Office of Fair Trading

Ad Hoc Expert Meeting on Consumer Protection: The interface between competition and consumer policies

Geneva, 12 to 13 July 2012

Session 2: Emerging Issues in Consumer Protection: New Conceptual Frameworks

Presentation by

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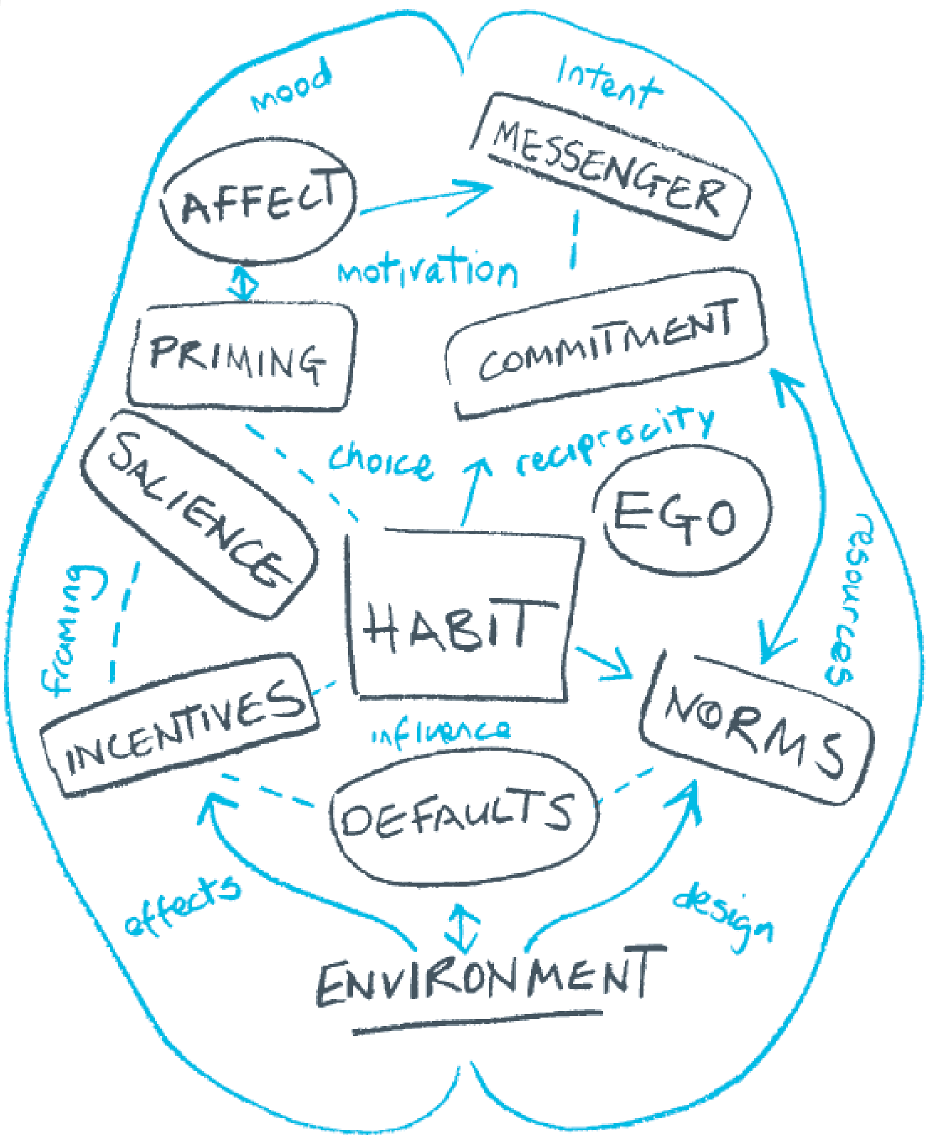


Emerging Issues in Consumer Protection: New Conceptual Frameworks

Andrew Pickering
International Team, OFT (UK)

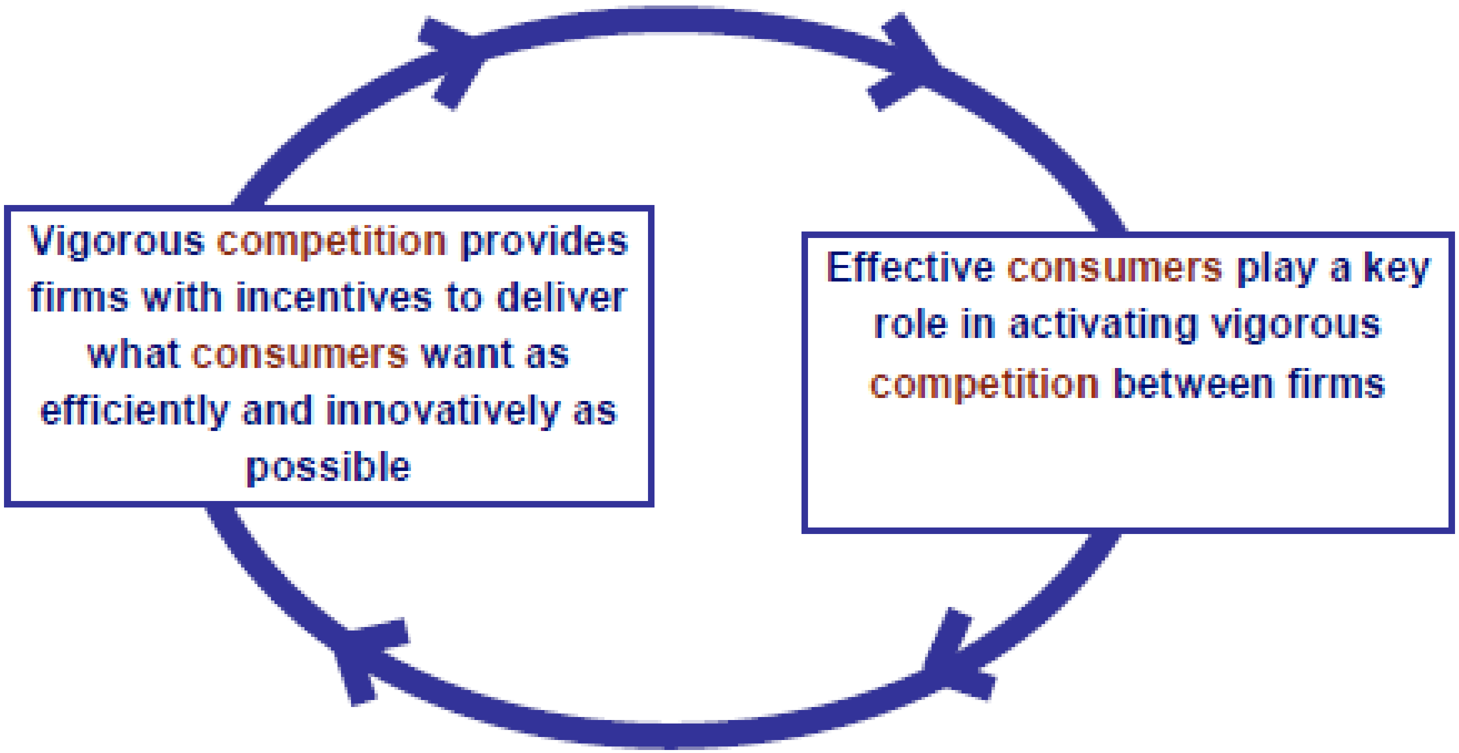
What does competition policy gain from consumer policy?

- Richer understanding of consumer detriment and consumer interaction with firms
- Learning about how consumers actually behave
- Accounting for perverse effects
- Alternative remedies

What does consumer policy gain from competition policy?

- Guards against over-enforcement
- Diagnosis of market origins of consumer problems
- Better understanding of private sector market responses
- Consumer detriment can be analysed with additional economic rigour

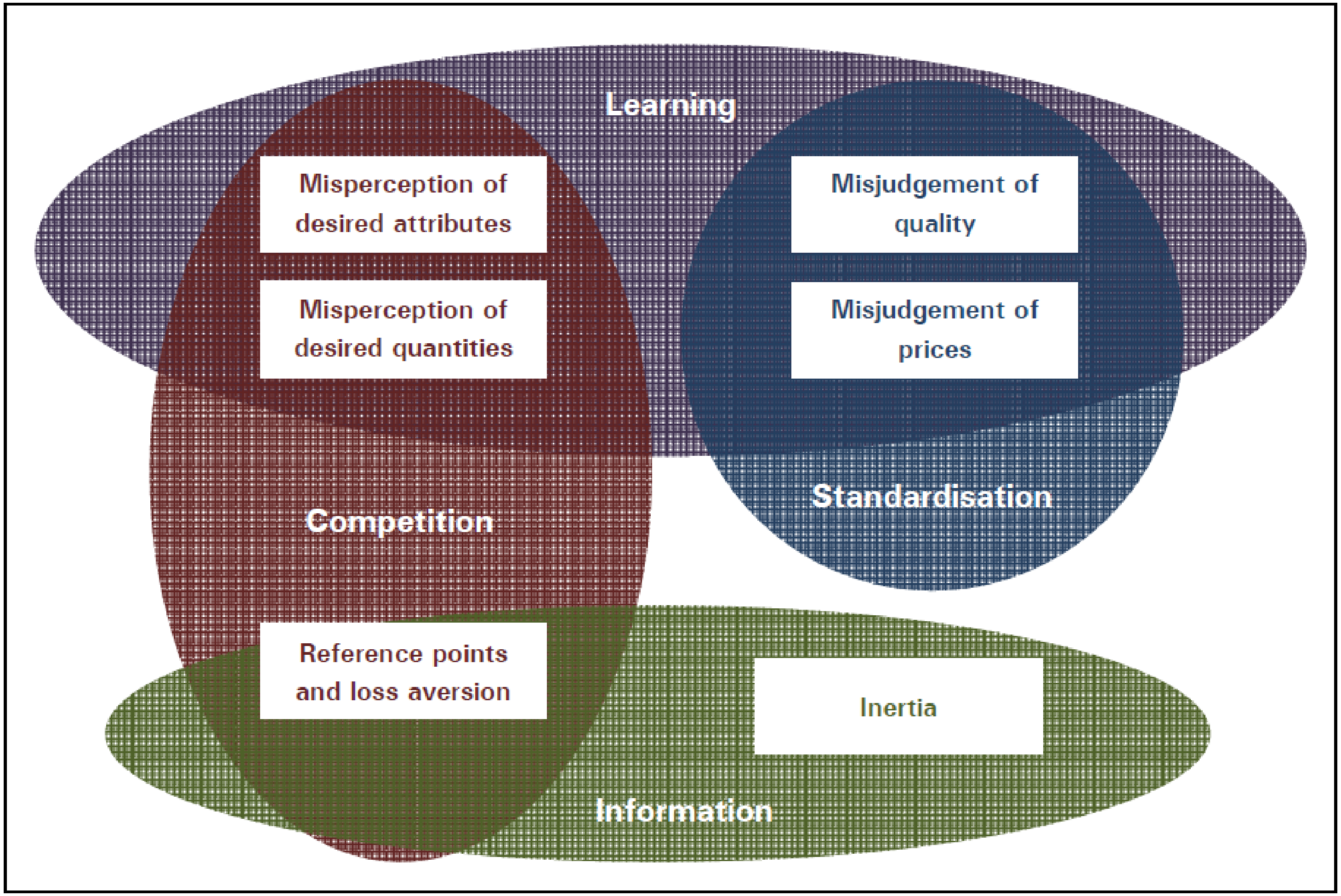
Joining up competition and consumer policy



What is behavioural economics?

- **Homo economicus vs homo sapiens**
- **Irrational and imperfect consumer behaviour**
  - Heuristics
  - Biases
  - Imperfect information
  - Loss aversion
- **Bounded rationality**
- **Consumer protection, competition law and behavioural economics are all concerned with *choices***

Improving consumer decision making



Behavioural economics at the OFT

- **Research**
  - What does Behavioural Economics mean for Competition Policy? (OFT1224)
  - The impact of price frames on consumer decision making (OFT1226)
  - Advertising of Prices (OFT1291)
  - Consumer behavioural biases in competition: A Survey (OFT1324)
- **Key examples**

  a) Price framing

  b) Personal current accounts

Price framing

- **Value is an abstract concept.** People use cues from the world around them to decide if an offer is good or bad value
- **Price framing** - the way in which prices are presented - therefore **has the power to influence and mislead**
- Misleading price frames may lead to consumers **spending more than they need to, buying a product which is not best for them, wasting time** or **suffering annoyance, disappointment or regret**
- Misleading pricing is not only bad for the consumer, it is also **bad for competition**, and creates an uneven playing field between fair dealing businesses and those that push the boundaries too far

The OFT 2010 price frames study

- **In December 2010 the OFT published a study focusing on the impact of price frames on consumer decisions. The study:**
  - Explored the behavioural psychology literature on how price frames trigger behavioural biases
  - Included an economic experiment to measure how search and purchasing decisions are affected by price frames, and
  - Surveyed 3000 consumers about their experience and attitudes toward price frames.
- **6 price frames were considered:** Drip Pricing, Reference Pricing, Time Limited Offers, Volume Discounts, Complex Pricing/Tariffs and Bait Pricing
- **Drip pricing was found to have the most egregious effects**

An overview of drip pricing

Still a bargain at twice the price?

- **Drip pricing triggers a number of common behavioural biases:**
  - Anchoring
  - ...owment effect
  - ...tment an... ...cy
- **...rip pr... ...s in:**
  - ...ers ma... ...g choi...
  - ...competing ... ...ong dimen...
  - Reduced switching

The effects of drip pricing

- **Psychology literature identifies a number of effects on consumer behaviour triggered by drip pricing:**
  - Higher demand and perceived value of the deal
  - Lower recall of the total price
  - Reduction in shopping around and comparing prices
  - Increased difficulty in comparing total prices
  - Strengthened belief that, as the consumer is choosing a product based on their particular need, prices will be about the same everywhere
  - Consumer purchasing decisions are driven by who has the cheapest headline prices – disadvantaging firms that include all charges in the headline price

Personal current accounts

- **2008 market study looked at 'the psychology of personal current accounts'** (OFT1005e)
  - *Over-optimism:* Do consumers underestimate the likelihood of triggering charges?
  - *Myopia:* Do consumers overly discount the future when choosing provider?
  - *Calculation inability:* Are consumers unable to calculate what charges will mean for them?
  - *Failure to learn:* Are consumers unable to learn about liability and extent of charges?

OFT action to improve switching

- Steps to reduce problems that arise from transferring Direct Debits
- Measures to reduce the impact on customers of any problems with transferring Direct Debits
- A new consumer guide and website on switching accounts

Complementarities and tensions

- Care is needed and behavioural economics is not a substitute for traditional analysis
- But both competition and consumer policy can benefit from stronger understanding of real consumer behaviour
- Behavioural economics can be particularly useful when looking at new markets where:
  - products are heterogenous
  - pricing is complex
  - information is poor

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