Protecting consumers from themselves

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In many markets, competition for consumers that are actively involved is effective, but the market is not working well for those who do not engage by shopping around regularly. The markets in question can include those for telecommunications services such as fixed and mobile voice and broadband, but also include those for home insurance, breakdown insurance, banking and domestic energy. These services are typically offered with subscriptions for a period of time (such as 1 or 2 years), with some form of service continuity at the end of this period, at which point, the tariff can be significantly worse value than the initial offer. Indeed, in insurance markets, the 'roll-over' is often at an elevated premium, and thus the prices paid are actually increasing over time. In effect, there is no loyalty bonus; instead, loyal customers are often being gouged. A related worry is that many of the customers that are not actively involved in the market may be from vulnerable groups.

When markets are working in this way (that is, competing for customers who will remain loyal), it can be economically rational for all operators to mirror such behaviour and provide low teaser offers followed by worse value later. In this sense it can be a 'race to the bottom'. Of course, service providers may choose not to indulge in this behaviour, and some do (for example, a British bank has stated that they offer the same rates to existing customers as they offer to new customers). However, fundamentally, the problem is 'us'. Although some customers choose ethical providers, not enough of us respond to this kind of behaviour by favouring the better-behaved service providers and rejecting the offers of those involved in this kind of pricing. Apparently, (and this is not news), we favour low prices today over low prices tomorrow.[1] So, should regulators step in to save us from ourselves? The British consumer body (Citizens Advice) has just launched a so-called super complaint in this area, which means that the British competition agency (CMA) needs to investigate.[2]

Sector regulators already take many actions to improve the level of transparency in the market, to enable shopping around (for example, Ofcom's accreditation scheme for price comparison sites) and to reduce the barriers to switching providers (for example, enabling number portability). However, they are increasingly doing more. Several recent cases in the UK illustrate some of the approaches that are being taken or being considered in this area.

- Ofcom has used its ex-ante powers to reregulate prices for BT voice line rental for single play customers (many of whom had never switched from the former monopoly supplier).
- Ofcom is also consulting regarding how contract mobile customers should be charged at the end of a contract once the handset subsidy has been paid off. One of the options is to move to a SIM-only deal at the end of the handset subsidy period.
- In the domestic energy market, the regulator Ofgem has imposed a retail price cap protecting those on the so-called standard variable tariff.

1 This is one of the biases that 'nudge theory' seeks to address.

2 https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/excessive-prices-for-disengaged-consumers-a-super-complaint-to-the-competition-and-markets-authority/

- The Financial Conduct Authority is considering imposing a minimum interest rate for instant-access savings accounts.
- There have been trials of collective switching schemes for domestic energy to improve switching behaviour and encourage engagement with the market.

These approaches suit different situations, use completely different powers, directly affect different parts of the market and are likely to have different outcomes. If badly implemented, some could even make the situation worse. For example, direct retail price controls can risk making competition less effective by reducing the incentive to switch provider.

A very interesting blog on this topic and the related subject of price discrimination has been published by Citizens Advice.[3] The author of the blog favours strong enforcement and a principles-based approach to the pricing issue (rather than applying detailed rules which may be gamed by operators). However, it is not clear what these principles should be, and how we can justify applying rules on pricing in some specific retail markets and not others. Why should these rules apply to (say) mobile telephony and not to (say) breakdown insurance? As an initial thought, we suggest that there are economic ideas about 'fairness' in pricing which might be applicable, such as the 'principle of dual entitlement'. However, to avoid unwanted side-effects, it is likely that some limit to the scope of such constraints would be needed (for example, this 'fairness' test should perhaps only apply to the pricing of automatic roll-overs to subscription services).

If you are interested in this area and would like to know more, please contact James Allen, Head of Regulation.

[3] https://wearecitizensadvice.org.uk/markets-dont-work-like-they-used-to-and-people-are-starting-to-notice-af00ed38014d