

Complexity and Smart Nudges with Inattentive Consumers

BACKGROUND

- In a number of service markets where choice is possible, it has been observed that many consumers do not switch service providers even though the tariffs they are holding are suboptimal. Moreover, when choice is exercised, chosen tariffs are not always optimal.
- The service markets at issue include: bank accounts, mobile telephony, internet services, consumer gas and electricity services, fixed telephony and multichannel TV services.

METHODOLOGY

- The authors draw on stylised features of UK gas and electricity retail markets to explore the psychological motivations to consumer behaviour.
- Through a series of experiments the authors seek to identify *whether* consumers are likely to stick to default options and achieve suboptimal outcomes, *why* they do this, and *what* can be done about it.
- Participants in the experiments took the role of consumers deciding upon tariffs, where a financial loss was incurred in the event that the best tariff was not chosen.
- The authors focus on the role of complexity and the part played by inattention in behaviour.
- Three forms of complexity are considered:
 - the complexity arising from bundling two goods together, as in dual-fuel tariffs;
 - complexity in the structure of tariffs; and
 - complexity in the number of tariffs.

KEY FINDINGS

- Poor outcomes are realised by a significant proportion of people, either because of sticking to the default option or because of switching to a bad option.
- The complexity of the choice problem is found to matter. In particular, a reduction in the number of tariffs from 24 to 4 is found to improve consumer outcomes.
- However, the role of complexity in poor outcomes is overstated if the explanatory power of inattention is neglected: subjects who do not pay enough attention to the task in the first place tend to stick to the default option.
- By using 'smart nudges' and making the default option work for (instead of against) consumer welfare, optimal outcomes can be obtained approximately 85% of the time.

POLICY ISSUES

- Simplification of the choice problem may help with the problem posed by complexity but does not help with the problem posed by consumer inattention.
- A generic warning that a better energy tariff exists in the market does not help consumer choice. However, more research is needed on more tailored warnings.
- A 'smart nudge' solution can be used to exploit consumer inertia grounded in inattention: when consumers are automatically switched to the best default energy tariff, better consumer outcomes can be achieved while leaving consumers free to choose an alternative tariff if they so wish.

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November 2012

Policy Brief 12-13

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