SMF Market Competition Bulletin 2018

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CONTENTS

EXECUTIVE SUMMARY

This SMF briefing note presents new estimates of industry concentration in consumer markets, exploring the extent to which markets are dominated by a small number of large businesses. It also assesses whether consumer outcomes are improving and deteriorating in markets where there have been notable changes in industry concentration.

The briefing note updates figures for market concentration originally presented in our 2017 report, "Concentration, not Competition"[1], and discusses the extent to which consumer markets have changed between 2016 and 2018.

The key findings of our analysis are:

- **Of the eight consumer markets examined in our analysis, six are estimated to be moderately or highly concentrated in 2018, on the broad HHI[2] measure of industry concentration.** The mobile and broadband markets remain "highly concentrated", while the electricity, gas, groceries and personal current account markets remain "moderately concentrated".

  The mortgage and car markets remain unconcentrated and, compared with the other consumer markets considered, much less dominated by a small number of large firms. For example, Ford, with the highest car market share, accounted for just 11% of the new car market at the start of 2018. This compares with the 36% market share of BT-EE in the broadband market and the 30% market share of British Gas in the gas market.

- **Most of the markets examined in our analysis – cars, groceries, electricity, gas and mortgages, have become less concentrated since 2016.** There have been particularly notable declines in market concentration in the electricity and gas markets as an increasing proportion of customers have switched away from the large "Big Six" incumbents to newer "challenger" companies.

- **In gas, the consumer market share of the largest four suppliers (the CR4 ratio) has fallen from 68% to 61% between 2016 and 2018, as consumers have switched towards smaller challenger brands in the market.** In the electricity market, the CR4 ratio has fallen sharply from 65% to 58%.

- **Telecoms has, unlike the other categories examined in this analysis, become even more concentrated since 2016, with the merger of BT and EE increasing concentration.** The merged entity of BT and EE accounts for about 36% of the UK broadband market and 28% of the market for mobile contracts in 2018.

- **Policymakers appear to be ignoring the high levels of customer inertia and consumer detriment in the telecommunications market.** Mobile network switching rates currently

[1] http://www.smf.co.uk/publications/concentration-not-competition-state-uk-consumer-markets/
[2] The Herfindahl-Hirschman Index (HHI) is a measure of industry concentration, calculated as the sum of the square of company market shares. A score of 10,000 relates to a monopoly (100 squared) while a score close to zero relates to a highly unconcentrated market with many small firms.

stood at just 9% per year in 2017, down from 13% in 2007. Switching rates for fixed-line telephone contracts are just 5% per year, and for pay TV just 10% per year.

Research by Citizens Advice shows a loyalty penalty of £264 per year for mobile phone contracts and £113 per year for broadband contracts – both higher than the £110 estimated for energy. The loyalty penalty is the cost of being a long-standing customer, compared to a new customer receiving the same product or service.

- **It is crucial that the policymaking debate in the UK starts to focus on telecoms as well as energy.** While policymakers, businesses and those in the third sector have made large strides to make the energy market more competitive and to reduce levels of consumer inertia, the telecommunications market has been largely ignored in recent discussions about the state of UK consumer markets. The SMF urges government and regulators to explore the case for improving competition in the telecoms market by:

    - **Extending the principles of Open Banking to telecommunications – "Open Telecoms".** Giving consumers power to easily access data on their mobile and broadband usage, and the tariffs that they face for such usage, would allow the creation of much more sophisticated price comparison apps and internet tools. Using open telecommunications data, apps would be able to provide consumers with well-tailored recommendations for broadband and mobile contracts, based on an individual's usage patterns. Furthermore, such apps could automatically switch users onto the best tariffs on the market, based on their usage patterns at a given point in time.

    - **Ending subscription traps with a "click-in, click-out" rule for contracts.** If consumers are able to subscribe to a broadband package, pay TV or mobile contract online, they should also be able to cancel such services on the internet. Forcing people to call a supplier to cancel a contract creates unnecessary barriers to customer switching or walking away from a poor quality service.

      While regulators have taken steps to reduce such "subscription traps", there is still more to be done here. For example, while it is possible to switch broadband supplier between companies using the Openreach network without contracting your current supplier, this is not the case for those switching cable networks – for example those switching to or from Virgin Media.

    - **Automatically switching sticky customers to cheaper providers in the fixed-line telephony market –** We would like to see an automatic switching scheme introduced, whereby regulators, the State or another non-profit entity automatically switches "sticky" customers on poor value fixed-line contracts to cheaper providers. The default would be that individuals are opted into the scheme. They can choose to opt out in they wish.

    - **A "presumption in favour of competition" at the heart of M&A policy –** putting consumer interests first and adopting a more sceptical stance towards mergers in concentrated markets.

CHAPTER 1: INTRODUCTION

The political economy of the UK is at a critical juncture. Politicians, the media and the public are increasingly questioning the desirability of an economic system which appears to be struggling to achieve strongly growing real incomes for a significant number of households. High prices and poor customer service pervade some consumer markets. At the same time, the economy is dogged by lacklustre productivity growth, low levels of investment compared with other developed economies and employee wages which remain lower in real terms than before the financial crisis.

Many of these problems are at least partly driven by markets which are far removed from the economic ideal of “perfect competition”. All too often, some of the UK’s most important consumer markets are concentrated in the hands of a small number of companies, which face fewer pressures to reduce prices, cut costs, invest and innovate than they would in a more competitive market. In such circumstances, a *laissez faire* approach to the economy is unlikely to lead to optimal or even good outcomes for consumers.

In our 2017 report, *Concentration, Not Competition*[3], the Social Market Foundation provided new, detailed analysis of some of the most important consumer markets in the UK – banking, energy, telecommunications, groceries and transport. In particular, in one of the first economy-wide studies of its kind, we analysed the extent to which consumer markets in the UK were becoming more or less *concentrated* – dominated by a handful of large businesses.

The study, which examined 10 consumer markets in total, showed that eight of these markets were “concentrated”, with a small number of companies accounting for the overwhelming majority of the market. Not only were markets such as energy, banking and telecommunications found to be concentrated, but they were also found to be relatively *uncompetitive* – with very little pressure on large incumbents to cut prices or deliver higher quality services. A key feature of these markets is a high degree of consumer inertia, with low rates of customer switching between suppliers. Low switching rates limit the extent to which market forces place downward pressure on prices and upward pressure on service quality, as companies know that they have a large pool of sticky customers that can be relied on as a source of income even in the event of price hikes and service deterioration.

Causality between market concentration and how competitive a market is works in both directions. Companies with a high degree of market power may undermine competition through substantial supply chain bargaining power and access to a large pool of customer data. These factors give the dominant company a significant competitive advantage, making it harder for other companies to enter and grow in a market. Working in the other direction, markets where competitive pressure is weak (for example because consumer switching rates are low) are likely to gravitate towards relatively high levels of industry concentration.

Many consumer markets are far away from the usual economic ideal of perfect competition, and consumers are paying the price for this. It is unsurprising that many are calling for a move away from a market-oriented economy. A 2017 Populus survey commissioned by the Legatum Institute

[3] http://www.smf.co.uk/publications/concentration-not-competition-state-uk-consumer-markets/

shows that a majority of the public favour a return to nationalisation in the water, energy and rail industries[4].

Unless regulators, politicians, and businesses get their act together in delivering a radically-improved market economy that delivers much better outcomes for UK households, the electorate is set to vote for a return to nationalisation and statism. In our view this would be a poor solution to the prevailing problems in consumer markets, replacing a lack of competition with no competition at all.

Given the political and policymaking importance of concentration and competition in consumer markets, it is crucial that measures of concentration and competition are tracked over time. This SMF report presents new estimates of market concentration in consumer markets, examining the extent to which industry concentration – and associated problems – have increased or diminished over the past two years.

As we show, while there have been encouraging trends over this time period, with many consumer markets functioning better than was the case two years ago, other markets have become more concentrated and data suggests a high degree of consumer detriment. Most notably, this report shows rising levels of industry concentration and high levels of consumer detriment in the telecoms sector.

The structure of this report is as follows:

- **Section 2** provides updated estimates of industry concentration in UK consumer markets.
- **Section 3** explores the implications of changing levels of concentration and competition in consumer markets.
- **Section 4** discusses the policy implications of the most recent trends in consumer markets

[4] Legatum Institute (October 2017), "Public Opinion in the Post-Brexit Era"

CHAPTER 2: HAVE CONSUMER MARKETS BECOME MORE OR LESS CONCENTRATED?

Since our 2017 report on market concentration, a range of new data have become available – allowing us to examine the extent to which consumer markets have become more or less concentrated since 2016. In this analysis, we present 2017 figures for market concentration as well as estimates for 2018 based on year-to-date data for these industries.

These updated figures examine the following eight consumer markets:

- Personal current accounts
- Mortgages
- Mobile telephone contracts
- Broadband
- Groceries
- Cars
- Gas
- Electricity

We have been unable to produce updated figures for market concentration in the fixed line telephony or credit card markets, given an absence of more recent publicly-available data. As such, while we examined these markets in our 2017 report, we exclude them from this analysis.

How do we measure market concentration?

There are numerous ways of measuring the extent to which consumer markets are concentrated. In this research, we consider three separate measures of market concentration, which are based on the relative market share of different industries in the UK:

- **The Herfindahl-Hirschman Index (HHI) -** calculated as the sum of the square of company market shares. A HHI score of 10,000 relates to a perfect monopoly where one firm controls the entire market. Using the HHI, we can classify markets into three types:

  a. **Un-concentrated markets –** those with a HHI below 1000

  b. **Moderately concentrated markets –** HHI between 1,000 and 2,000

  c. **Highly concentrated markets –** HHI above 2,000

  These thresholds are in line with those in the European Commission's guidelines on the assessment of horizontal mergers – Commission notice (2004/C31/03).

- **The CR1 ratio -** the market share of the largest firm within a consumer market.
- **The CR4 ratio -** the market share of the four largest firms within a consumer market.

Unlike the CR1 and CR4 ratios, the Herfindahl-Hirschman Index considers the relative size of the market shares of different industries. For example, a consumer market with four firms each holding 25% market share will have a lower HHI score than an industry where one of the four firms has a market share of 50%. The CR4 ratio does not take into account such variations – its score would be 100% in both instances. In this sense, the HHI can perhaps be seen as a broader and more complete measure of the extent to which a consumer market is concentrated.

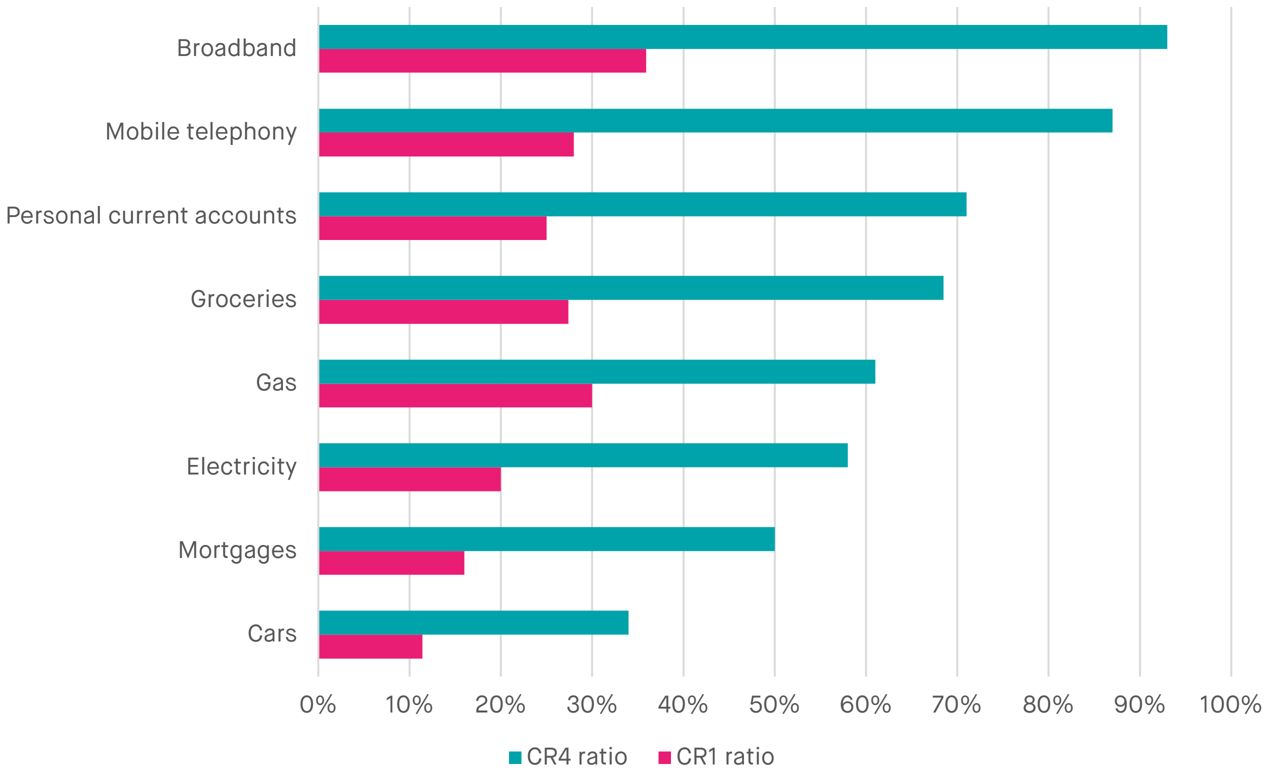
The appendix of this report provides information on the data sources used to create our measures of industry concentration.

Are consumer markets still concentrated?

Of the eight consumer markets examined in our analysis, six are estimated to be moderately or highly concentrated in 2018, on the broad HHI measure of industry concentration. The mobile and broadband markets remain "highly concentrated", as they were in 2016, while the electricity, gas, groceries and personal current account markets remain "moderately concentrated".

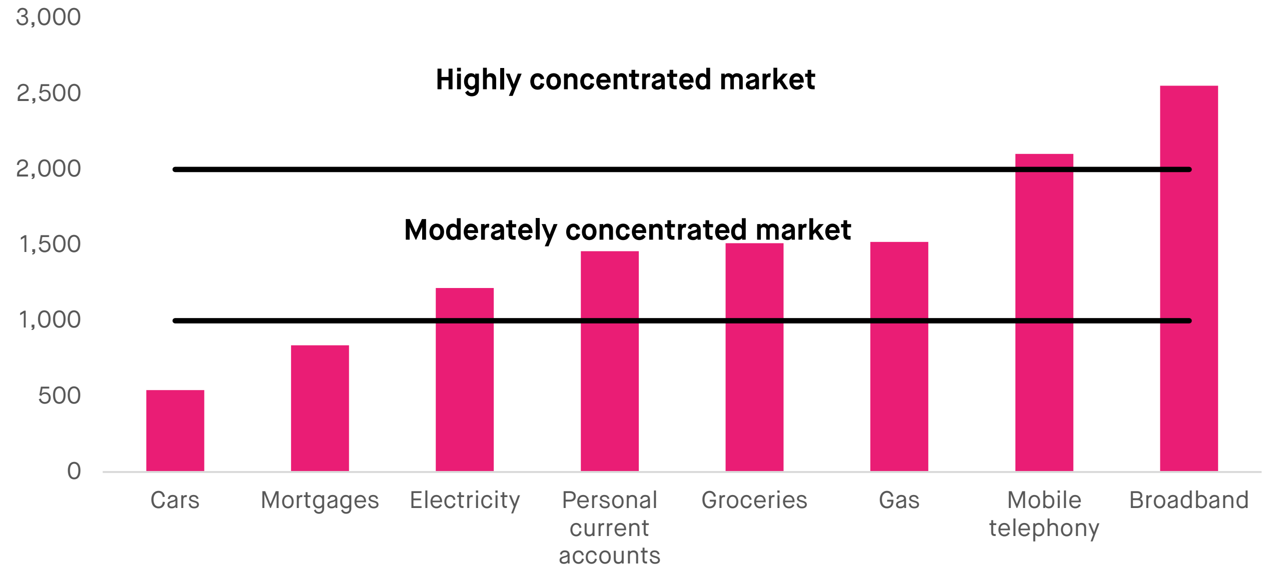
The mortgage and car markets remain unconcentrated and, compared with the other consumer markets considered, much less dominated by a small number of large firms. In the car market, for example, Ford, with the highest market share, accounted for just 11% of the new car market at the start of 2018. This compares with the 36% market share of BT-EE in the broadband market and the 30% market share of British Gas in the gas market.

Figure 1: Estimates of industry concentration in consumer markets, CR1 and CR4 ratios, 2017/2018. CR1 ratio refers to the market share of the largest firm it the sector, while CR4 ratio refers to the market share of the four larger firms.



Source: SMF analysis. Figures based on 2018 year-to-date data for the car, groceries, gas, electricity, broadband and mobile markets. Mortgage market figure based on 2017 data. Personal current account market concentration assumed to be largely unchanged from 2016, in light of recent Financial Conduct Authority research showing little change in the market share of the largest six banks: https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-progress-report.pdf

Figure 2: Estimates of industry concentration in consumer markets, HHI score, 2018 estimate



Source: SMF analysis. Figures based on 2018 year-to-date data for the car, groceries, gas, electricity, broadband and mobile markets. Mortgage market figure based on 2017 data. Personal current account market concentration assumed to be largely unchanged from 2016, in light of recent Financial Conduct Authority research showing little change in the market share of the largest six banks: https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-progress-report.pdf

What have been the key changes over time?

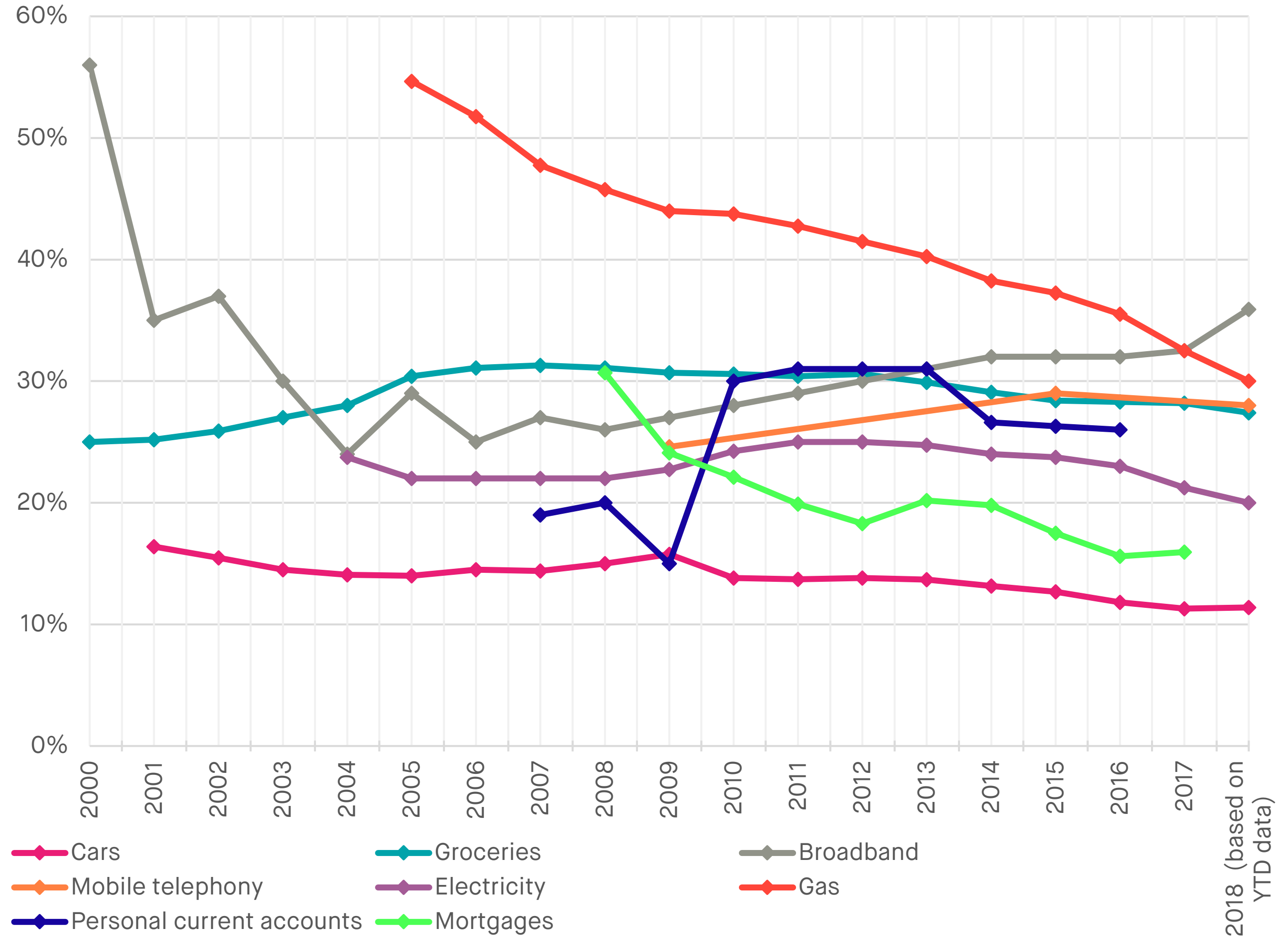
Most of the markets examined in our analysis – cars, groceries, electricity, gas and mortgages, have become less concentrated since 2016. There have been particularly notable declines in market concentration in the electricity and gas markets as the markets have continued to broaden out.

In gas, the consumer market share of the largest four suppliers (the CR4 ratio) has fallen from 68% to 61% between 2016 and 2018, as consumers have switched towards smaller "challenger" brands in the market. In the electricity market, the CR4 ratio has fallen from 65% to 58%.

One key development in the consumer energy market has been the convergence in industry concentration measures between the electricity and gas industries. In 2005, the consumer gas market was much more concentrated the electricity market, with British Gas accounting for over 55% of the market compared with 22% in electricity. In 2018, British Gas-Centrica has a market share of 30% in gas and 20% in electricity, based on year-to-date data. The increasing proportion of consumers with dual-fuel tariffs has probably contributed to converging market concentration trends in the electricity and gas markets.

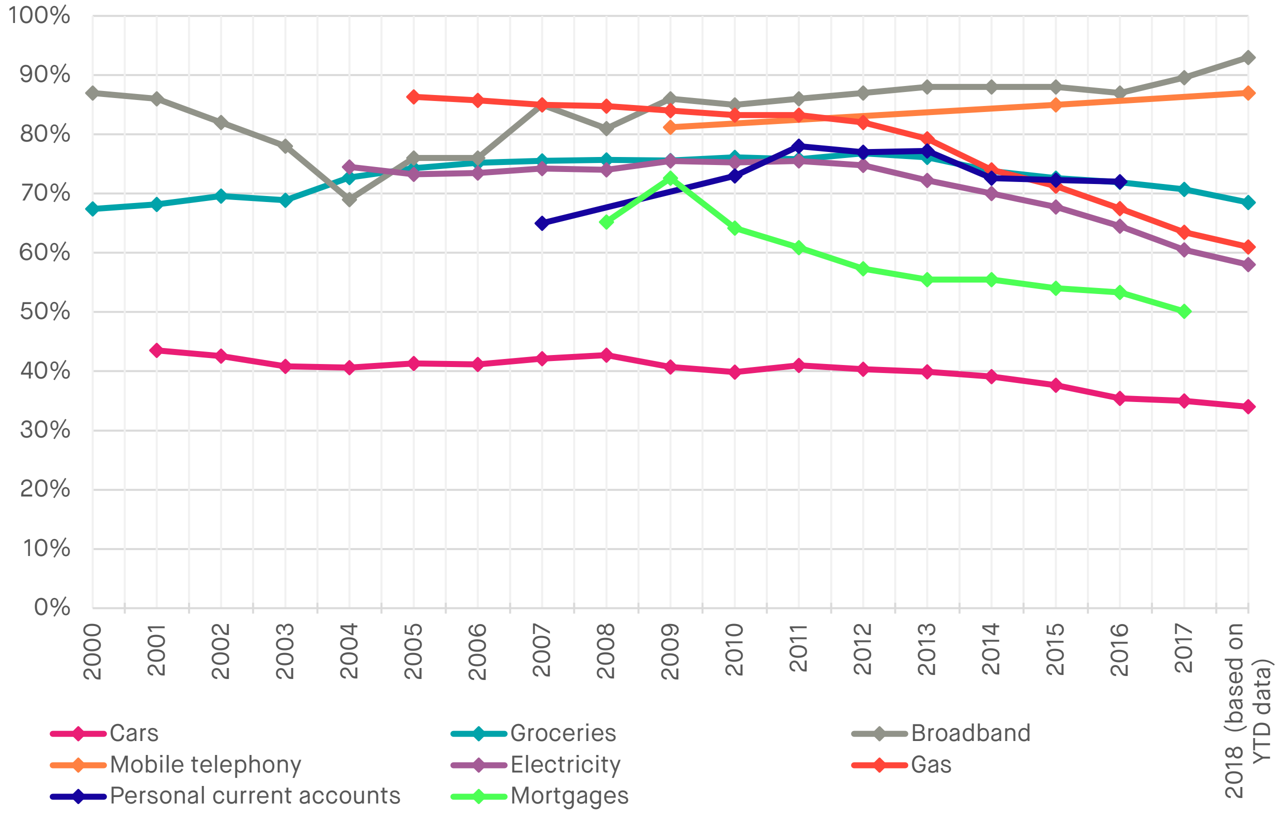
Telecoms has, unlike the other categories examined in this analysis, become even more concentrated since 2016, with the merger of BT and EE increasing concentration. The merged entity of BT and EE now accounts for about 36% of the UK broadband market and 28% of the market for mobile network contracts. As we discuss in the next section of this note, not only is the telecoms market highly concentrated, but it appears to be relatively uncompetitive - with very low customer switching rates and substantial levels of consumer detriment in terms of high "loyalty penalties".

Figure 3: CR1 ratios over time



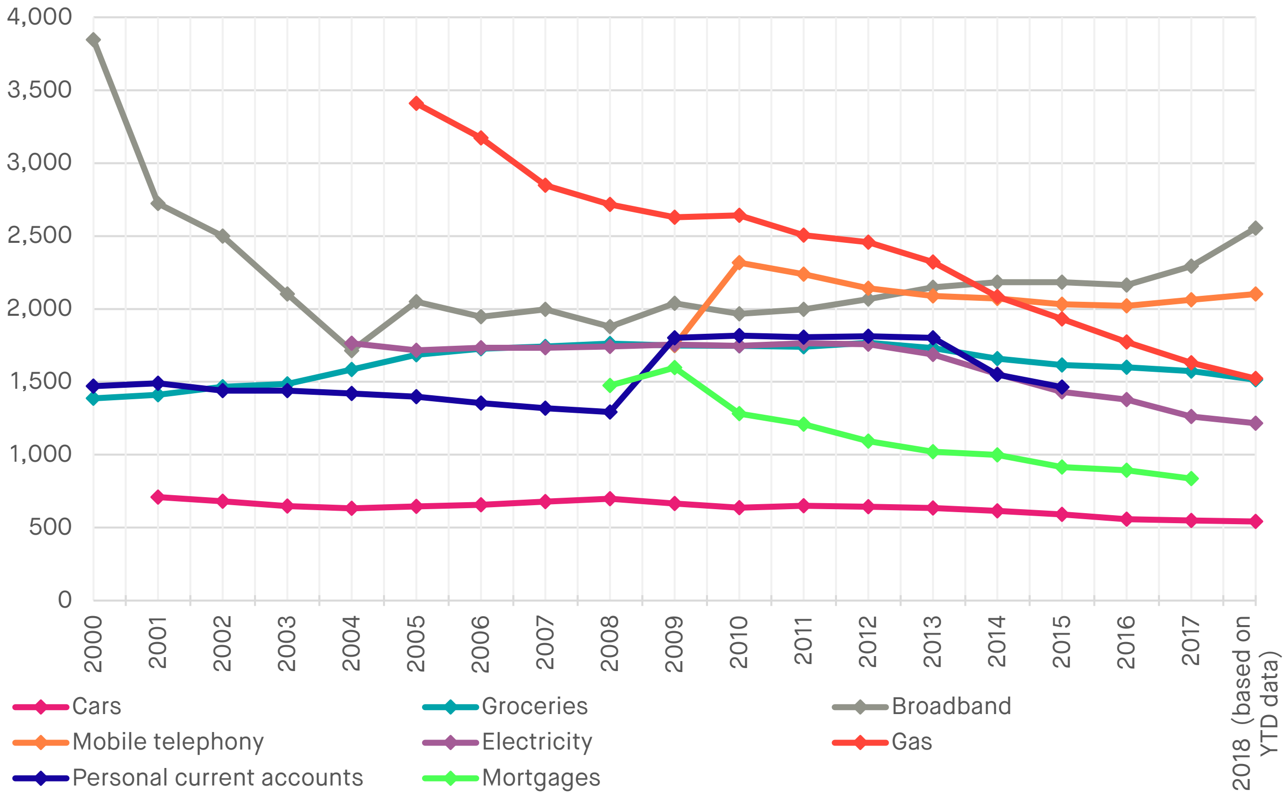
Source: SMF analysis. Time periods are not consistent across consumer markets, reflecting data limitations.

Figure 4: CR4 ratios over time



Source: SMF analysis. Time periods are not consistent across consumer markets, reflecting data limitations.

Figure 5: HHI scores over time



Source: SMF analysis. Time periods are not consistent across consumer markets, reflecting data limitations

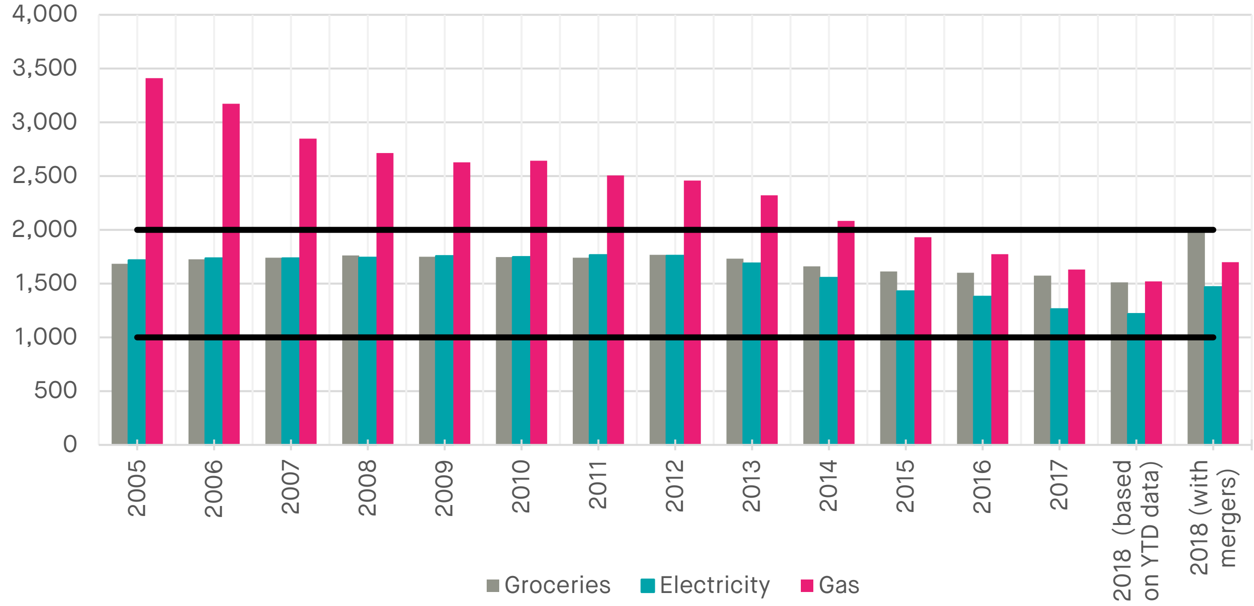
Potential mergers – SSE-npower and "Sasda"

Although industry concentration has diminished in the energy and grocery sectors since 2016, this could change if two proposed mergers go ahead.

The Competition and Markets Authority (CMA) is currently investigating a proposed merger between Asda and Sainsbury's in the groceries sector. If this merger goes ahead, the merged entity ("Sasda") would be a similar size to what is currently the largest supermarket chain in the UK – Tesco. Under such a merger arrangement, industry concentration on the HHI measure be close to the 2,000 mark leaving the UK with a borderline "highly concentrated" grocery market sector.

The consumer gas and electricity markets could also change dramatically over the coming years, following the 2017 announcement of a proposed merger between SSE and nPower, under which the Big Six group of large incumbents would become the Big Five. In August 2018, the CMA provisionally cleared the merger after an in-depth review. As Figure 6 below shows, this merger would have a smaller impact on industry concentration in the energy market than the Asda-Sainsbury's merger would have on the groceries market. The CMA has also argued that an SSE-nPower would be unlikely to have a dramatic impact on competition in the energy sector, given the current lack of competition between nPower and SSE for customers.[5]

Figure 6: HHI ratio, groceries and energy markets. "with mergers" bar shows what industry concentration would look like in the event of Sainsbury's-Asda and SSE-nPower mergers, holding everything else constant.



Source: SMF analysis

The jury is still out on the likely long-term impact of a merger between Sainsbury's and Asda. The two firms have argued that the merger would benefit consumers as the combined purchasing power of the two firms allows them to purchase goods at lower prices – and pass on the savings to UK households. However, this raises the prospect of negative outcomes for firms in the

[5]https://www.gov.uk/government/news/ssenpower-merger-provisionally-cleared-after-in-depth-review

groceries supply chain, as their profits are squeezed by the large supermarkets. There is a long-standing discussion on the extent to which supermarkets might be exploiting their purchasing power and squeezing companies along their supply chains[6].

Furthermore, as the SMF has argued elsewhere[7], a merger between Sainsbury's and Asda might be detrimental to innovation in the groceries sector in the long-run. Arguably, the two firms are looking to merge so that they do not have to make tough decisions around reorienting their business models to compete more effectively with discounters such as Aldi and Lidl. Rather than reshaping their businesses, the firms are looking to increase their purchasing power and squeeze suppliers in order to be more cost competitive. Higher levels of innovation and investment might be more likely to be realised if the two firms are required to "reshape" their way out of current challenges, rather than seeking refuge in a merger that allows them to use greater purchasing power as an alternative to innovation.

Unlike the SSE-nPower merger, there is evidence that a substantial portion of UK households see Sainsbury's and Asda as rival suppliers, with many people choosing to shop at both retailers. Recent research by Kantar estimated that nine million households visited both Sainsbury's and Asda over a 12 week period[8] - highlighting the extent to which a merger could undermine competition and choice across the grocery sector in the UK.

[6] See, for example, https://www.reuters.com/article/us-britain-retail-workers-abuse/uk-supermarket-squeeze-on-suppliers-fuels-poverty-and-abuse-campaigners-say-idUSKBN1JH0OJ
[7] https://unherd.com/2018/05/benefits-supermarket-sweep/
[8] https://uk.kantar.com/consumer/shoppers/2018/may-grocery-market-share/

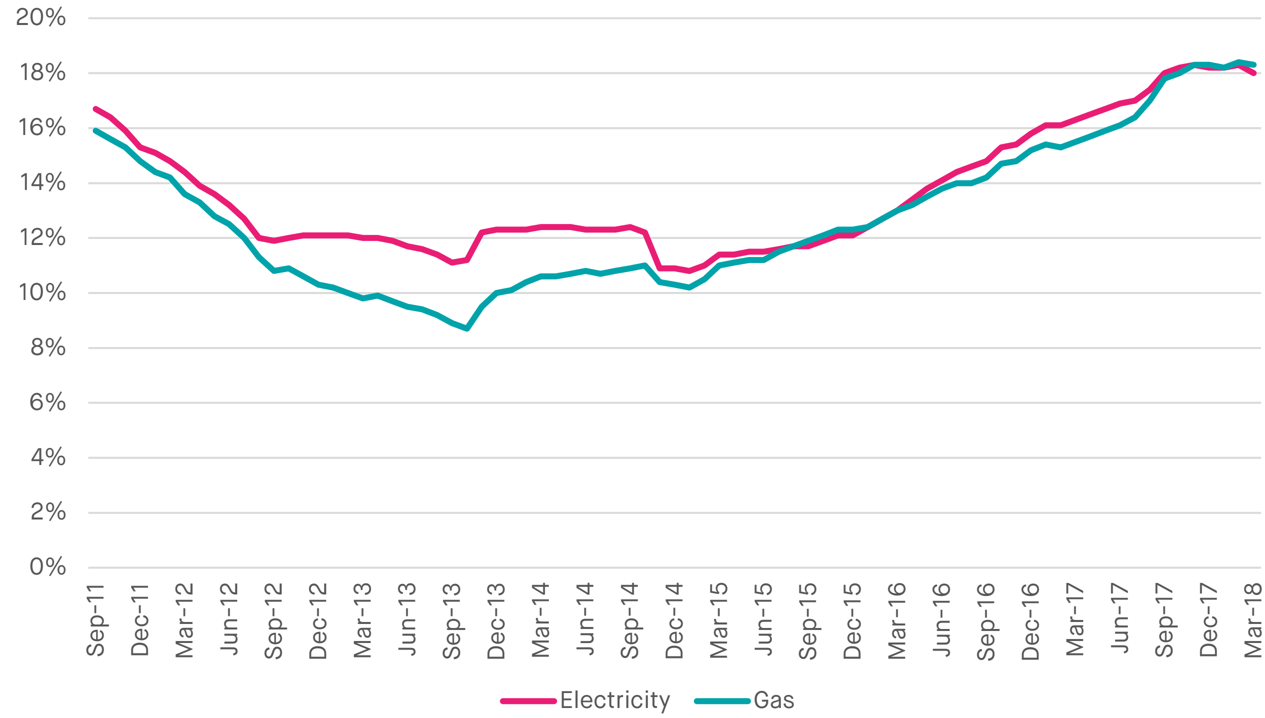
CHAPTER 3: ARE CONSUMER MARKETS IMPROVING OR DETERIORATING?

The previous section of this report identified two key trends in consumer markets since 2016 – a substantial decline in industry concentration in the energy market, and a notable increase in market concentration in the telecoms market. Here, we explore trends in consumer outcomes in these markets, and identify potential issues for policymakers.

Improving outcomes in energy, but still some way to go

A key driver of reduced industry concentration in the electricity and gas markets is the substantial increase in customer switching rates seen in recent years – as illustrated below.

Figure 7: Energy switching rates, 12 month rolling total



Source: Ofgem

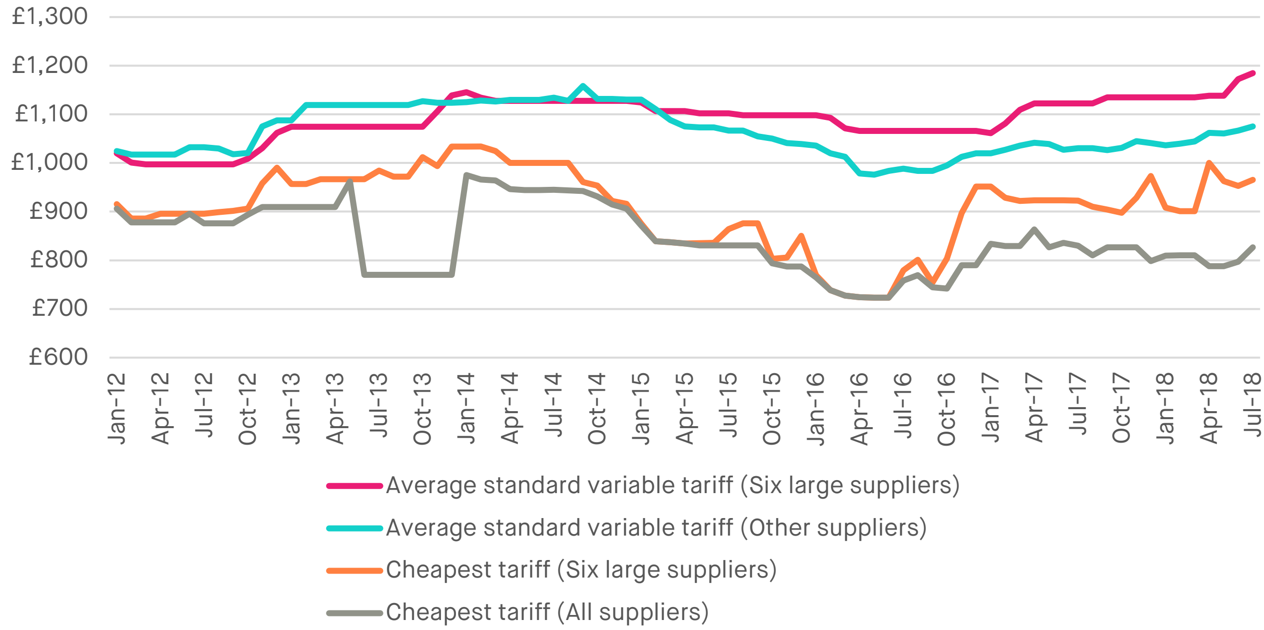
Increased rates of consumer switching, and the weakening grip of the Big Six firms on the energy market, have in turn led to improving consumer outcomes. Ofgem research published at the end of 2017 showed 57% of people with the 10 largest suppliers on non-price-protected Standard Variable Tariffs (SVTs), which are generally notably more expensive than fixed tariffs. This was down from 59% in April 2017.[9] However, this still leaves a majority of households on what are, ultimately, poor value energy tariffs. It is crucial that policymakers ensure momentum is maintained in ensuring that the energy market continues to become more competitive over time – particularly as there is a risk that the incoming energy price cap will increase consumer inertia in the sector.

As Ofgem price data show, the average variable and fixed energy tariffs of smaller suppliers are generally much cheaper than those of the large Big Six incumbents, highlighting the extent to

[9] https://www.ofgem.gov.uk/publications-and-updates/standard-variable-tariffs-latest-trends-september-2017

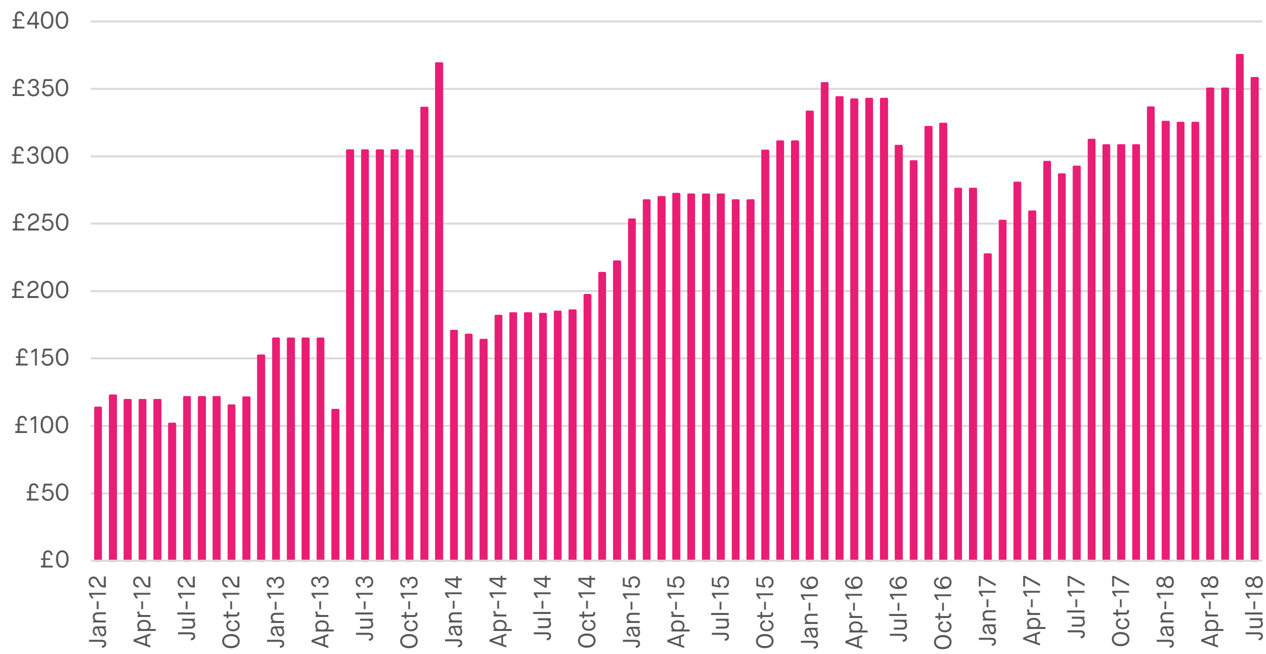
which declining market concentration in the energy sector is likely to be translating into better consumer outcomes in terms of average energy tariffs.

Figure 8: Retail price comparison by company and tariff type, typical dual fuel customer paying by direct debit, annual expenditure.



Source: Ofgem

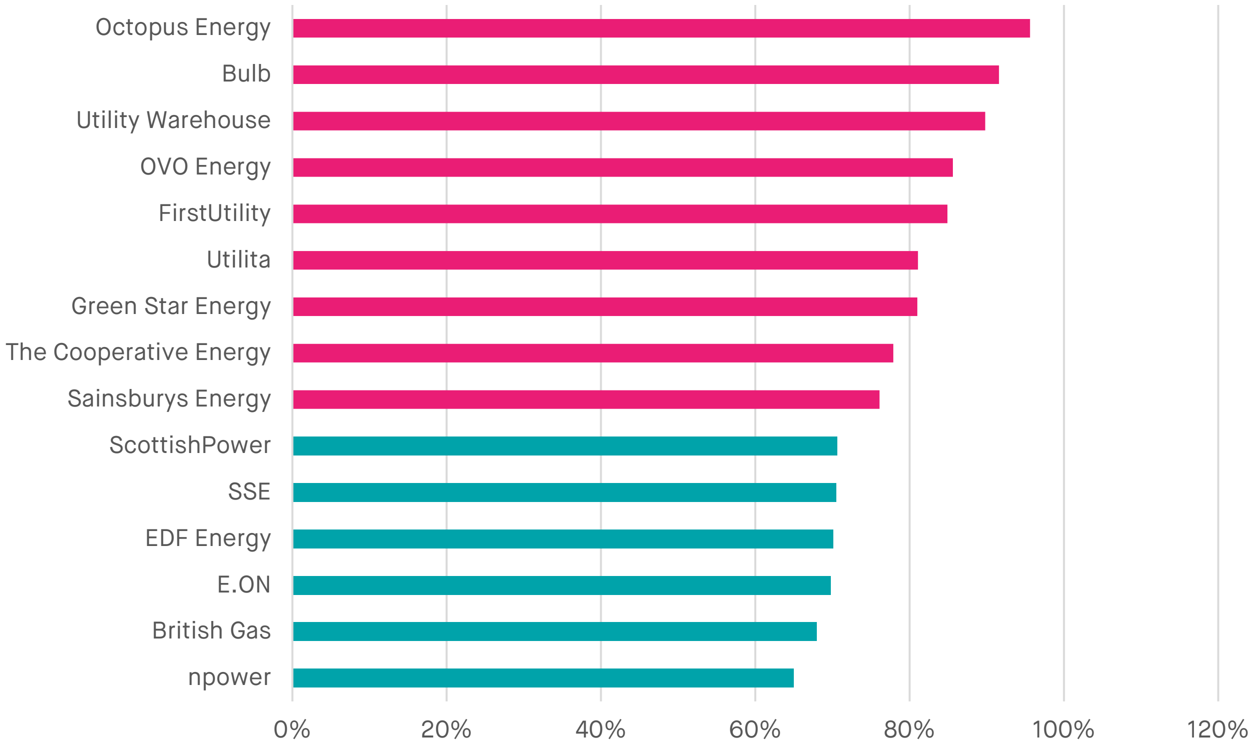
Figure 9: Annual amount saved from switching from average "Big Six" supplier SVT to cheapest tariff on the market



Source: SMF analysis of Ofgem data

Furthermore, the shift in customers away from large incumbents in the energy market may also be bolstering the quality of customer service received. Customer satisfaction data, such as that collated by uSwitch, point to higher levels of satisfaction among customers of smaller "challenger" energy companies than among the large Big Six incumbents.

Figure 10: Overall customer satisfaction, %. Big Six suppliers shown in teal bars, smaller "challenger" providers in pink bars



Source: uSwitch.com Energy Customer Satisfaction Report 2018

Overlooked problems in the telecoms market?

While the energy market appears to be functioning more effectively than was the case two years ago, at least from the point of view of consumers, it is not clear that the same can be said for the telecommunications market.

Among politicians and policymakers, little has been said of the very low rates of customer switching in telecoms, which now stand much lower than in the energy sector. This is despite the fact that Ofcom data suggest that mobile contract switching rates have in fact fallen over time – from 13% in 2007[10] to just 9% in 2017.[11]

Very high rates of consumer inertia support high levels of market concentration in the telecommunications market. Furthermore, consumer inertia is contributing to a wide range of negative outcomes for customers. Research by Citizens Advice found that the "loyalty penalty" in telecommunications stood at £377 per year in 2017 – of which £264 was a mobile tariff loyalty penalty and £113 was a broadband loyalty penalty[12]. The loyalty penalty is the cost of being a long-standing customer, compared to a new customer receiving the same product or service. A loyalty penalty arises, for example, when introductory "teaser tariffs" for new customers come to

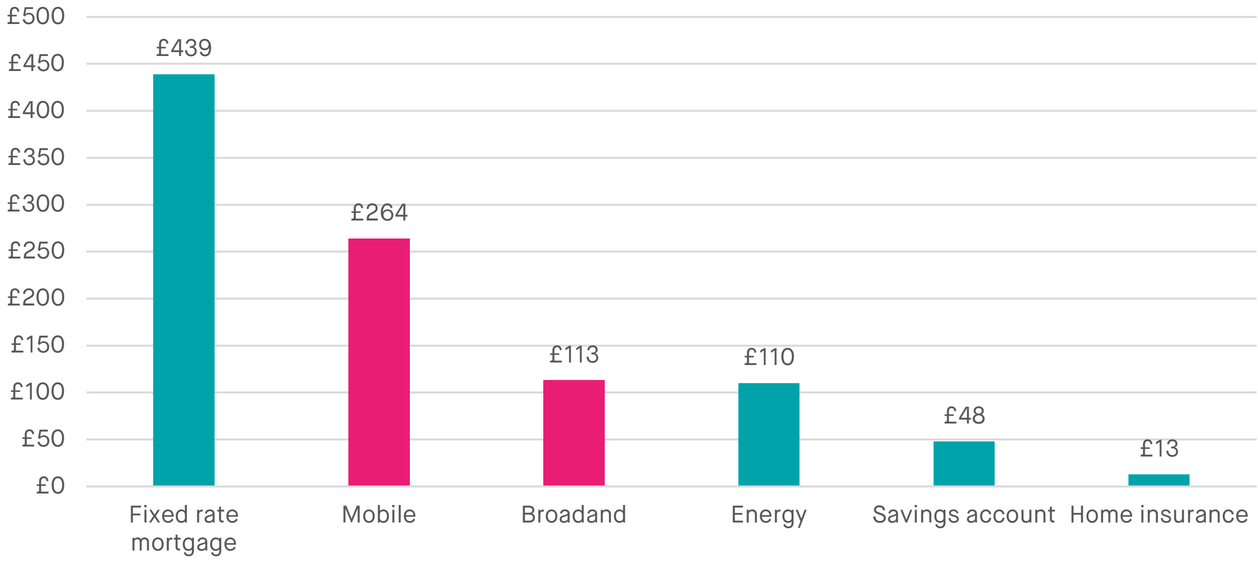
[10] www.three.co.uk/ss/Satellite?blobcol=urldata&blobkey=id&blobnocache=false&blobtable=MungoBlobs&blobwhere=1400686140463&ssbinary=true
[11] https://www.ofcom.org.uk/__data/assets/pdf_file/0030/113898/pricing-report-2018.pdf
[12] Citizens Advice, "The Cost of Loyalty"

an end, or when customers are switched from fixed to variable contracts for products such as energy and mortgages.

Recent SMF research argues that a "poverty premium" is likely to exist in parts of the telecommunications market, whereby lower income households pay more for services such as broadband and telephony, given generally lower rates of customer switching among low income households[13].

If businesses know that an overwhelming majority of customers are unlikely to switch provider even in the event of price rises or poor customer services, this incentivises firms to bake in large loyalty penalties into their product offers.

Figure 11: Annual loyalty penalty, 2017



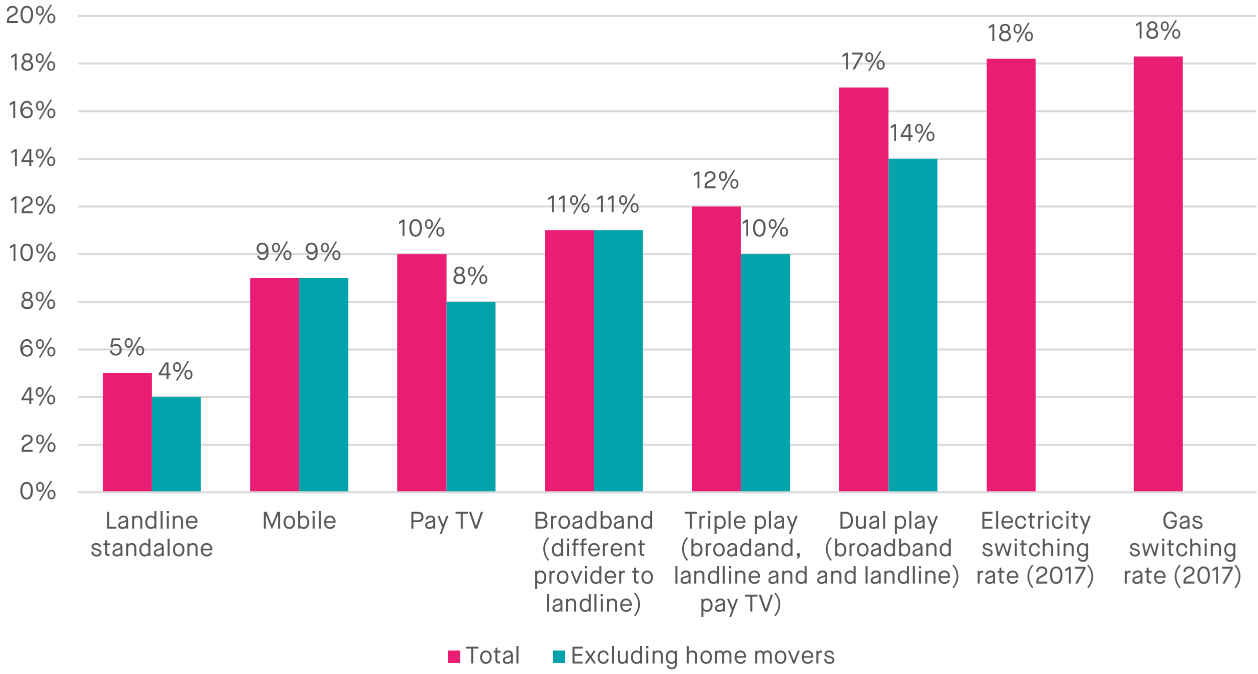
Source: Citizens Advice

Notably, the loyalty penalty for both broadband and mobile is higher than the loyalty penalty in energy. This is true both in cash terms and as a percentage of typical annual spend on each product. The very high loyalty penalties that pervade the telecoms market, which probably result from very low levels of competition, highlight the urgent need for policymakers to start focusing on this consumer market, rather than fixating solely on energy.

As the graph below shows, customer switching rates across a range of telecoms products are currently much lower than in energy - suggesting a high proportion of telecoms customers are subject to substantial loyalty penalties.

[13] http://www.smf.co.uk/wp-content/uploads/2018/03/Measuring-the-Poverty-Premium.pdf

Figure 12: Cross-market overview, switching of telecoms products in the 12 months to September 2017. Switching rates for electricity and gas included for comparison



Source: Ofcom Switching Tracker, Ofgem energy switching data

Not only do the high proportion of inert customers in the telecoms market pay a substantial financial price for not switching supplier, but they also suffer worse customer service. Research from the consumer group Which? found that, as with energy, smaller challenger telecommunications companies tend to see higher rates of customer satisfaction than the large incumbents[14].

[14] https://www.which.co.uk/news/2018/04/best-and-worst-mobile-phone-networks-of-2018-revealed-by-which/

CHAPTER 4: WHAT NEXT FOR POLICY MAKERS?

As we have shown in this report, many of the UK's consumer markets have moved in the right direction since 2016 – becoming more competitive and delivering better outcomes for consumers.

The notable exception in our analysis is telecommunications, which has become even more concentrated since 2016. The lack of competitive pressures in the mobile and broadband markets are contributing to lower levels of customer satisfaction and a high "loyalty penalty" – where customers that stay with a provider pay a substantial financial price.

Government and regulators need to start talking more about our telecommunications, not only because there are clear issues with a lack of competition in the market but also because telecoms have become an increasingly important part of the day-to-day lives of UK households. The internet and mobile communications are increasingly regarded as "essential" rather than "discretionary" services - and this needs to be reflected in discourse among politicians, regulators and other policymakers.

Below we set out a range of policy options that could help improve consumer outcomes in the UK - in telecommunications and beyond.

From open data to open everything

Data has the potential to increase competition and reduce levels of concentration in consumer markets – but only if there is open access to such data. If data is hoarded, for example by large incumbents that hold vast pools of consumer information, it can ultimately lead to reduced competition and worse outcomes for consumers. For example, as mentioned in the previous chapter, having a significant "data advantage" makes it easier for incumbents to compete in a market compared with new entrants. Data on consumer behaviours can also pave the way for greater levels of price discrimination where, for example, customers less likely to switch supplier see higher prices than those that are more price sensitive.

Regulators are currently exploring how to better use data to improve competitiveness in consumer markets. For example, Ofgem is constructing a secure "disengaged customer" database. This database contains information on consumer tariffs, energy usage, and customer names and addresses. Ofgem is currently exploring how this database can be used to target customers that have been on poor value energy deals for a long period of time – for example by inviting them to participate in a collective energy switch[15].

In financial services, Open Banking has the potential to drive product innovation and better consumer outcomes. Open Banking refers to technologies and standards which allow consumers to give companies other than their bank or building society permission to securely access their accounts. This is expected to lead to some significant innovations in the banking market. For example, Open Banking should pave the way for the development of online and mobile phone apps that allow an individual to view details from all of their financial service providers in one

[15] https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/how-switch-energy-supplier-and-shop-better-deal/ofgem-disengaged-customer-database

place. That is, Open Banking eliminates the need for an individual to have an app for *each* financial service provider.

Open Banking may also allow sophisticated algorithms to be developed which provide recommendations to consumers about, for example, choice of personal current account provider and other financial decisions.

We would like to see further innovation with respect to data, including establishing a disengaged customer database in the fixed line telephone market, to enable automated switching of sticky customers in this market. We would also like to see the sharing of appropriately anonymised disengaged customer databases with a range of third parties. For example, consumer charities such as Citizens Advice may be able to better advise consumers through the information contained in such databases.

Furthermore, we would like to see new ownership and sharing principles around personal data in consumer markets, with the principles of Open Banking extended into other markets. Consumers should be the owners of personal data collected by companies, and they should be able to easily and freely request a digital copy of this data. For example, in the energy market individuals should be able to easily acquire data relating to their energy usage, and the costs they incur for this usage, in a digital format that they can share (if they wish) with other companies and price comparison websites. Similarly, with the telecoms market – it should be easy for customers to acquire data on their mobile and broadband usage, and the costs they are incurring.

We note that the implementation of General Data Protection Regulation (GDPR) in 2018 requires data controllers to provide “data portability” when accounts are closed – allowing individuals to potentially use this data to switch supplier more easily and locate a better deal on the market.

We envision open, readily available data driving increased switching rates in a range of markets, such as energy, telecoms and personal current accounts. For example, in telecoms, open data could lead to the development of websites and apps which provide tailored product recommendations to customers based on their broadband and mobile usage. Indeed, there is potential for apps to go further, using data to carry out the switching process seamlessly.

“Click in, click out” - tackling subscription traps in telecommunications and beyond

Regulators have made strides in reducing the frictions – time, money and inconvenience – associated with leaving a company and switching supplier. But there is still scope to go further.

One friction to leaving a company that we would like to see eliminated is the asymmetry that companies place between subscribing and unsubscribing from services.

For example, while it may be possible to subscribe to a broadband package or pay TV on the internet, unsubscribing often requires an individual to make a telephone call to the company. This is a deliberate attempt by companies to make it harder to walk away from a service. A phone call is often more onerous than an internet-based cancellation, and hard selling techniques are often applied to prevent a customer from leaving a company. Furthermore, lengthy hold times before speaking to someone, and limited call centre opening hours create additional frictions compared with internet-based cancellations.

We would like to see this asymmetry removed from consumer markets. One simple way of doing this is for the government and regulators to require companies to have a symmetric approach to subscription and unsubscription – if it is possible to sign-up online to a product, such as a pay-TV or broadband service, it should be possible to unsubscribe online.

Creating symmetric consumer markets, in terms of ease of subscription and unsubscription, would support competition, driving up service quality and value for money. Making it easier for consumers to abandon a product will place extra pressure on companies to retain their customers. At present, many companies deliberately make it much easier for consumers to acquire a service than to walk away from it, often using "teaser rates" to draw customers in. This practice needs to be curtailed.

Automatic switching in the energy and landline markets

A key driver of industry concentration and low levels of competition is the fact that customer switching rates are low across a range of key consumer markets. Data from Ofgem show that switching rates for electricity and gas both stood at 18% in 2017 – while an improvement on a few years ago, this is still arguably a low rate given the homogenous nature of electricity and gas and the fact that about six in ten households are on poor value standard variable tariffs (SVTs)[16].

Low switching rates leave large incumbent companies with a significant pool of customers that are insensitive to price changes. Companies know that, even if they increase prices sharply and at a higher rate than competitors, they can expect a significant number of "sticky" customers to remain loyal to their services. Pressures to offer low and competitive prices across the board are therefore greatly diminished. This is perhaps most apparent in the energy market, where sticky customers find themselves on SVTs which are significantly more expensive than the best fixed tariffs on the market. In the current account market, given the "free banking" model, impacts on consumers are more subtle – though potentially include lower rates of interest on deposits and higher overdraft charges.

Government and regulators are of course aware of the key role of switching rates in determining levels of competition in consumer markets, and a range of initiatives have been introduced in recent years to try to increase switching rates. The focus of these initiatives has been on raising awareness of the ease and benefits of switching, as well as measures that aim to reduce any time, monetary and inconvenience costs associated with switching.

But these initiatives have not *dramatically* reshaped consumer markets, as evidenced by low switching rates and the significant proportion of consumers on poor value products. Ultimately, this suggests that a policy framework which focuses on encouraging consumers to switch, through better information and reduced barriers to switching, is unlikely to ever act as a game changer in reforming consumer markets. We need to be honest about the reality of consumers and the fact that nudging them to switch supplier will often only have a modest impact on increasing competitive pressures in markets.

Faced with conflicting information, a lack of trust and high levels of uncertainty, consumers are often unlikely to switch supplier despite the potential financial benefits of doing so. This is particularly the case with vulnerable and lower income households, with a growing body of

[16] https://www.ofgem.gov.uk/publications-and-updates/ofgem-publishes-supplier-standard-variable-tariff-league-table

research suggesting that poverty is associated with higher levels of risk aversion as well as constrained ability to make financial decisions[17], both of which undermine a household's propensity to switch providers for goods and services.

A much more radical approach to increasing competition in consumer markets is for regulators, the State or other non-profit entities to *automatically switch* customers that have not switched supplier for a number of years. For example, customers that have not switched energy tariff in the last three years could be automatically switched by Ofgem to an energy provider that offers lower tariffs than their current supplier.

Under such a policy regime, we propose that, at least initially, sticky customers in concentrated markets are only switched towards smaller "challenger" companies in markets. The rationale is that this has greater potential to reduce industry concentration in consumer markets – enabling new entrants offering good value propositions to greatly increase their market share. One driver of high levels of market concentration is barriers to scale, where companies struggle to gather a "critical mass" of customers from which their growth and expansion can gain momentum. This policy would help drive expansion of smaller companies by making it easier for them to acquire new customers – thus creating broader markets which are less concentrated.

Individuals that do not wish to participate in an automatic switching scheme would have the ability of opting out of the process, perhaps through notifying the relevant regulator using an online form or making a phone call. That is to say, the default under our proposed policy is that households are enrolled into the automatic switching scheme.

An automated switching scheme needs to have safeguards in place, and we would caution against an approach that focuses on price alone. For example, we would expect the regulator or other body overseeing the automatic switching process to take account of factors such as customer service provision, the ability of challenger companies to provide good service to a much greater number of customers and the underlying financial resilience of companies' business models. Recent failures of smaller energy suppliers, such as Future Energy which ceased trading in early 2018, highlight the need to ensure financial durability among energy suppliers, or at the very least assure consumers that a company failure will not result in their electricity or gas supply being cut off.

While a policy of automated switching perhaps lends itself most readily to the energy market – given the homogenous nature of the products being purchased by households (electricity and gas) – we could envision it being rolled out elsewhere. For example, while automated switching might not be appropriate in markets such as broadband and pay-TV, given that choice of product is dictated by a range of factors beyond price (such as broadband speed and TV content) – we could envision automated switches being applied to customers on fixed-line only phone contracts. Ofcom analysis suggests that those on fixed-line only contracts are particularly likely to be older, on low incomes and disengaged from the telecoms market[18].

[17] See for example, Behavioural Insights Team, *Poverty and decision-making – how behavioural science can improve opportunity in the UK* (2015); Sheehy-Skeffington and Rea, *How poverty affects people's decision-making processes* (2017); Anandi Mani et al, 'Poverty Impedes Cognitive Function', *Science*, 341 (2013)
[18] Ofcom (February 2017), "The review of the market for standalone landline telephone services"

A “presumption in favour of competition” at the heart of M&A policy – putting consumer interests first

When considering the implications of mergers and acquisitions in consumer markets, regulators undertake detailed assessments and consultations to establish the potential implications for consumer outcomes and market competitiveness. This analysis is thorough, rigorous and provides a valuable safety net to prevent mergers and acquisitions which undermine competition, and which potentially lead to higher consumer prices and reduced levels of product innovation.

At present, when considering whether to permit a merger, the Competition and Markets Authority identifies possible “theories of harm” – ways in which the merger might lead to worse outcomes in a market[19] – such as a substantial loss of competition and higher consumer prices. If these theories of harm are considered likely to occur, and no credible remedies to these harms can be implemented, then the CMA can prevent a merger going ahead.

While the “theories of harm” approach to assessing mergers has helped prevent detrimental mergers going ahead, we note some of the inherent challenges and judgment calls involved in the process. Assigning probabilities to theories of harm is often a subjective process with significant uncertainties – meaning that mergers may be permitted when the *actual* probabilities of harm to consumers are inherently greater. This is not a criticism of the CMA’s processes, but an inherent challenge with assigning probabilities to economic events.

As well as difficulties associated with assigning probabilities to harms, there are challenges associated with measuring the *scale* of harms, particularly when harms may take several years to materialise. One type of harm that is difficult to measure, for example, is what economists call “X inefficiencies” – inefficiencies that arise when firms behave in a sub-optimal manner due to a lack of competitive pressure. Similarly, the net impacts of product bundling on consumer markets are often difficult to establish. While bundling following a merger may enable efficiency savings and lower costs for consumers, it can also act as a barrier to switching and make it harder for new entrants to compete in a market.

Given the inherent uncertainties associated with establishing the likelihood and scale of harms to consumers following mergers and acquisitions, our preference is for the “theories of harm” framework to be replaced with a new “presumption in favour of competition” – under which the CMA would be expected to prevent mergers in the most concentrated consumer markets – energy, groceries, banking and telecommunications – unless it could be demonstrated that there was a strong chance of the merger leading to significantly improved outcomes for UK consumers (for example, lower prices, better service quality and higher levels of product innovation) while not undermining competition.

The distinction between the current and our proposed policy framework may sound subtle at first glance, but the implications are potentially significant. For example, while the recent merger of BT and EE was granted under the CMA’s theories of harm framework, it could have struggled to gain approval under a “presumption in favour of competition” framework.

[19] https://www.regulation.org.uk/competition-merger_control.html

Under this M&A policy framework, we would expect the interests of UK households to be better assured than under current arrangements, with a much clearer emphasis on consumer interests.

APPENDIX

To calculate the concentration and competitiveness measures, we have drawn on a number of data sources, documented in the table below:

Table 1: Market share data sources

Consumer market	Market share data sources used in analysis
Automotives	Department for Transport data on new car registrations
Groceries	Market share data collated by fooddeserts.org, owned and hosted by Dr Hillary J Shaw (London School of Commerce) and Dr Julia J A Shaw (De Montfort University) Kantar Worldpanel grocery market share data
Broadband	Ofcom Communication Market Reports, 2004-2018 Statistica data on broadband market share
Mobile telephony	Ofcom Communication Market Reports, 2004-2018 Ofcom "award of the 2.3 and 3.4 GHz spectrum bands", 2017 Statistica data on mobile market share
Electricity	Ofgem electricity supply market shares by company
Gas	Ofgem gas supply market shares by company
Personal current accounts	Independent Commission on Banking (ICB), "final report recommendations", 2011 Office of Fair Trading (OFT), "review of the personal current account market", 2013 British Bankers Association, "promoting competition in the UK banking industry", 2014 Competition & Markets Authority (CMA), "personal current accounts: market study update", 2014 Competition & Markets Authority (CMA), "retail banking market investigation: final report", 2016 Financial Conduct Authority, "Strategic Review of Retail Banking Business Models: Progress Report", June 2018
Mortgages	Council of Mortgage Lenders market share data for new lending

The time period covered by these data sources varies, and in some instances we have been unable to acquire data for every single year. We have endeavoured to provide the most comprehensive picture of concentration and competition in consumer markets, given the data available. Where we have been unable to find data, we have sometimes interpolated between data points, or extrapolated.