

Gain or Pain: Does Consumer Activity Reflect Utility Maximisation?

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BACKGROUND

- Since the mid-1990s, liberalisation of energy and financial markets across Europe and in many other countries has opened up opportunities for consumers to switch supplier with a view to obtaining better deals. Yet levels of switching activity have varied substantially across markets. The effects of this variable activity are twofold: not only are many consumers potentially missing out on deals which are advantageous to them, but, with a relatively stable customer base, suppliers have less of an incentive to compete. In other words, the anticipated benefits of liberalisation are not being fully realised.
- In response to the evidence, several Competition Authorities have introduced a variety of 'informational remedies' with the objective of making it easier for consumers to compare alternative deals and select the one which best suits their needs. The assumption underpinning such remedies is that consumers who are provided with more information and with simpler, less time-consuming switching procedures will react by becoming more active. At issue is whether this is the case.

METHODOLOGY

- The authors examine the determinants of consumer activity in eight markets: electricity, mobile phone services, fixed phone line rental, national and overseas calls, broadband internet service provision, car insurance, mortgage, and current bank account.
- A specially commissioned dataset was used to estimate the gains, search and switching time which consumers anticipate.

KEY FINDINGS

- Consumers' decisions to become active in a market can be partially explained by higher expected gains and lower anticipated costs in switching supplier.
- However, the influence of a consumer's expected gains and costs provide only a small part of the explanation for the possibility that they will be active in a market. The *confidence* with which consumers predict their likely gains and costs seem to be much more influential in determining whether or not they will switch.
- The experience of switching supplier in other markets increases the likelihood of search and switching activity.

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- An interpretation of the importance of the experience of activity in other markets is that it increases the confidence which consumers place in their estimates of the time needed and the likely gain.
- The probability of switching varies substantially between markets: consumers are more likely to be active in the car insurance market than in electricity and mobile phone services; and less likely to search and switch for fixed line products, broadband, mortgages and current bank accounts.
- Other positive influences on switching include knowledge about which markets are competitive and the level of educational attainment. These influences point to the importance of a good general education about consumer matters and opportunities.
- There is weak evidence that consumers may be more deterred by switching than by search costs.

POLICY ISSUES

- To encourage activity in any one market, Competition Authorities need to provide consumers with good information, in which consumers have confidence about the likely costs and benefits. The benefits extend to other markets as consumers build confidence through experience.
- The importance of consumer confidence, the role of other factors, and the differences between markets indicate the need for Competition Authorities to tailor action carefully to each situation.

THE CCP

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ABOUT THE AUTHORS

- **Dr Yoonhee Tina Chang** is a Lecturer in the School of Management at the University of Bath. Her research interests include industrial economics, competition and regulation of financial institutions, networked industries and intermediaries, and consumer policy.
- **Professor Catherine Waddams** is Director of the Centre for Competition Policy. She has published widely on privatisation, regulation and the introduction of competition, especially in energy markets, in the UK and elsewhere.