose to take other actions which offset the effectiveness of the intervention.

[15] For example, see Fletcher, A. (2016), 'The Role of Demand-Side Remedies in Driving Effective Competition', a review for Which?, available at: http://www.staticwhich.co.uk/documents/pdf/the-role-of-demand-side-remedies-in-driving-effective-competition-456067.pdf

[16] See pg11-12 of Deller, D., M. Hviid and C. Waddams (2016), consultation response to the Competition and Markets Authority, 'Energy market investigation – Provisional decision on remedies', available at: http://competitionpolicy.ac.uk/documents/8158338/11690925/CCP+Response+to+CMA+Energy+Market+Provisional+Remedies+Decision_April+2016.pdf/41c9a129-1b58-4558-8aea-169fc163f196