

Joining up Competition and Consumer Policy

The OFT's approach to building an integrated agency

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1 EXECUTIVE SUMMARY

- 1.1 This paper sets out the OFT's approach to the integration of competition and consumer interventions.
- 1.2 Traditionally, competition and consumer policy have each been attributed distinct objectives and features, and they have generally been treated as separate disciplines. We believe that this traditional separation is damaging to both sets of objectives. Competition and consumer policy are interdependent. Good consumer outcomes rely on competitive markets to provide choice and value, while vibrant competition relies on consumers confidently shopping around. Competition and consumer policy together provide a framework for markets to deliver maximum benefits for consumer welfare and productivity growth.
- 1.3 The connections between consumer and competition interventions mean that there are advantages to aligning them in policy and practice. For example, in consumer enforcement the costs of lost competition from interventions can be thought through in advance, and competition decision-making can be based on a richer understanding of consumer detriment and customer interactions with firms.
- 1.4 The OFT has been a combined agency since the 1970s, handling both competition and consumer problems and with powers to enforce both kinds of law. There is more to integration, however, than competition and consumer enforcement being alongside each other in the same institution. Three and a half years ago we embarked on a programme of full and positive integration. A new organisational structure has brought our competition and consumer enforcement departments together within the same market-facing, project-based part of the OFT. Unifying the structure has made expertise readily available between the disciplines.
- 1.5 The strongest expression of the OFT's commitment to integration can be seen in our focus on understanding markets. That underpins all our thinking and casework, but it is clearest in our market studies, which seek out the root causes of problems in markets then pick the most

workable remedial tools. In the past five years we have published 17 market studies and we are currently conducting five more.

- 1.6 Our integrated market-focused approach has delivered practical results in advancing cases and investigations and has made the OFT more sure-footed when advising other government departments on regulatory issues.
- 1.7 The OFT is working to take full advantage of its status as a combined body to maximise the benefits of integrating consumer and competition policy. Our work is based firmly on understanding how markets function and tracing the causes of problems so that appropriate remedies can be chosen. We believe that neither competition policy nor consumer policy can reach their full potential to transform markets when they are confined within intellectual, professional and institutional silos.

2 INTRODUCTION

- 2.1 The Office of Fair Trading is the lead public body in the UK responsible for competition and consumer policy and enforcement, and our mission is to make markets work well for consumers. This paper sets out the OFT's approach to the integration of competition and consumer interventions.
- 2.2 We look first at the connections between competition and consumer policy, and the reasons why each should take account of the other. Secondly we explain how the OFT tries to ensure that UK consumers and the economy benefit from bringing the two together in one organisation. In particular we describe the steps the OFT has taken to go further than operating as a dual-function agency – moving from 'co-habitation' towards positive integration.

Challenging the traditional assumptions

- 2.3 Traditionally, competition and consumer policy have each been attributed distinct objectives and features, and they have generally been treated as separate disciplines. According to this view, competition policy is about how firms interact with each other and looks at issues such as cartels, mergers, and monopolisation. It is seen as less concerned with individual retail consumers and their contract terms, as long as the market is competitive. Competition policy generally does not look at individual consumers to determine if there is anti-competitive harm. If the market is competitive, then competition policy generally assumes that the market will provide consumers with efficient outcomes. The focus of competition policy also tends to be on large players, both upstream and downstream.
- 2.4 Consumer policy on the other hand is seen as focusing on how firms interact with consumers, on trading practices and contract terms. It is also about how consumers interact with firms – purchase decisions, confidence, buying practices, search and switching. Traditionally consumer policy examines firms' dealings with retail consumers to determine whether they lead to consumer harm and it is concerned with

issues such as fairness at the level of individual transactions. It is less concerned with whether the market is competitive or not, and indeed consumer policy issues may arise in industries that seem highly competitive, such as house repairs and airlines. Consumer policy is interested in suppliers of all sizes, right down to individual traders.

- 2.5 We believe that this traditional separation is damaging to both sets of objectives. It ignores the interdependency of consumer welfare and competition, encourages narrow thinking about the origins of market problems and fails to grasp the practical benefits from integrated approaches to remedies. In the next chapter we examine the vital connections between competition and consumer policy.

3 THE CONNECTIONS BETWEEN COMPETITION AND CONSUMER POLICY

- 3.1 Why do we say that competition and consumer policy are interdependent? Fundamentally, because good consumer outcomes rely on competitive markets to provide choice and value, while vibrant competition relies on consumers confidently shopping around.
- 3.2 Just as competition promotes customer focus within firms and encourages innovation, so confident and demanding consumers drive competition between firms and higher standards by seeking out new products and best value. Strong competition and open markets can assist in incentivising firms to provide better information flow to inform and protect consumers. In this way competition and consumer policy together provide a framework for markets to deliver maximum benefits for consumers and the economy – consumer welfare and productivity growth.
- 3.3 Competition law aims to safeguard competition from agreements between firms to frustrate competition, from conduct by dominant firms designed to exploit customers or diminish competition, and from harmful mergers and acquisitions. Our interventions in this area are designed to preserve the firms' incentives to meet customers' needs, and to safeguard the choices available to customers. Consumer law aims to protect customers from deceptive or misleading practices by suppliers which diminish customers' ability to make an effective choice. By promoting 'clean' conditions in which customers can exercise choice, consumer law underpins efficient competition.
- 3.4 This means that interventions to reduce consumer and competition problems tend to be mutually supportive. Without effective consumer protection, firms do not compete on a level playing field – they may, for example, compete on opaque pricing or disguised levels of lower quality. Without effective pro-competitive legislation, consumers not only miss out on choice and innovation, but also pay higher prices. Competition in the market provides a great deal of natural consumer benefit.

- 3.5 Furthermore, these synergies can increase the efficiency of intervention and ease the administrative burden on business. When confident and demanding consumers meet efficient and customer-focused sellers, there is less need for regulatory intervention. A balanced and integrated approach to consumer and competition policies can encourage such well-functioning markets and reduce the need for regulation and enforcement over time.
- 3.6 Alongside this natural supply-and-demand interdependency there are two other distinct points where competition and consumer policy have important connections and potential mutuality. One is the need in both areas of intervention to analyse and understand what is happening in the market, whether in individual cases or systemically. The ability to diagnose the true origins of harm, failure and non-compliance is vital for competition and consumer policy alike. The other common feature is the limited range of remedies that each can deploy. Each has a set of legal and non-legal intervention tools designed to bring about changes in behaviours and markets, and those tools have developed separately in the competition and consumer jurisdictions, largely along the compartmentalised lines described earlier. Both jurisdictions suffer from gaps in their respective toolkits, a problem that can be eased by the two working together.

The gains from working together

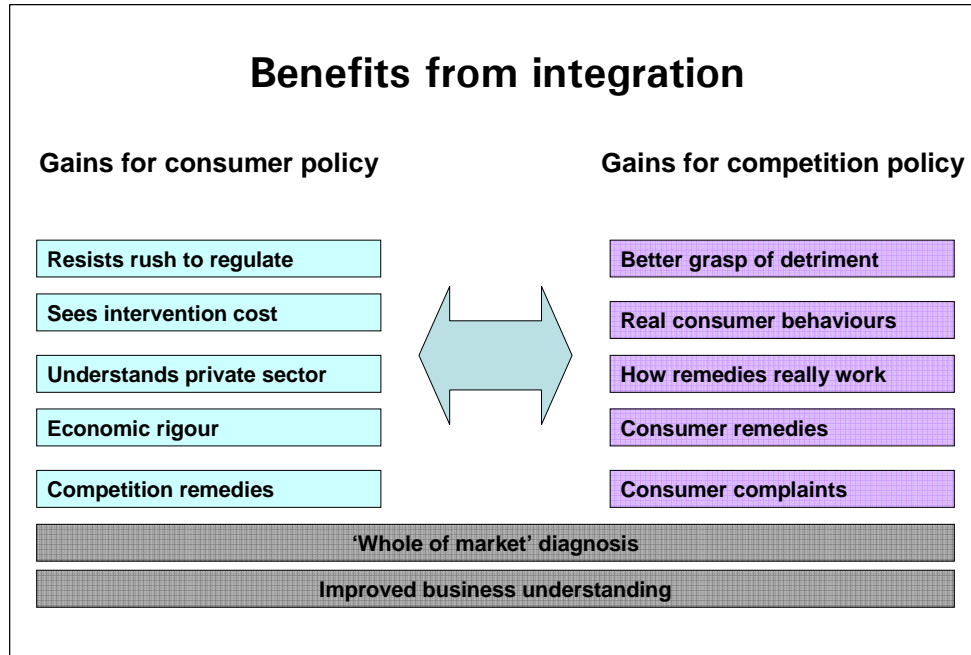
- 3.7 The connections between consumer and competition interventions mean that there are advantages to aligning them in policy and practice. What are the benefits?
- 3.8 First, what does consumer policy gain from competition policy?
- Historically, consumer agencies tend to regulate, often believing the answer to a problem is to reach for a new rule, law or licence regime. Applying competition thinking shows that in some instances market processes can solve consumer problems, and that regulation carries risks such as pushing consumers away from making active, informed choices and learning from experience.

- Even when a market solution is not viable and consumer intervention is necessary, the costs of lost competition from such interventions can be thought through in advance. Similarly, the market practices causing the consumer problem might also be producing efficiencies, and the risks of losing those can be factored into our thinking.
- Diagnosis of the market origins of a consumer problem often points to a more sophisticated remedy than case-by-case enforcement and in some cases may enable us to get closer to the root cause.
- Strategies to set and raise standards can be examined to see if they create barriers to entry, discourage innovation or facilitate collusion.
- A better understanding of private sector market responses, including game playing and 'water-bed' effects, means that intervention outcomes can be predicted more accurately.
- Consumer detriment can be analysed with additional economic rigour and regulatory arguments can be scrutinised from a 'theory of harm' perspective.
- Useful alternative or additional remedies can sometimes be found in the competition toolkit.

3.9 Secondly, what does competition policy gain from consumer policy?

- Decision-making on cases is more likely to be based on a richer understanding of consumer detriment and customer interaction with firms.
- Lessons from consumer policy in looking at how consumers actually behave, rather than making economic assumptions about 'rational consumers', promote more effective remedies. A policy mistake that illustrates this point was the opening-up of directory enquiry services to competition, which traditional economic theory had predicted would deliver consumer benefits, and led instead to confusion and a plethora of services that consumers found harder to use and compare.

- Intervention thinking is more likely to take account of perverse effects – for example, aggressive price competition that erodes quality – and to look at evidence of how remedies work in practice.
- Useful alternative or additional remedies can sometimes be found in the consumer toolkit. For example, activating consumer choice by increasing suppliers’ obligations to disclose information in combination with consumer awareness programmes can kick-start markets where there is a lack of competition.
- All these benefits increase the potential to tackle problems by harnessing market forces rather than by formal competition interventions, when appropriate. Market-oriented solutions also stand a better chance of success if they come from combined agencies because they enjoy greater public trust and support, generated by consumer protection activity.
- There is less reliance on competition complaints. Consumer complaints may highlight competition problems the authority is unaware of.



- 3.10 Often a problem needs to be tackled holistically by analysing the market without prejudging whether the failure or mischief should be resolved by a competition remedy or by a consumer remedy. A large part of a firm's strategy to compete is how it behaves towards consumers - what offers it makes, what reputation it has, how it advertises and what retail business models it pursues. Thus in the business world, competition and consumer strategy are welded together within a marketing strategy – and therefore many of the issues that confront our agencies are similarly two-headed. Diagnosis that draws on both competition policy and consumer policy stands a greater chance of success than confining the analysis and legal options to one or the other. For example, in markets where there are genuine consumer problems arising from vigorous yield management and complex pricing, it is important for government to intervene with a coherent analysis of where there is harm and where business practices are legitimate and efficient.
- 3.11 One example is our own work on bank current accounts in the UK which grew out of consumer complaints about fairness of contracts and charges, specifically in unarranged overdraft situations, and which could have been seen as wholly within the realm of consumer policy. Further analysis of the market, however, has revealed additional underlying problems of low switching and limited choice, with banks stuck in a 'bad equilibrium' that tended to fix them to their existing business models. Thus our understanding of a 'consumer issue' has been improved by considering competition issues, enabling us to take a broader approach to intervention.
- 3.12 Another benefit of aligning consumer and competition interventions is improved understanding by business. Companies' strategy towards their rivals and their behaviour towards consumers are integrated, and it is important that they get an integrated approach from government. We can avoid mixed messages in areas of apparent conflict between competition and consumer regimes. For example the OFT's support for self-regulatory mechanisms for consumer protection could have been interpreted as 'promoting collusion', so our response has been to explain to trade associations the proper limits of cooperation and to advise them on strict measures to prevent anti-competitive behaviour. Bringing

greater clarity to messages about business obligations can make a big difference to the promotion of compliance.

4 FROM COHABITATION TO POSITIVE INTEGRATION

- 4.1 The OFT handles both competition and consumer problems and it has powers to enforce both kinds of law. From a recent 'back of the envelope' check on 37 other countries, we see that about one third of them also have agencies in which competition and consumer functions are combined. Notably, there are combined agencies in the USA, Canada and Australia.
- 4.2 There is more to integration, however, than putting competition and consumer enforcement together in the same institution and the same place. The OFT has been a combined agency since the 1970s but until recently our competition and consumer enforcement work sat within two separate divisions - in effect two silos with their own legal and intellectual worlds which had little to do with each other. Each had its own staff to work on cases, its own policy team and administrative support. Competition and consumer staff were physically separated in different parts of our building. They had separate external relationships and different approaches to advocacy. For the most part, our lawyers were individually allocated to one side or the other and our economists worked almost entirely on competition. Moreover, each side had its own framework of theory and principles, and its own diagnostic tools and mechanisms for selecting and prioritising cases. Market studies, a relatively modern development, were based in a third division dedicated to a whole-of-market perspective, drawing when necessary on expertise from the consumer and competition specialists, providing the only real connection between them. The OFT's version of a combined agency was like two old fortresses standing next to each other, each staffed by a loyal garrison with their own culture, history and view of the world. The two bastions were connected by a shiny new bridge, where interesting things happened. While each side was aware that it was serving a common cause, none of the troops could fully see how their own duties reflected that.
- 4.3 We wanted to go beyond living alongside each other. To benefit fully from the connections between consumer and competition policy, we

realised that a deeper fusion was necessary. Three and a half years ago we therefore embarked on a programme of full and positive integration.

- 4.4 The most visible aspect of the OFT's move from cohabitation to integration is a new organisational structure which has largely done away with the old fortresses. We have brought our competition and consumer enforcement departments together within the same market-facing, project-based part of the organisation. Unifying the structure has made expertise readily available between the disciplines. It has also given each the benefit of the other's analytical approaches and intervention toolkit. Practical lessons learned in litigation and other intervention can be shared. As a result our knowledge and understanding of individual markets is deeper, our ability to compare and make links across markets is more sophisticated, and we can therefore respond more quickly and in an informed and targeted manner. This is particularly important in relation to innovation in new markets.
- 4.5 At the level of casework teams it has proved difficult to deliver comprehensive structural integration - in other words, there are still specialist teams at the sharpest end of our enforcement work. Our major competition investigation teams are strongly focused on their particular cases. This is also true of consumer investigations, many of which are located in our new Consumer Markets Group. For practical reasons our merger control work is still in a single dedicated group, suiting the fast flow of cases with clear processes and rapid turnaround of binary decisions. The structure is evolving, and we are confident that we can amalgamate more of our functions over time. For example, after the reorganisation our cartel investigation group at first retained its exclusive competition specialism but has now taken on responsibility for all criminal cases, both competition and consumer.
- 4.6 We have taken additional positive steps to facilitate mixing and sharing between our consumer and competition experts. Staff have learned from each other in cross-office training, seminars, joint teams and project steering groups that combine competition and consumer representation. Staff move between work areas, and even in the remaining specialist teams we have staff with differing professional backgrounds. Skills,

