



Welcome to the launch of *Behavioural Economics in Competition and Consumer Policy*

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ESRC Centre for Competition Policy



Who are we?

- ✦ A group of academic researchers from the ESRC Centre for Competition Policy
 - ✦ An independent ESRC funded research centre focusing on competition policy and regulation
 - ✦ Covering multiple disciplines
 - ✦ Covering multiple approaches to studying consumer, firm and regulator behaviour
 - ✦ Covering views from sceptics to enthusiasts





Who is the book for?

- ✦ Policy makers and practitioners wondering whether and to what extent behavioural biases are relevant factors in specific cases
 - ✦ We hope the book finds a place on your shelf
- ✦ And a little request from us:
 - ✦ If and when the book is useful and if you have a moment, please tell us about it.



Why did we do it?

- ✦ Behavioural economics has been the flavour of the last few years
 - ✦ Regulators and competition authorities have (almost) all produced discussion papers
 - ✦ One of the first, for OFT, produced by CCP
 - ✦ There is considerable policy enthusiasm, especially post “Nudge”
 - ✦ More scope for intervention?
 - ✦ We see a need for an independent, research based voice in the debate
 - ✦ CCP has a long-established and wide ranging knowledge and research interest in the area

Why was CCP so well placed to deliver this?



- ✦ Mix of long traditions of research in:
 - ✦ Behavioural economics to understand the robustness of consumer (and firm) behaviour
 - ✦ Industrial Organisation to understand implications for competition
 - ✦ Regulation for implementation difficulties
 - ✦ Competition law to understand the constraints on using BE
 - ✦ Political science to understand how this can all too easily be manipulated

And now...



- ✦ Three short presentations, followed by an opportunity to raise questions and issues
 - ✦ *We can then continue the conversation informally over drinks*

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**Behavioural economics,
market competition &
competition policy enforcement**

Bruce Lyons

UEA University of
East Anglia

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Outline

- ✦ What is behavioural economics (BE)?
- ✦ What are the implications for market competition?
- ✦ What are the implications for competition policy enforcement?









Why is BE different to standard economics?

- ✦ 'Rational' economic man/woman
 - ✦ Ability to make choices to maximise utility
 - ✦ Coherent preferences
 - *underpins why we think competition is beneficial*
- ✦ 'Behavioural' man/woman
 - ✦ Does not make optimal choices
 - ✦ May appear not to have coherent preferences
- ✦ BE is more than random noise
 - ✦ Systematic biases in decision making by 'behavioural' man/woman
 - ✦ Individuals may be 'rational' in one situation and 'behavioural' in another





What are the systematic differences identified by BE?



- ✦ Cognitive limitations
 - ✦ Use simple heuristics to make decisions
- ✦ Bias in appraising risk
 - ✦ Greater weight on very low probability events and certainties
- ✦ Non-standard preferences
 - ✦ Time, status quo, other people, fairness
- ✦ Unstable or incoherent preferences
 - ✦ E.g. Exercise, cream cakes

What is the evidence underpinning BE?



- ✦ Casual empiricism that people make 'bad choices'
 - ✦ Is *not* evidence of BE – could be random
- ✦ Experimental evidence
 - ✦ No simple alternative to rational behaviour has emerged
 - ✦ Some regularities do emerge
- ✦ Econometric evidence of actual behaviour remains rare

Who acts 'behaviourally' and when?

- ✦ Firms subject to competition enforcement/inquiries?
 - ✦ Expertise, experience, incentive, teams, evolution
 - ✦ But delegation, easy life, 'group think'?
 - ✦ Best enforcement assumption remains rational profit maximisation
- ✦ Some consumers are 'behavioural' in some situations
 - ✦ But others are 'rational', so what is the likely market outcome?
 - ✦ Identifying balance is a challenge for regulators
- ✦ Do SMEs act as behavioural customers/consumers?
 - ✦ Time constraints, other priorities
- ✦ And what about the regulators??

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Firms *can* exploit behavioural traits in consumers



- ✦ Too little (or too much) information to make rational choice (or to process)
 - ✦ Drip pricing, hidden terms,...
- ✦ Information framed to bias response
 - ✦ 'Half price', 'bogof's, 'buy now before sale ends',...
- ✦ Exploitation of *status quo* bias
 - ✦ Low switching despite economic incentives, 'devil you know',...
- ✦ Apparently irrational choices are made by consumers
 - ✦ At least according to what the regulator thinks!
 - ✦ Smoking, cream cakes, sugary drinks, payday loans,...

Do firms exploit behavioural traits?



- ✦ **Hinder consumers** from making decisions according to their own true preferences
 - ✦ Make switching difficult, inappropriate information provision,...
 - ✦ Deliberately or incidentally
- ✦ Such practices also **distort competition**
 - ✦ Reduce incentive to cut price
 - ✦ *Note:* no evidence that obfuscation is due to competition
 - ✦ Miravete (2013): introduction of competition in mobile phones in US did not significantly raise the number of dominated tariffs
- ✦ **But** intervention is not always necessary...
 - ✦ Markets can still work well if sufficient rational consumers
 - ✦ Incentives for firms to deviate from obfuscation
 - ✦ Behavioural consumers may prefer suppliers with well presented information




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If an adverse effect is found... what remedies *may* be appropriate?

Anything that helps consumers fulfil their preferences...

- ✦ Improve presentation of relevant information
- ✦ Make switching easier
- ✦ Restrictions on marketing complementary products
 - ✦ e.g. point-of-sale insurance, PPI, extended warranties
- ✦ Changing default
 - ✦ Opt-in/out pension, annual contracts with renewal dates

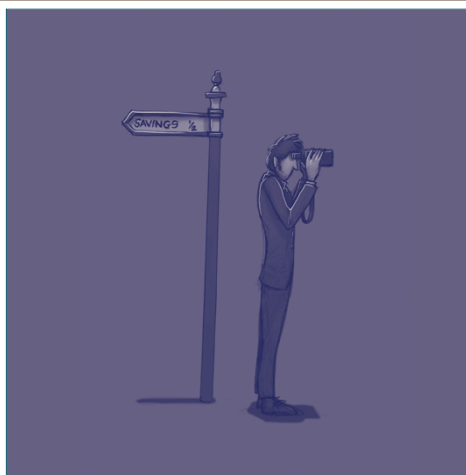




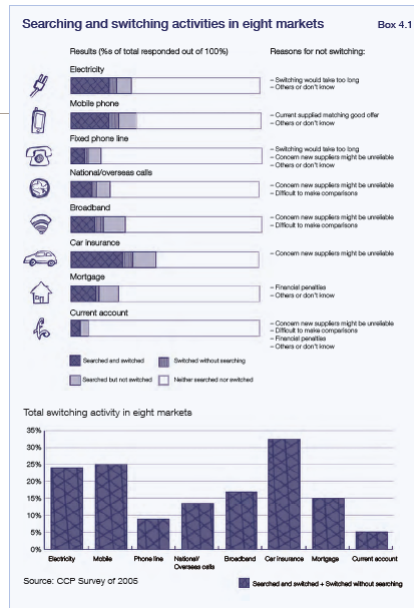
But two important pitfalls for remedies 'justified' by BE



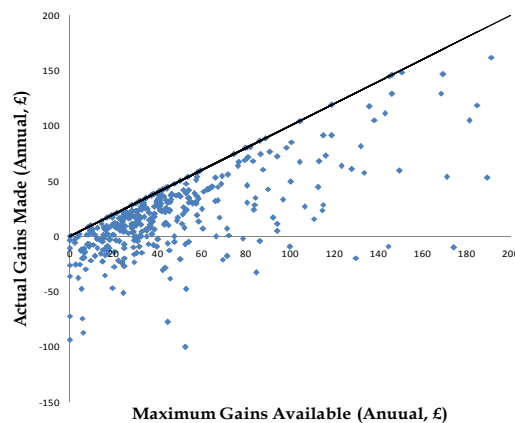
- ✦ Remedies that do more harm than good
 - ✦ Less danger in information provision or reduced switching costs
 - ✦ Minor costs on firms and big potential upside
 - ✦ But beware remedies that ignore consequences for competition
 - ✦ Some (possibly all) consumers may be harmed by remedy
 - ✦ E.g. putting all customers on 'best available tariff' may eliminate those 'best' tariffs for all customers
 - ✦ E.g. point of sale restrictions may leave some uninsured
- ✦ Substituting 'apparently incoherent' preference with those of unelected regulators
 - ✦ Libertarian paternalism (e.g. 'Nudging') – not for a competition authority?



Switching (and reasons) vary across markets: error or preference?



Even consumers trying to save money sometimes spend more



Consumers differ in what affects them



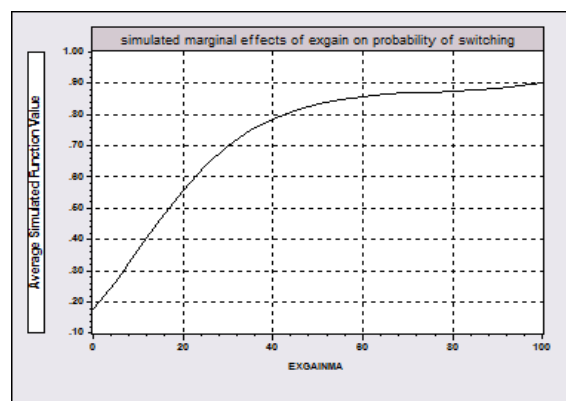
But those with different attitudes respond differently
internet availability important for the most and least active groups, but not for those with little time to search

But this group's behaviour is affected by confidence in estimates of time required and gains available

Among the less than half who could estimate time required and gain, differences in the expected time and difficulty of switching did not affect activity

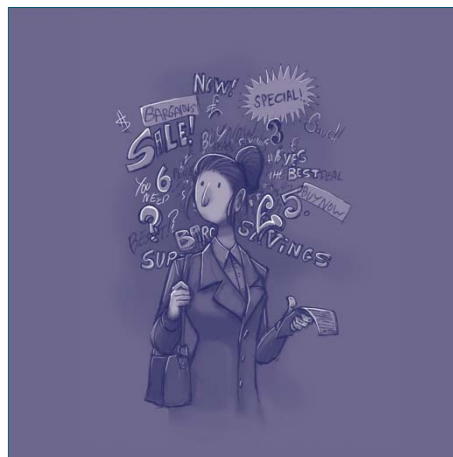
But average behaviour 'rational' in that.....

Switching is more likely with higher gains



Policy implications

- ✦ Policies to make search and switching easier may have disappointing effects
- ✦ Different policies will stimulate activity amongst different types/groups/ expectations
- ✦ Changes which reduce potential gains will reduce consumer searching and switching



Modelling naïve consumers

Amelia Fletcher

Is it worth modelling naïve consumers with behavioural biases?

- ✦ **View 1:** Behaviour of consumers (and firms?) cannot be simplified as mathematical models. Thus:
 - ✦ theoretical economics needs a greater historical/intuitive focus – less maths!
 - ✦ empirical economics (*ex ante* trials, *ex post* evaluation) becomes far more important
- ✦ **View 2:** We see directionally consistent biases which can be readily incorporated into models to gain new intuitions.
- ✦ Both views have their merits. Three key categories of model incorporating biases have emerged so far.

Incorporating biases into models 1: Search and switching costs



- ✦ If search and switching costs are driven by biases then firms may engage in strategic over-complexity:
 - ✦ Eg Ofgem concerns around 'confusopoly' in energy
 - ✦ Eg Ofcom action to ban 'rollover' contracts
- ✦ If search and switching costs can be reduced through new business models, firms may wish to hamper this
 - ✦ Eg Firms refusing to sell through PCWs or through Internet
- ✦ Behavioural biases can help explain 'shrouding' of secondary product prices and POS advantage
 - ✦ Eg OFT action against extended warranties

Incorporating biases into models 2: Asymmetric information



- ✦ Representativeness bias can lead firms to compete hard on what can be seen while offering poor VfM for what can't
 - ✦ Eg OFT action against unauthorised overdraft charges
- ✦ Overconfident consumers, who underestimate the likelihood of a product going wrong, can undermine role of cancellation rights in driving up quality
 - ✦ The legal provision of minimum cancellation rights may thus be welfare-enhancing

Incorporating biases into models 3: Demand mis-estimation



- ✦ Anchoring can result in consumers placing heavy weight in reference prices
 - ✦ Eg OFT action against (ab)use of reference pricing by furniture and carpet retailers
 - ✦ Does this mean the replica football shirts of rival teams constrain each others' prices?
- ✦ Combined with loss aversion, anchoring can be exploited by firms to reduce competition
 - ✦ Eg OFT action against drip pricing by airlines of payment surcharges
- ✦ Over-confidence and/or hyperbolic discounting can lead to underestimate of likely cost of debt
 - ✦ Eg FCA proposed regulations for payday loans

Conclusions



- ✦ *Ex ante* trials and *ex post* evaluations are crucial if we are to get (especially demand-side) interventions right.
 - ✦ Even if we know the direction of behavioural biases, we don't typically know their magnitude
 - ✦ And we don't always even know their direction
- ✦ But there is also merit to developing new intuitions by incorporating biases into mathematical models....
- ✦ ... and also considering the policy implications

Thank you...any questions?

