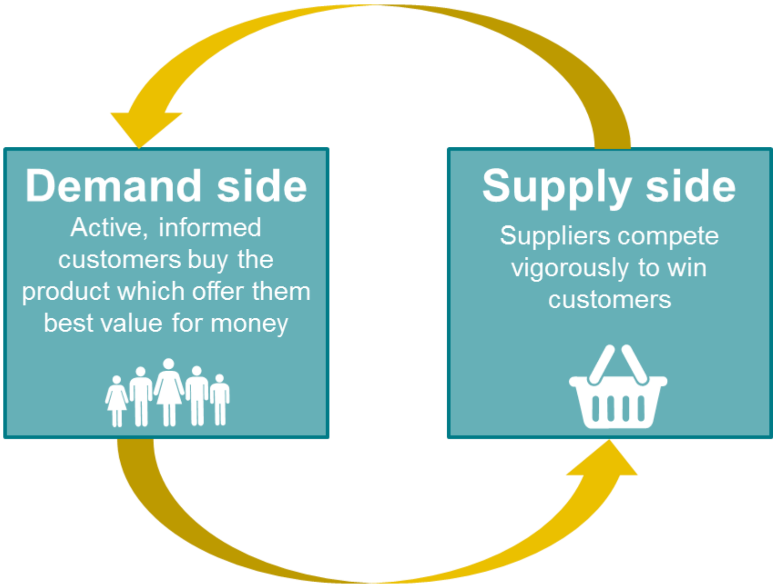
Briefing

Alternative Medicine

THE WHAT, WHY AND HOW OF "DEMAND-SIDE REMEDIES"

Intervening on the supply side isn't always the best way to solve competition problems, and so regulators have increasingly tried to find ways of dealing with market imperfections on the demand side. Hence the flurry of requests to make prices more transparent, provide comparative information or nudge customers to shop around. But these interventions aren't easy to design or enforce, and success has been patchy. So at a Frontier discussion event on 8th February, Professor Amelia Fletcher of the Centre for Competition Policy, James Edgar, Strategic Policy Adviser to Which?, and Frontier's own Phil Graves, applied their understanding of consumer behaviour to the challenge of making such "remedies" work.

The event began with a reminder of the interaction between supply and demand side difficulties. This shows the principles which regulators generally try to follow in designing remedies: on the supply side, ensuring there are enough suppliers who can compete freely with each other; and on the demand side, ensuring consumers are active and engaged enough to secure the best value for money.



Professor Fletcher explained that, to begin with, regulators relied heavily on information to deliver better results - a natural response, when in so many markets they were worried that consumers were clearly poorly informed about both the price and quality of what they were buying. This was particularly true of long-term contracts for financial services or utilities. But by 2008, the limits of this approach were becoming obvious, with consumers suffering from (or, more usually, ignoring) an overload of information. Another problem was compliance, with information being delivered too late, in the wrong form, or not at all.

BE AWARE

However, behavioural economics (BE) was at this point beginning to come to the regulators' aid, helping them to understand the ingrained biases that affect consumer behaviour far more potently than volumes of small print. A bias towards the status quo, loss aversion, susceptibility to framing, myopia and saliency bias are all examples of influences well-identified by BE. These concepts help to explain consumers' reluctance to pursue what regulators might suppose to be their best interests, and by doing so to increase competition. They also help to explain why a number of the remedies imposed simply hadn't worked.

James Edgar took an example from Professor Fletcher's review: the regulators' approach to the vexed competition issue posed by the sale of extended warranties for domestic electrical goods. The first attempt to encourage purchasers to shop around for warranties, rather than buy at point of sale, relied on detailed information requirements which weren't fulfilled by suppliers (or used by customers); a second attempt, relying on an industry-wide price comparison website (PCWs), was smarter, but failed because not enough independent suppliers of the product signed up and so there is not much to compare (check it out at www.compareextendedwarranties.co.uk).

Last year was a boon year for demand-side remedies, with the Competition and Markets Authority (CMA) both reaching for demand-side remedies in the retail banking and energy market investigations. In the past, the CMA may have tried to design these remedies itself. But in 2016 the momentum was behind testing and trialling "what works" rather than relying on "what ought to work".

Phil Graves argued that this shift needs to go a lot further, drawing on BE not only to explain why some approaches didn't work, but in designing ones that do. And this means going well beyond the "triple A" approach, which relies on the presumption that consumers do want to "access, assess and act", to the realisation that actually, for most of the time, they don't want to do any of these things very much at all.

James Edgar identified this as the problem of the "disengaged customer". Or, as Phil Graves put it, regulation is usually focused on facets of life that are profoundly dull. In psychological terms, the level of reward that can be derived from the cognitive effort required to choose an energy supplier or bank seems marginal (particularly in the short term) relative to other aspects of life (like falling in love or eating a Kit Kat). So the unconscious mind is likely to pull people elsewhere. BE has enhanced our understanding of how we ration cognitive effort, and resort to all kinds of short cuts to avoid making it. In short, regulators need to think harder about encouraging people and saving them trouble than supplying them with all the information they need to sit an exam.

In his presentation, Phil Graves gave examples of how similar questions are approached outside the regulatory arena: in thinking how to get people to take liquids out of their hand luggage, how to increase viewing of new TV programmes, or how to develop a strategy for selling a brand of smoothie. This last example provided a simple, but particularly relevant message: while the content information may be a necessary hygiene factor, it's the visual associations that sell the product.

Similarly, in requiring suppliers to provide information that helps consumers "assess" financial services offerings, how the information is provided may be critically important. Quite small changes (colour, positioning, etc.) may have big effects on the way information is absorbed and used by consumers.

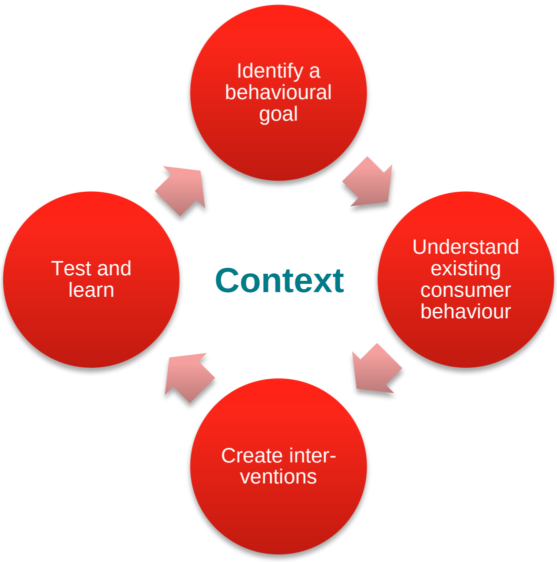
For both retailers and regulators, all three speakers were agreed on the importance of trialling, testing - and tweaking. Just as retailers can become over-reliant on instinct, regulators can lean too much on logic and reason: both types of organisation need constantly to test their assumptions about what works in practice.

LEARNING BY DOING

So what were the key lessons put forward by our speakers? Professor Fletcher concluded that rules on disclosure had to be fairly prescriptive, to ensure comparability; but that sometimes less is more, since overload reduces effectiveness. Monitoring is important, to ensure compliance, and check what works in a changing market place. Comparison websites are useful, but only for people who use them; mobile apps increase their coverage.

Consumer awareness of information is crucial, as is timeliness; and techniques that keep the information in the public (media) eye may be more effective than one-off awareness campaigns. The question as to who hosts the PCW is important: commercial PCWs may need to be regulated, while consumers may be happier to supply the information needed for personalised comparisons to an independent PCW. And above all, perhaps, regulators need to focus on reducing the consumer hassle and cost of changing supplier if they really want to increase competition by stimulating switching.

James Edgar focused similarly on the power of the PCW, but with a warning that regulators need to avoid being drawn too deep into the design of remedies, and should focus on outcomes rather than process. And Phil Graves stressed the importance of working your way round the full cycle from existing behaviour to desired outcome, testing interventions along the way: the figure below illustrates the dynamics.



ANY QUESTIONS

The audience brought different perspectives from regulators, lawyers and those charged with implementing some of the remedies in the banking and energy sectors, and the discussion explored some different themes.

A question was raised about whether part of the problem of engagement is a lack of coordination. Consumers are bombarded with prompts from regulators, and government more generally, telling them to do different things or shop around. But most people only have the time and cognitive resource to consider a few each year (in between more fun and interesting problems like choosing a holiday or which TV streaming service to subscribe to). There may be a role for prioritisation of messages across sectors and more focal points throughout the year to build engagement.

Professor Fletcher described demand-side remedies as being delivered either by regulators themselves, or by imposing requirements on firms. But a third category was identified from those involved in the retail banking investigation. The CMA's 'open banking' remedy aims to increase consumer engagement, but to do so by catalysing the supply-side – in this case, by requiring banks to build functionality that will enable new tools, products and services that will likely be built by 'fintech' entrants to the market. This type of remedy has the potential to harness both sides of the market, and could perhaps avoid some of the problems with the pure demand-side remedies of the past. We shall see how this works as these tools emerge in the next 18 months.

Finally, Professor Fletcher's review highlighted that evaluation of these remedies is helpful. But these exercises take time (three years later in the case of warranties). The message from the speakers was that this process needs to be more agile, creative and flexible – with testing, trialling and iterating remedies repeatedly until the desired goal is reached. This may require different regulatory processes from what we have today.

TESTING TIMES AHEAD

In emphasising creativity and flexibility, the event also raised the question of where regulatory requirements should end and commercial ingenuity be allowed to begin. The idea of a framework, with specified outcomes, within which providers could experiment, therefore came to the surface throughout the seminar, but with an understanding of the difficulty of ensuring regulatory consistency and provider compliance at the same time.

Even with that note of caution, however, these three presentations and discussion showed how far the science (or art) of demand-side remedies had begun to move on. The world where consumers were assumed to read terms and conditions, and information asymmetries were assumed to be solved by checklists and appendices, is, it seems, giving way to a new reality in the regulatory world as well as the commercial one - a world better informed by BE and beyond.

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