SMF Social Market Foundation

TSB

Consumers and the economy are getting a bad deal because companies don't face enough competition

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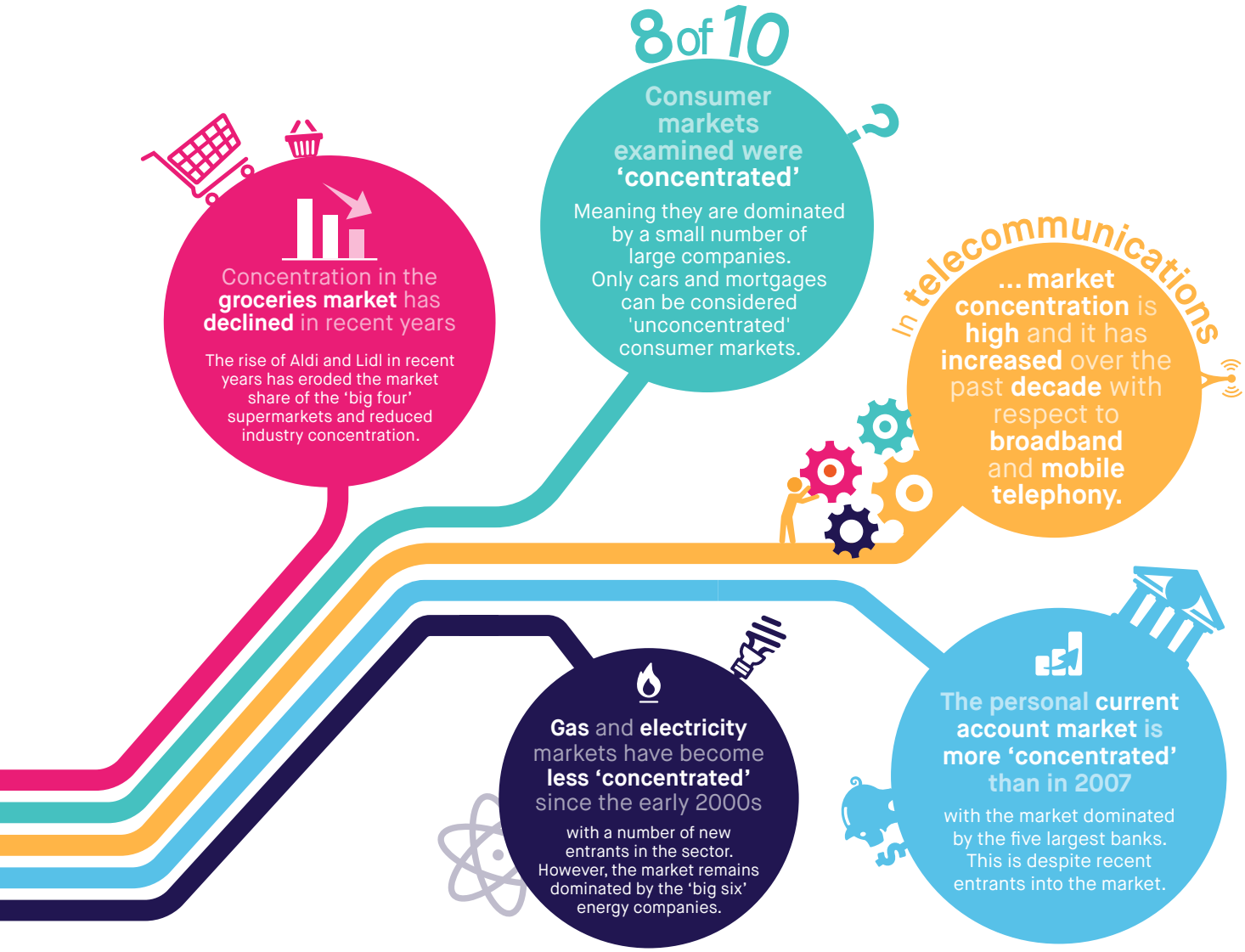
The SMF's new report, *Concentration, not competition: the state of UK consumer markets*, analyses 10 key consumer markets, which collectively account for about 40% of all consumer spending – cars, groceries, broadband, mobile telephony, landline-only phone contracts, electricity, gas, personal current accounts, credit cards and mortgages.

The research finds that all too often, the markets that matter most to consumers are concentrated in the hands of a small number of large companies. That's bad for customers and bad for the wider economy: where companies don't have to fight hard to win and keep their customers, they face less pressure to reduce prices and to increase quality, to invest and to innovate. In other words, concentrated markets are often uncompetitive. The research also identifies a link between higher levels of market concentration and lower levels of customer service and trust in markets.

The UK's economic status quo is at a critical juncture. Faith in a largely "free market" settlement is increasingly in doubt, as household incomes are squeezed and many fail to see economic growth translating into an improvement in their day-to-day lives.

In this environment, it is more important than ever that consumer markets work well and deliver good outcomes for households. If they don't, markets risk being replaced with state ownership as the electorate loses faith in private enterprise.



Four negative outcomes of a lack of competition

The new SMF analysis finds that lack of competition in key consumer markets is resulting a range of negative outcomes for UK consumers:

1. **Lack of choice** - In concentrated markets, consumers may not have access to the diversity of product and service choices that they would like.
2. **Poorer customer service and lower levels of trust** - We identity a link between higher levels of market concentration and lower levels of customer service and trust in markets.
3. **Higher prices** - Where markets are more concentrated, consumers often face higher prices.
4. **"Supernormal" profits and underinvestment** - Where competition is weak, company profit margins are likely to remain higher than would otherwise be the case. The presence of supernormal profits contributes to an unequal distribution of wealth and income in the UK, raising questions around social justice and fairness.

Seven drivers of market concentration

The analysis identifies seven key drivers of concentration and a lack of competition in consumer markets in the UK:

1. **Barriers to entry in markets** - High fixed costs and regulatory/licensing requirements deter new entrants into consumer markets.
2. **Barriers to scaling up** - For example, energy companies face significant environmental and social obligations once they exceed 250,000 customers. Regulatory and licensing requirements for financial services firms can deter entrants from providing new products and services.
3. **Bundling and gateway products** - Bundling of services has become much more prevalent in the telecommunications sector. Similarly, the dominance of dual fuel energy tariffs may undermine competition in the gas and electricity markets. Bundling can decrease the likelihood of an individual switching supplier for a given product, given the need for them to "unbundle" and choose new products for other services. In banking, personal current accounts may act as a "gateway product", with individuals more likely to opt for a loan, credit card or mortgage from institutions with which they hold a current account.
4. **Low switching rates** - Low switching rates make it much harder for new entrants to significantly grow their market share. For example, data from Bacs shows that less than two per cent of current account holders switch accounts each year.
5. **Incumbent advantages** - For example, in the retail sector, incumbent firms have significant supply chain bargaining power, allowing them to purchase goods and services at a lower price than a new entrant to a market. This can make it difficult for a new company to compete on price with a larger firm.
6. **Natural monopolies** - There are some industries where there is an inherent natural tendency towards monopolies or limited competition. For example, rail transport often inherently lacks consumer choice given the challenges associated with having multiple train providers on a given route. The introduction of competition in these instances may actually lead to inefficiencies compared with a monopoly situation.
7. **Uncompetitive sub-markets** - An example of this is "mortgage prisoners" who are unable to switch mortgage - for instance, because they are in negative equity. These individuals can find themselves facing relatively high interest standard variable rate mortgages from which they are unable to switch.

Concentration, not competition: the state of UK consumer markets is sponsored by TSB. The report can be read in full here: http://www.smf.co.uk/publications/concentration-not-competition-the-state-of-uk-consumer-markets. SMF retains full editorial control of its reports.

The purpose of this report has been to analyse the level of competition and concentration in UK consumer markets, and the consequences for consumers. It is the first part of a research project that will conclude in early 2018. The next report will consider the ways in which policymakers and others can reduce concentration, encourage competition and get a better deal for consumers.

About the SMF

The Social Market Foundation (SMF) is a non-partisan think tank. We believe that fair markets, complemented by open public services, increase prosperity and help people to live well. We conduct research and run events looking at a wide range of economic and social policy areas, focusing on economic prosperity, public services and consumer markets. The SMF is resolutely independent, and the range of backgrounds and opinions among our staff, trustees and advisory board reflects this.