



# Competition and Markets Authority: Retail Banking Market Investigation - Statement of Issues

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## Consultation response from the ESRC Centre for Competition Policy

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

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Contributing authors:

- Dr Minyan Zhu
- Prof Catherine Waddams

This response has been drafted by Dr Minyan Zhu following discussions held in the Centre and it has the broad agreement of both contributors.

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## Consultation Response

Our response draws on research at the Centre for Competition Policy on consumer search and switching, and is particularly relevant to:

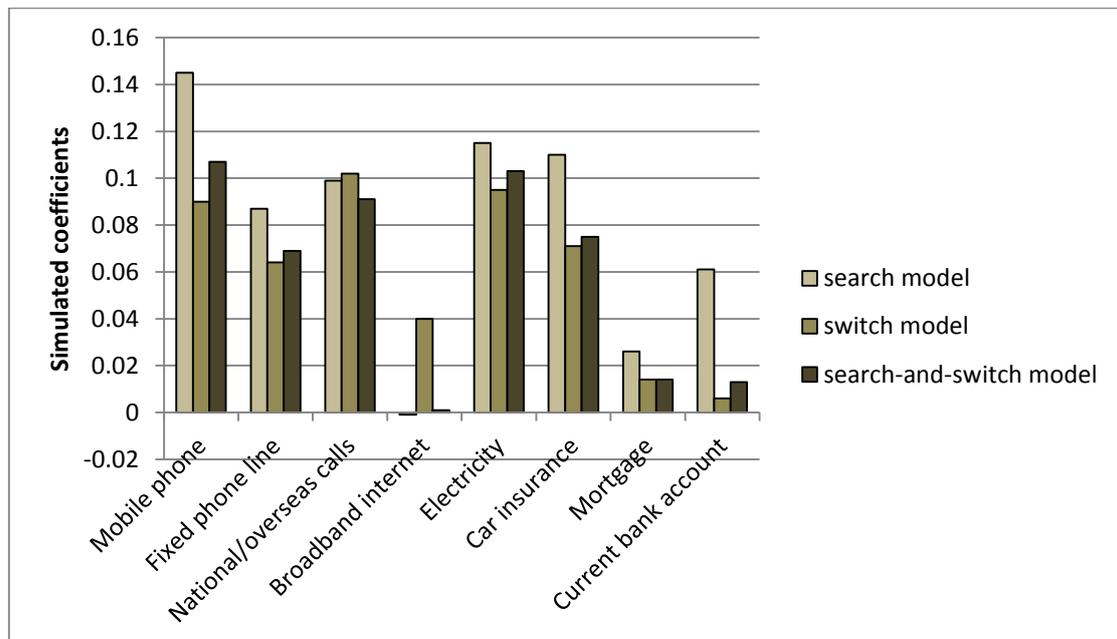
Theory of harm 1: Impediments to customers’ ability to effectively shop around, choose and switch products or suppliers, resulting in weak incentives for banks to compete for customers on the basis of price, quality and/or innovation.

Hypothesis 1c (Act): Costs and risks of switching and the absence of prompts due to the evergreen<sup>24</sup> nature of banking products, act as a disincentive for consumers to shop around and switch.

It is well known that switching rates are particularly low in the PCA market compared to other service markets such as mobile phones and energy. As a result comparative analysis across markets may help to understand if this market bears any special features that explain its particularly weak consumer response. Waddams Price and Zhu (2013) provides empirical evidence in this respect. Rather than concentrate on average consumer response, this research focuses on the differences between 8 service markets in how expected gains from changing supplier and the time required for searching and switching affect consumers’ decisions (probability of searching/switching/searching and switching).

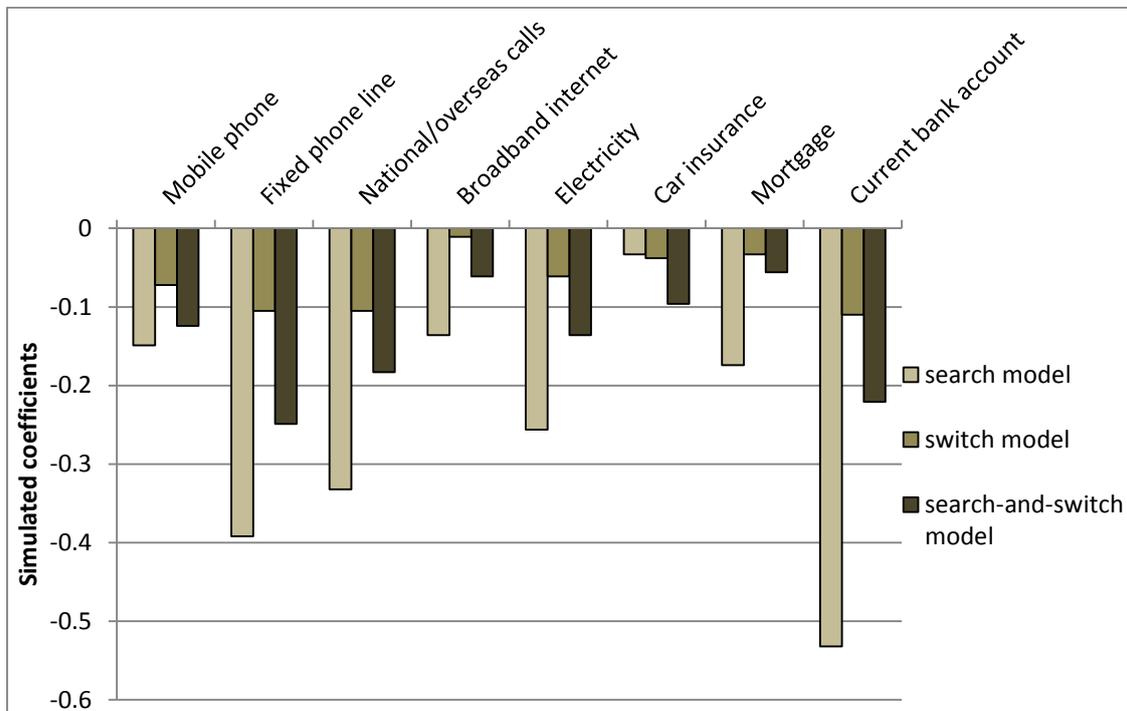
Considerable differences in the simulated coefficients<sup>1</sup> averaged across markets are observed. These are described in the following figures. An additional pound of expected gain is less likely to stimulate searching for an alternative provider in current accounts (and broadband and mortgages) than in the other markets. Similarly expected switching time seems to provide more of a deterrent to searching and switching in current accounts (and fixed line phone provision), and is less off-putting for mobile phones, broadband, car insurance and mortgages.

**Figure 1 The effect on the probability of searching and switching activity associated with an additional gain of £1 per month in different markets**



<sup>1</sup> Please note that simulated coefficients are not the same as marginal effects.

**Figure 2 The effect on the probability of searching and switching activity associated with an additional hour required to switch in different markets**



An interesting question arising from these results is why perceived monetary gain does not have as large an effect on consumers' search and switch decisions (note that we control for various relevant factors including demographic differences and random heterogeneity across individual consumers) in the current account market as it does in other markets. While ambiguity or complexity related to current account product and pricing structures may be a contributing factor as mentioned in Hypothesis 1b in the statement of issues, it may also be possible that unlike other service markets, the focus of competition in this market segment is predominantly based on quality rather than price. This interpretation is supported by the OFT's 2008 market study, suggesting that the four 'established banks' compete predominantly on quality rather than on all price dimensions. The OFT found there were no major differences between the four established banks and the challengers in the quality of their accounts (measured by customer satisfaction), suggesting that competition has raised the general level of quality.

Other than quality, it is well known that location and reputation are important factors when consumers choose banks. In this respect, retail banking is special because both customers and banks invest in building the relationship. Branch networks and low switching rates could be reflecting this relationship investment from both sides. This may also explain why bank consumers have a relatively lower propensity to switch compared to other regulated services markets.

These findings suggest that factors related to the nature of the market and competition such as quality, location and reputation may be as important as the factors mentioned in the statement of issues including lack of information, product and pricing structure and consumers' cognitive limitations. However our findings are based on analysis of a group of consumers who are more active than average, and were able to give us estimates of their expected gains from switching and switching

times. The challenges of information, structure and cognitive limitations are likely to be far more important for respondents from a representative sample of the population who were unable to provide all the information required for the analysis. Additional information is needed about the barriers which this 'hard to reach' group may be facing for assessment of the market as a whole.

**References:**

OFT (2008). Personal current accounts in the UK: an OFT market study, OFT

Waddams Price, C. and M. Zhu (2013). Searching and Switching: Empirical estimates of consumer behaviour in regulated markets, CCP working paper 13-11, available at: <http://competitionpolicy.ac.uk/publications/working-papers-2013>