Competition assessment guidelines

Part 2: guidelines

Competition & Markets Authority

Contents

1. Summary

1.1 Policy makers should conduct an in-depth competition assessment if their proposed policy measure:

1	Directly or indirectly limits the number or range of suppliers
2	Limits the ability of suppliers to compete
3	Limits suppliers' incentives to compete
4	Affects consumers' ability to engage with markets and make choices that align with their preferences
5	Affects suppliers' ability or incentive to introduce new technologies, products or business models

1.2 This document provides policy makers with further guidelines on how to conduct an in-depth competition assessment. The document should be read alongside Part 1 which provides an overview of the competition assessment process. Policy makers should refer to the appropriate chapter in this document depending on what competition issue is likely to affect their policy. The document is structured as follows:[1]

- Chapter 2 addresses how to identify the affected markets and establish a baseline.
- Chapter 3 outlines competition checklist question 1 – will the policy measure directly or indirectly limit the number or range of suppliers?
- Chapter 4 outlines competition checklist question 2 - will the policy measure limit the ability of suppliers to compete?
- Chapter 5 outlines competition checklist question 3 – will the policy measure limit suppliers' incentives to compete?

[1] Chapters 1–8 of the guidelines have been written by the Competition and Markets Authority (CMA). Chapter 9 has been edited but is closely based on material written by Sean Ennis, a Senior Economist in the OECD's Competition Division for the previous edition of the Competition Impact Assessment guidelines, published in 2015. We are very grateful for Sean's support.

- Chapter 6 outlines competition checklist question 4 – will the policy measure affect consumers' ability to engage with markets and make choices that align with their preferences?

- Chapter 7 outlines competition checklist question 5 – will the policy measure affect suppliers' ability or incentive to introduce new technologies, products or business models?

- Chapter 8 considers alternatives to regulation.

- Chapter 9 outlines methodologies that can be used to assess competition impacts.

2. Identifying affected markets and establishing a baseline

2.1 The starting point for any in-depth assessment of the impact a proposed measure might have on competition should be to look at the product and geographic market affected by the proposal. A product market for the purposes of this guidance comprises all those products and/or services which are regarded as interchangeable or substitutable by their consumers. A geographic market comprises the area in which the firms concerned compete in the supply of products or services. Depending upon the circumstances, it could be local, regional, national or international.[2] No formal market definition is required for the competition assessment, but it is useful to identify:

- products and services which are directly impacted by the policy measure;
- wider product markets which might be indirectly affected;
- wider geographic market which might be indirectly affected; and
- related upstream or downstream markets.

2.2 Developing an understanding of the affected markets can help to determine the likely impact on the market, will help to assess whether the policy measure will have the desired effect (particularly if the aim is to reduce or change patterns of consumption) and will make it easier to identify what information needs to be collected and from whom in order to assess the impact of the measure.

2.3 It might be the case, for example, that on closer analysis the measure actually affects two or more markets. The impact of the measure might be different in these different markets depending on the extent and nature of competition in these markets. If one market were more concentrated than the other then the impact of a new regulation might potentially lead to a greater reduction in competition in the concentrated market.

2.4 Alternatively, it might be the case that the market is wider than those suppliers directly affected by the regulation. As outlined in the hypothetical example below, suppliers in the wider market might act as a source of competitive constraint on suppliers affected by the policy changes. The

[2] For detail on market definition see Market investigations guidelines: CC3

extent to which affected suppliers could pass on the costs of regulation to consumers may be limited as a result of the competition they face from the wider geographic market.

2.5 Further it may be the case that consumers will switch from buying the product or service affected by the policy to alternative products or services which are not affected. The extent to which they will do so will depend on the willingness and ability of consumers to switch and the willingness and ability of suppliers to increase their production.

The wider product market

2.6 Consideration should be given to whether or not the policy measure will affect wider product markets, including those products or services that may be indirectly affected by the policy because consumers or suppliers would substitute to other products in response to the new policy.

New regulation requiring professional towel laundering imposed on hairdressers

Suppose a new regulation was proposed that required all towels used in a hair-dressing salon to be laundered professionally. The proposal would affect hair-dressing salons. The regulation would raise hairdressers' costs directly. Hairdressers would likely respond by raising their prices. Consumers, faced with higher prices in hairdressers' salons, may choose to have their hair cut elsewhere where the regulation did not apply and there was no increase in price. Hairdressers themselves may respond by offering to cut hair at customers' homes or in any other location than a salon.

The wider geographic market

2.7 Policy makers should consider whether the wider geographic market will be affected by the proposal. Geographic markets may be local, regional, national or international. While policies may be limited in their jurisdiction, they may have wider effects because of the ability of consumers and suppliers to purchase or supply in a broader geographic area.

2.8 If a firm controlling all the supply in a particular area or region would find a price rise unprofitable due to customers switching to suppliers outside of that area, then the geographic market should be wider than that area. The boundary of the market can be considered again, taking account of some of the other suppliers that customers were switching to.

New regulation imposed on hairdressers (continued)

Extending the hypothetical example above, the restriction on hairdressers requiring hairdressers to launder towels professionally may be introduced only in England. Customers living near the English borders could switch to having their hair cut in Scotland or Wales to circumvent the effect of the regulation (and higher prices in England). In effect the regulation will lead to a step change in costs and prices leading to a diversion along the borders away from English hairdressers. Policy makers might wish to quantify this effect to see if it makes a material difference to the effectiveness of the policy they are seeking to introduce.

Related upstream or downstream markets

2.9 When identifying affected markets it is important to consider whether or not there will be knock-on effects in related markets. In making this assessment, policy makers should identify the supply chain for the product or service affected by the proposed measure and the impact of that proposed measure on the supply chain.

2.10 Policy makers will need to consider the effect of their proposals on suppliers of inputs required to produce the affected product and those who distribute, wholesale or retail the affected products. This requires a reasonable understanding of the production process – where policy makers do not have this information, they should use the consultation process to gather it. In general one would expect the supply chain to respond to regulations that increase demand for a product (such as microchips for dog tagging in the example below). The question that is relevant to policy makers is over what time and at what price.

Regulation requiring micro-chipping dogs

Suppose there were concern about stray dogs, and policy makers wanted to introduce a regulation that would require all dogs to be fitted with microchip identification tags. The aim of the policy measure is to reduce irresponsible dog ownership. Local authorities and charities can no longer bear the cost of having to treat and care for abandoned dogs. Policy makers have been advised that it would be sensible to allow pet shop owners who have received the relevant training to fit microchips into dogs.

What markets would be affected?

The proposed regulation would have a direct impact on the services provided to dogs' owners. Vets and pet-shop owners would need to undertake training, acquire equipment and fit tags in dogs. The cost of this would likely be borne by dog owners who would need to pay more for dogs and dog ownership. The wider market for 'companion animals' might also be affected. The increased cost associated with dog ownership may lead some pet owners to switch to ownership of other pets. Related upstream markets would also be affected by this proposal including:

- UK trainers providing training to vets and pet shop owners
- UK or overseas manufacturers, wholesalers, and retailers of microchips
- UK or overseas manufacturers, wholesalers, and retailers of microchip scanners

What could be the potential competition issues?

The regulation could create a large fixed cost for all veterinarians and pet-shop owners who have to provide dog tagging. Fixed costs (those do not vary depending on the number of dogs tagged) could create a barrier to entry and result in dampening of competition in markets for veterinary services and pet supplies. Policy makers would need to assess the impact of these costs relative to overall firm revenues after the implementation of the regulatory reform to assess the likely effects.

Related upstream markets will need to expand their capacity in order to respond to the increase in demand for micro-chipping. It would be useful to analyse over what time period existing or new suppliers would be able to respond to the increase in demand. If existing providers would remain capacity constrained and entry is costly, it may be that incumbent upstream suppliers would be able to charge higher amounts for the inputs needed to fit tags. Policy makers would have to check with these parties whether or not they would be able to supply sufficient microchips, training and scanners to meet demand for these inputs. These parties may also be able to provide information on the cost of the inputs and the level of current demand, as well as their estimates of the impact of the regulation on prices, which would allow policy makers to estimate the cost of the proposed regulation.

One unanticipated effect that may occur is that dog owners unwilling to pay for tags to be fitted in their pets may abandon them to avoid the regulation. To mitigate this effect policy makers may consider that the requirement should be limited to requiring puppies only to be micro-chipped and registered on a database of ownership.

Establish a baseline

2.11 Once the affected markets have been identified, policy makers will then need to identify the baseline option against which to assess the impact of the policy. This could be the ‘do nothing’ option considered as the baseline in the Impact Assessment process.

2.12 To identify this baseline, policy makers should collate information on:

- the characteristics of products and services in the markets affected by the proposed regulation;
- the nature of competition, including whether competition is between relatively standardised products focused on price, or whether competition is focused on product quality, differentiation and innovation; and
- basic indicators of the state and strength of competition. On the supply side, this could include the number of suppliers; their market shares and profitability; barriers to entry and expansion; and rates of firm entry and exit. On the demand side, this could include barriers to customer switching between competing products or services; rates of switching; and indicators of customer satisfaction. [3]

[3] Further information can be found ing CMA guidance Market investigations guidelines: CC3 .

3. Competition question 1 – will the policy measure directly or indirectly limit the number or range of suppliers?

3.1 Regulations might reduce competition by limiting entry either directly (by regulatory limits on who can participate in a market), or indirectly (through raising entry costs). This is different from the direct cost impact of regulations (which is something which you would expect to be central to the main assessment of the policy).

3.2 Some regulations, such as requirements to invest in new production methods, will result in a direct cost-driven price increase. This will be particularly likely when the supplier is able to pass on increased costs via a price rise to customers, rather than taking a hit to its profitability. A 2014 report by the OFT commissioned from RBB Economics shows that the likelihood and extent of cost pass-through to customers by a business differs depending on whether the cost change is firm-specific or industry-wide; the responsiveness of the demand and supply conditions it faces; and the degree of competition between businesses up and down the supply chain.[4]

3.3 Alternatively, regulation may raise costs and result in firms leaving the market and subsequently enhance the market power for the firms that remain.[5] A reduction in the number of firms in the market might also increase the risk of collusive behaviour amongst suppliers leading to consumers paying higher prices.

3.4 Given the importance of maintaining competitive pressure on existing suppliers, the first question that policy makers should ask when conducting a competition assessment is:

Will the policy measure directly limit the number or range of suppliers?

3.5 A policy measure might directly limit the number or range of suppliers through:

- the award of exclusive rights to supply;

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[4] A report prepared for the OFT by RBB Economics (2014), *Cost pass-through: theory, measurement, and potential policy implications*.

[5] Market power of suppliers is the ability to profitably increase price, decrease quality, or decrease innovation relative to the levels that would prevail in a competitive market.

- procurement from a single supplier or a restricted group of suppliers;
- the creation of a licensing scheme that limits the number of suppliers; and
- the creation of a licensing scheme for quality standards.

Will the policy measure award exclusive rights to supply?

3.6 Exclusive rights to supply exist when an organisation is granted rights by the state to be the sole supplier of goods or services. For example, historically, electricity, natural gas, telecommunications, water, postal services and railroads, for example, were granted legal monopoly status – or exclusive rights – to provide the services.

3.7 Policy makers may consider there is a case for granting exclusive rights to supply goods or services where there are natural monopolies[6] and substantial investments in infrastructure are required that may not otherwise be supplied by the private sector. However, even when there is justification, policy makers should take into account that granting an exclusive right to supply amounts to the establishment of a private monopoly. As a result, the granting of exclusive rights may:

- give firms market power, allowing them to raise prices of the products over which they have exclusive rights; and
- create an opportunity for the firm to leverage market power in related markets.

3.8 Given that the granting of exclusive rights may lead to monopoly pricing and market power, careful consideration should be given as to whether there are less restrictive methods of achieving the same objectives.

3.9 One such mitigation is to consider distributing exclusive rights through a competitive bidding process known as 'competition *for* the market'.[7] To ensure competition for the market has the desired effect of introducing the threat of competition over time, policy makers should ensure that the length of contracts is suitable for the market in question and allows for regular competition for the exclusive rights which is likely to be beneficial unless there are some other requirements such as long term investment. Care must

[6] A natural monopoly is a monopoly in an industry in which it is most efficient (involving the lowest long-run average cost) for production to be permanently concentrated in a single firm rather than contested competitively.
[7] Another mitigation is to seek to introduce at least some competition or contestability in part of the value chain. For example, competition introduced in the non-domestic water supply.

also be taken to ensure that the current provider is not placed in an advantageous position relative to others because of its previous experience and other factors relevant to the bidding process.

Exclusive rights to manage the data and communications network to connect smart meters

The government granted Smart Data Communications Company Ltd (DCC) a licence in September 2013 to establish and manage the data communications network to connect smart meters to the business systems of energy suppliers, network operators and other authorised service users of the network.

In order to mitigate the risk that DCC faces no competition, it has been granted an exclusive licence, through a competitive tender process for a fixed term, to manage platform communications in the energy sector.

DCC also operates under an ex-post price control regime whereby Ofgem scrutinises costs and revenues to help ensure value for money.

3.10 Where exclusive rights are awarded, there may also be a need for further regulation to ensure the monopoly provider does not abuse its market power. In relation to the example above, Ofgem is able to exert direct regulatory control to ensure that DCC applies its charging methodology in line with its licence obligations, as well as regulating the quality and service levels delivered by DCC.

3.11 Awarding exclusive rights to supply to a vertically integrated company – that is, a company that operates in two or more stages of a production process – can also affect other parts of the supply chain. For example, the upstream part of the company – if it had exclusive rights – would be able to supply inputs to its downstream operations at a lower price than it supplies to its competitors. This would put the vertically integrated company at a competitive advantage with respect to other providers in the downstream market.

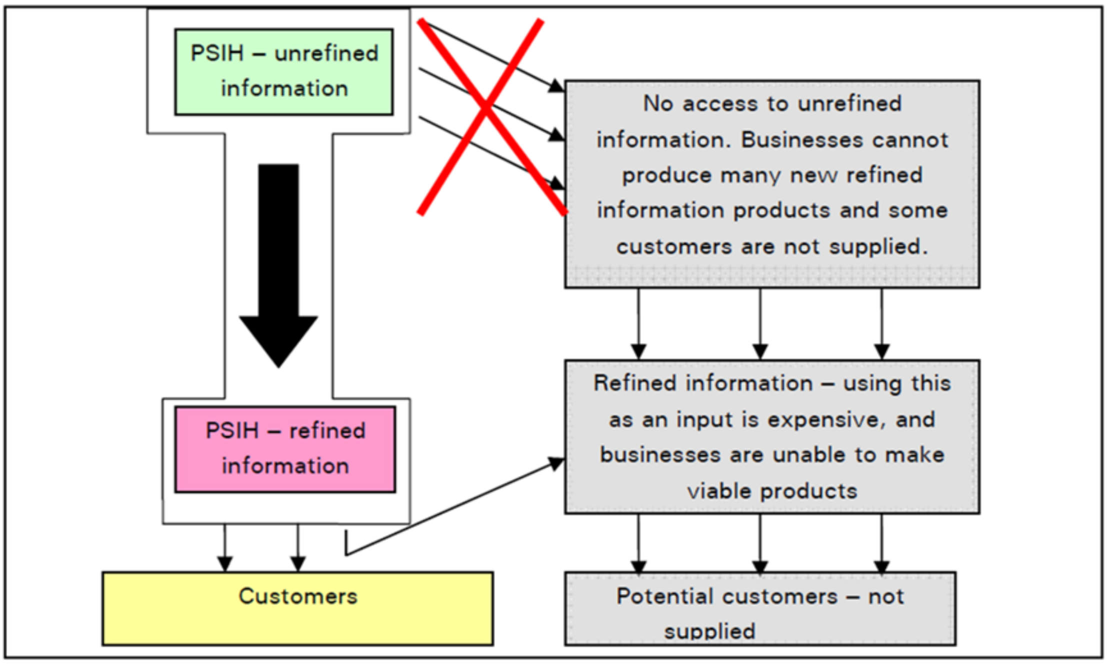
Commercial use of public information (CUPI) market study

Some organisations (mostly public bodies) may have the exclusive right or obligation to collect certain data. Through collecting this information, they are then the only organisation that could supply that information to firms that may want to create value added services using the data. The OFT's 2006 CUPI market study recommended that public sector information holders (PSIHs) should draw a distinction between the information that could only be gathered and supplied by the PSIH ('unrefined' information) and information that could be competitively supplied by other organisations if they had access to the unrefined information ('refined' information). The study recommended that the unrefined data should be supplied to other organisations in a way that would not limit or restrict competition. Issues the OFT identified that raised concern included:

- PSIHs were not defining unrefined and refined information so as to separate the monopoly products from those where there were or could be competition for supply.
- PSIHs were not providing businesses with complete knowledge about the information assets they held that could be considered for commercial use and reuse.
- Negotiations over licence terms and licences could be complex and could impose overly restrictive conditions on businesses that wished to use and reuse unrefined information.
- There could be quality of service issues where there were delays in provision by PSIHs or data that is provided was not accurate.
- PSIHs may not separately account for costs related to unrefined and refined and even where they did so costs may not be allocated appropriately. It is possible that prices for unrefined information charged to businesses were recovering some costs that should be attributed to refined information. If this occurred it would give PSIH an undue advantage in the sale of refined information products.

As the diagram below shows, limited access to unrefined information can restrict the extent that downstream competitors can compete to provide unrefined products:[8]

[8] A PSIH collects the unrefined data and transforms it into refined information before supplying this to users. The PSIH may make access to the unrefined information difficult or impossible for potential competitors that want to produce value added services. The access to the refined information may not have enough detail to enable a competing product to be produced or may be too expensive. Thus these potential products cannot be produced or supplied to the market.



Best practice examples

The Environment Agency has taken a proactive approach to identifying information to be made available for reuse by developing a topic map and has amended the terms on which raw data series are offered for reuse.

The Met Office allocates its indirect/common costs using an activity-based costing approach and separates the information for which it is sole supplier to that where it faces competition from businesses.

Market study Impact

The market study was independently evaluated in 2015.[9] The evaluation found that steps were made in the right direction, but the OFT's recommendations were not fully implemented. There was a tension between the need to finance the PSIHs adequately and a push for free access to information under Open Data which discouraged implementation. However, the CUPI study promoted the Open Data agenda and helped lead to the UK releasing a high volume of data for commercial use. The additional access to information and benefits from value-added products associated with the CUPI report were estimated to be in the range of £10m - £50m.

3.12 Where the assessment points to potential distortions in related markets then policy makers might consider steps to mitigate the effect.[10] These include:

- Periodically reviewing special/exclusive rights.

[9] Evaluation of CUPI study (2015)
[10] Autorité de la concurrence, *Guide for competition impact assessment of draft legislation*. http://www.autoritedelaconcurrence.fr/doc/guide_concurence_uk.pdf

- Separating regulatory powers (for example, granting access to the essential facility, issuing of technical standards) and the task of supplying the goods/services to different operators.[11]

- Considering whether there is a case for functional or structural separation that would prevent cross subsidy from the activity covered by the exclusive rights to downstream markets in which they compete with other providers.[12]

- If not, consider making the monopoly provider set up an activity-based accounting system that distinguishes between activities relating to the supply of goods or services in the sector for which exclusive or special rights are granted and, other activities relating to the supply of goods and services.

- Where an essential input is being made available for reuse to all customers this should be on comparable terms to those that the vertically integrated company provide to their own internal operations.

Will the policy measure result in procurement from a single supplier or a restricted group of suppliers?

3.13 Large public sector organisations, such as prisons, may purchase all of their requirements from a single supplier. They may do so because they consider it is logistically easier to deal with a single supplier who understands their particular requirements and can supply across a number of regions. There may also be benefits resulting from efficiencies in the procurement administration and lower costs from awarding a single contract.

3.14 However, where a policy proposal would lead to a single supplier gaining a public sector contract, and that single supplier is the sole supplier or one of a few suppliers in the market, the procurement process is akin to the award of an exclusive right to supply and the same competition issues apply. The benefits of restricted procurement processes should be weighed against the loss of competition and choice.

3.15 As with the awarding of exclusive rights to supply, procurement from a single supplier or a restricted group of suppliers should involve a competitive bidding process. Bidding markets are often used in situations where it is known that there will be no competition in the market, and thus no

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[11] Eurotunnel is an example of “split ownership” in practice: it is operated entirely separately from train companies (such as Eurostar) who use the facility.
[12] An example of this “structural unbundling” was seen in Ofcom’s decision to split BT’s wholesale and retail activity into two companies with the creation of BT Openreach.

competitive pressure, to ensure that potential suppliers face competitive pressures in bidding for the contracts.

3.16 In order to maximise competitive pressures in bidding for contracts, policy makers should consider whether the design and implementation of commissioning and procurement policies and processes can be altered to encourage bidding. Long and complex bidding processes can create barriers to entry by increasing the costs of entering public markets and disproportionately favouring large suppliers and incumbents that will typically have more resource to devote to the bidding process.

3.17 The size of the contract on offer may also limit the number of firms able to bid, and this may itself restrict the number of potential suppliers. Frequently in large contracts sub-contracts are let to smaller, and often more specialist, suppliers. It may be possible to consider designing the supply chain to ensure there is sufficient competition for the market. In the absence of significant, countervailing economies of scale and scope, consideration should be given to disaggregating contracts for different services to encourage the widest possible range of suppliers and avoid incumbency advantages.

3.18 Policy makers looking for a more detailed discussion of how best to design commercial strategies and contracts that promote competition and healthy markets should consult the Market Management Guidance Note of the Cabinet Office's Sourcing Playbook.[13] Market management guidance in the Outsourcing Playbook.[14]

Will the policy measure introduce a licensing scheme that controls market entry through a fixed limit on the number of suppliers?

3.19 In certain sectors such as dentistry, pharmacies and taxis, licensing schemes have been used to limit the number of firms that can operate in the market.[15] The limit may relate to the absolute number of firms that can operate, or it can be a function of population or other proxies for demand.

3.20 Policy makers may introduce a limit on the number of suppliers (or, at the extreme, grant existing suppliers rights to veto new entry) because they believe that there is an optimum level of provision in these sectors and too much entry will lead to oversupply, resulting in inefficiency and lack of

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[13] Market Management (publishing.service.gov.uk)
[14] The Outsourcing Playbook (2020).
[15] For example, in 2019 86 licensing authorities in England (30% of the total) had restrictions on the numbers of taxis (there are no limits on PHVs, Private Hire Vehicles). Taxi and Private Hire Vehicle Statistics: England 2019 (publishing.service.gov.uk)

profitability. Such restrictions would protect incumbents from competitive pressure and are likely to result in less competition and choice.

Pharmacies

In 2003 the OFT published a market study into the retail pharmacies market. The market study considered the control of entry regulations that had restricted, since 1987, the number and locations of National Health Service (NHS) contractor pharmacies. These regulations were based on an assessment of whether the entry of a pharmacy was 'necessary or desirable' for the adequate provision of pharmaceutical services in the local community. The OFT recommended removing the regulations that restricted the setting up of new community pharmacies.

There were concerns that free entry would be too disruptive for the market (e.g. it might cause a shortage of pharmacists or net exit as many existing pharmacies left the market). The recommendations were partially adopted in 2005 allowing (in England) for a criterion of 'reasonable choice' for consumers to be added to the entry test and exempting some pharmacies from the test including those open for at least 100 hours a week.

The impacts of these changes were independently evaluated in 2010.[16] The evaluation showed that the changes to the regulations led to a 9 per cent rise in the number of pharmacies in England, with no increase in exit while average dispensing per pharmacy continued to rise. Sixty percent of the increase in pharmacies was due to pharmacies with a 100-hour exemption, leading to longer opening hours. These longer hours allowed 1.6 million visits to be at different more convenient times such as after work.

There was no evidence for the feared ill-effects (e.g. service disruption) materialising, and total funding for community pharmacies by the NHS did not increase. However, as predicted by the OFT, the partial adoption of the recommendations led to more appeals and administrative costs resulting in additional annual monetary costs to the NHS of £3.8m and to businesses of £8.7m.

The evaluation quantified some of the benefits: in particular, it found that reductions in travel and waiting times, as well as savings resulting from wider availability of supermarket pharmacies, generated consumer benefits of £25m-33m. An alternative survey methodology estimated the wider consumer benefits in the availability of prescriptions to be £21m to £68m per annum. The survey methodology better accounted for the improved (prescription) convenience, but still did not take account of the improved offering in other pharmacy (non-prescription) goods and services. Overall the benefits (even of the partially implemented recommendations) significantly exceeded the costs.

[16] Evaluating the impact of the 2003 OFT study on the Control of Entry regulations in the retail pharmacies market OFT1219 2010

Will the policy measure introduce a licensing scheme that controls market entry through quality standards?

3.21 Licensing is frequently used as a means of ensuring suppliers have achieved a minimum level of competency or are fit to operate in a particular market. In some professions, such as the legal and accountancy professions, only persons holding certain qualifications are allowed to work in that profession. Restrictions such as this are a form of licensing. While benefits may arise in terms of ensuring a consistent standard of service, licensing schemes that control market entry through quality standards can harm competition.

3.22 Setting quality standards through licences will result in reduced numbers of suppliers or professionals in the market, which may help to keep fee levels high. The higher standard of provision may also restrict choices and ultimately result in reduced competition for those with low price and low quality preferences.

3.23 Many licensing schemes are self-funding. The cost of entry is directly linked to the licence fee or to changes in the entry requirements. The cost of new entry should be considered against the revenues that a new entrant could expect to receive. Should licensing costs be high relative to expected revenues then the cost may create a barrier to entry. Further, depending on market conditions, licensing costs may be passed on to consumers in higher prices.

3.24 Given the potential for licensing systems to restrict choice and create barriers to entry, careful consideration should be given to the pros and cons of introducing a licensing scheme.

3.25 Where it is decided that a licensing regime should be introduced, the incentives to comply with the licensing regime should also outweigh the incentives for non-compliance. Otherwise, unlicensed firms may continue to operate in competition with licensed firms and this might destabilise the licensing regime itself.

Legal Services market study

In 2016, the CMA published a market study into legal services which identified concerns regarding the sustainability and flexibility of the legal services regulatory model in England and Wales.

Amongst other conclusions, the CMA found that:

- reserved legal activities have the potential to have a significant negative impact on competition, in that unauthorised providers, which may be lower cost providers, are restricted from competing in the legal areas to which the reserved legal activities relate (although this could be justified from a public interest perspective, the CMA found that some of the reserved legal activities were poorly aligned with the risks of providing legal services to consumers).
- 'unauthorised' providers, which may be lower cost providers, were sometimes restricted from competing due to restrictions that prevent solicitors from offering non-reserved legal activities from unauthorised firms, and the importance customers place to titles such as 'solicitor' as indicator of quality.

The CMA considered that the review should be based on the following key principles:

- The regime needs to be more flexible – the current reserved legal activities would preferably be replaced (or supplemented) by an ability for the regulator to introduce or remove regulation directly in legal service areas which it considers pose the highest risk to consumers.
- Regulation should be proportionate and its costs justified on the basis of risk assessment. This means that when regulation is reviewed it is removed when there is insufficient evidence of risk.
- The scope of regulation should focus on activities and risks to consumers, with a shift away from regulation attaching solely to professional titles. An implication would be that some activities of currently unauthorised providers may fall within the regulatory net.
- Solicitors and other professionals should be less tightly regulated than they currently are for lower risk activities, reducing the costs of regulation and encouraging different approaches and business models.

In its response to the CMA's market study the government indicated that it could not commit to a formal review of the regulatory framework at the time, but agreed to continue to reflect on the potential need for such a review.

The CMA published a review of its findings in 2020, and noted limited progress towards the implementation of regulatory reform recommendations since the publication of the market study.
Source: CMA (2020), Reforming Regulation Initiative CMA response
CMA (2016) Legal services market study: Final report *and*
CMA (2020) Review of the legal services market study in England and Wales)

Will the policy measure indirectly limit the number or range of suppliers?

3.26 Policy makers undertaking a competition assessment should assess whether the proposals may indirectly limit the number or range of suppliers in a market. A policy may have this effect if it:

- significantly raises the costs of incumbent firms, causing them to exit the market;
- significantly raises the costs of new suppliers (including small businesses) relative to existing suppliers; and
- significantly raises the costs of some existing suppliers relative to other existing suppliers.

Will the policy measure raise the costs of existing suppliers and cause them to exit the market?

3.27 A policy measure may increase the cost of doing business to such a level that it is no longer profitable to compete in the market. Should sufficient numbers of firms leave the market or should particular competitors leave the market that were an important source of competitive constraint, then the competitive dynamic may change. Gaining an understanding of which types of business (if any) might leave the market will provide insight into the likely changes in the structure of the market and whether there will be a subsequent reduction in competition.

3.28 In order to assess the impact the cost of meeting the regulation will have on competition, policy makers can ask:

- What are the components of the costs that have to be incurred? Are these costs fixed or variable costs?[17]
- How large are the costs relative to businesses annual sales revenues?
- Will these costs lead businesses to exit the market?
- Which types of businesses are more likely to exit and will there be an ongoing source of competitive constraint in the event of exit?

[17] If regulations impose high levels of fixed costs these are more likely to represent a barrier to entry than variable costs which vary depending on the scale of production.

Will the policy measure significantly raise the costs of new suppliers relative to existing suppliers?

3.29 Policies raising the cost of entry may deter potential new suppliers. Policy makers should consider the risk that policies raise the costs of all new suppliers relative to existing firms and whether the policy will have a disproportionate impact on small and medium-sized enterprises.

3.30 Existing suppliers can often persuade policy makers to exempt them from the impact of new policies, at least for a time. This exemption, even if temporary, may deter new entrants who face higher costs in complying with the policy. Alternatively, when faced with scarce inputs, such as airport landing slots and radio spectrum, existing suppliers may argue that they should be given preferential access ('grandfather rights') or preferential rates for these inputs than new entrants to the market. In both these cases, new suppliers will face higher costs than existing suppliers and may be deterred from entering the market as a result. It is important therefore that regulatory proposals that raise barriers to entry are proportionate and do not afford undue protection to incumbents.

Airport slot allocation

The CMA has previously advised that the current regulation of airport slot allocation distorts competition in the airline to passenger market by protecting incumbents, who have an indefinite right to an airport slot, if they use their slots for a set % of the time (also known as the 'use-it-or-lose-it' rule).

- Airlines may hold onto slots they do not necessarily need or are not able to use efficiently, simply to prevent other airlines from using them.
- Incumbent airlines do not have an incentive to use slots in the most efficient way, for example they can use smaller aircrafts rather than maximise the capacity the slot offers.
- Grandfather rights restrict the ability of new or smaller airlines to enter the market or expand their offerings.

These distortions could limit choice of airlines, routes and flight times for passengers, and could lead to worse outcomes in terms of the routes and frequency of services, and higher air fares.

The CMA has advocated changing the current regulations from an administrative allocation system to a market-based approach (such as auctioning).

The CMA considered that an auction mechanism would promote competition between airlines and generate benefits for passengers, businesses, airports and the wider economy and alleviate many of the inherent problems of the administrative system. The introduction of a formal price mechanism means that airlines would face a direct cash cost of holding a slot, which could create the right incentives to use slots efficiently or exchange or sell slots to airlines that may use the slots more efficiently.

Short of that, the CMA has suggested that the administrative rules should be changed to move from a perpetual license to a time-limited allocation, allowing for new airlines to enter and expand services at busy airports.

Source: CMA (2019) Aviation 2050, Response from the CMA and CMA (2020) Reforming Regulation Initiative CMA response.

3.31 Small businesses can be an important source of dynamic competition in a market. The evidence indicates that government regulation and policies usually have a disproportionate impact on small businesses (up to 49 employees) – including micro businesses (up to 10 employees) mainly because they have significantly less resources available to cope with regulatory change and ongoing compliance costs.[18] Regulations that are likely to have a disproportionate impact on small firms can potentially cut off an important route of entry and source of competitive constraint.

3.32 The regulatory scrutiny process requires a small and micro-business assessment (SaMBA) to be undertaken to ensure that major new regulatory proposals are designed and implemented so as to mitigate disproportionate burdens. The assumption is that there will be a legislative exemption for small and micro-businesses where a large part of the intended benefits of the measure can be achieved without including them. Where this is not possible the Framework Manual[19] sets out other ways the impact on small businesses can be mitigated such as by extending transition periods or temporary exemptions where immediate compliance would harm their business.

3.33 Policies may raise the costs of firms wanting to exit the market and this may itself deter new entry. For example, if regulations require large investments

[18] BEIS (2020), *Better regulation framework manual, Practical Guidance for UK Government Officials*. Note that as of July 2023, this guidance is out of date and new rules will apply.
[19] Note that as of July 2023, this guidance is out of date and new rules will apply.

in specialist equipment to meet quality standards which cannot be recouped on exit from the market then this may deter companies from entering at all.

3.34 In order to determine whether the policy will deter suppliers from entering a market, the costs should be compared with the likely revenues of firms to assess their deterrent effect.

Will the policy measure significantly raise the costs of some existing suppliers relative to other existing suppliers?

3.35 Policies may, deliberately or inadvertently, favour some suppliers over others. For example, a policy that requires firms use a particular technology will favour those firms who have already adopted this technology. Such firms would then face lower costs than their rivals, for example, because they don't need to reconfigure their existing arrangements.

3.36 Similarly, a policy that specifies a product standard may favour suppliers already meeting that standard over others that are not. This situation may be further exacerbated if one supplier holds intellectual property rights that enable it to achieve the specified product standard. Alternative suppliers may be inhibited from competing by the need to licence the technology from the rightsholder or innovate around the existing right.

3.37 Policies may also create competition distortions by favouring certain types of business models over others. Policy makers, particularly those overseeing mixed markets where private, voluntary and state-owned undertakings compete alongside one another, should consider whether their proposals are 'competitively neutral'. This means that no firm should have a significant competitive advantage purely as a result of its ownership or control. Conferring advantages as a result of ownership or control may result in some inefficient firms remaining in the market and some more efficient firms being unable to grow and innovate effectively. This inefficiency may lead to lower quality and higher prices for consumers and also to lower levels of innovation in the sector as a whole than would otherwise have been the case.[20]

3.38 Key barriers to competitive neutrality are:

- differences in regulation, pension, and tax treatment between public private and voluntary providers; and

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[20] Further information about competitive neutrality can be found in OFT (2010), *Competition in mixed markets: ensuring competitive neutrality* (OFT1242) and in OECD (2015), *Discussion on Competitive Neutrality*

- incumbency advantages enjoyed by existing firms, such as access to information, pre-qualification and bid criteria, and transition costs.

3.39 Ensuring policies are competitively neutral may also require policy makers to consider whether consumers are afforded the same level of consumer protection regardless of the type of provider they choose.

Competitive neutrality in higher education

In a 2016 report on the higher education sector in England, the CMA raised concerns that some providers were operating outside the regulatory regime designed to protect students from poor quality. The nature of the higher education experience, namely that students cannot fully appreciate the quality on offer before they choose which university to attend, justifies a market intervention to assure quality.

The CMA was concerned that students would not appreciate that some institutions operated outside the quality assurance regime. Further concerns were raised that institutions operating outside the regulatory framework would not have sufficient incentives to focus on providing students with a quality learning experience.

This work influenced the UK's Higher Education and Research Bill. The Bill was enacted in 2017, establishing the Office for Students (OfS). As part of its general duties, the OfS must have regard to the need to promote quality, and greater choice and opportunities for students, in the provision of higher education by English higher education providers.
Source: *An effective regulatory framework for higher education: a policy paper*

4. Competition checklist question 2 – will the policy measure limit the ability of suppliers to compete?

4.1 Competition between suppliers may focus on price, quality, service or innovation. In some circumstances, policy makers may seek to place limits on these parameters. Policies that restrict the means by which suppliers compete with each other can inhibit competition between those suppliers. Regulations may also prevent innovative suppliers from developing new product characteristics, carrying out new advertising and marketing initiatives, or using alternative sales channels.

4.2 Policy makers should ask whether proposals limit the ability of suppliers to compete, for example where a policy:

- controls or substantially influences:
  - — the price a supplier may charge; and/or
  - — the characteristics of the products supplied, for example by setting minimum quality standards;
- limits the sales channels a supplier can use, or the geographic area in which a supplier can source inputs or operate;
- substantially restricts the ability of suppliers to advertise their products; and
- limits the suppliers' freedoms to organise their own production processes or their choice of organisational form.

Will the policy measure control or substantially influence the price a supplier may charge?

4.3 Concern about the price of goods and services may result in a policy that sets minimum or maximum prices (price floors or ceilings) for particular products or services. The policy objective may protect consumers in some respects but there may be significant adverse effects on competition, meaning that in some cases consumers may pay more than they would absent the floor or ceiling.

4.4 Minimum prices (price floors) have sometimes been proposed to ensure that certain quality or safety standards are maintained, in the interests of consumers, or (as with the case of minimum pricing in alcohol)[21] to limit consumption for public health reasons. Whether or not they achieve their social goal, the unintended side effect may be to protect producers from the competitive process. The price increase may also generate windfall gains for producers/retailers depending on where there is market power in the supply chain. Unlike an increase in tax, additional consumer spending would go to retailers rather than government. The unintended consequence may be to give retailers an incentive to sell more, rather than less, of the product in question, as retailers would gain additional profit for every extra unit they sold.

4.5 If the policy objective is to raise product quality, direct regulation of product quality might be a less restrictive means of delivery, although policy makers should note that some forms of quality regulation can themselves limit competition. If the policy objective is to limit harmful effects from excess consumption, imposing or increasing any duties or taxes payable on a product ensures that suppliers will continue to compete and innovate over the portion of the final purchase price on which they can make a profit.

4.6 On the other side of the spectrum, maximum prices (price ceilings) which are aimed at protecting consumers or purchasers from high prices may act as a focal point for suppliers, with prices drawn to the ceiling, reducing the intensity of price competition between suppliers. The imposition of maximum prices may also lead to some suppliers exiting the market, may distort the choice of products supplied, may limit innovation, and may lead to the imposition of hidden charges to circumvent the price ceiling.

Price controls on fruit and vegetables in Greece

In June 2011 the Greek government removed mandated maximum mark up prices on fresh fruit and vegetables. Research found that abolishing markups led to a significant cut in wholesale prices of previously 'protected' products and as a result retail prices also went down. The researchers suggested that mandated mark-ups enabled wholesalers to set their prices very close to the maximum allowed margin. Once this policy was removed, wholesalers were no longer constrained by the mark-up policy and this encouraged further competition.

Source: OECD, Evaluation of competitive impacts of government interventions (Paper by C. Genakos, Pantelis Koutroumpis, and Mario Pagliero).

[21] A ban on the sale of alcohol below cost price, defined as alcohol duty plus VAT, came into force on 28 May 2014. This followed the government's announcement in July 2013 that it would not introduce a minimum unit price. Alcohol charities and public health groups continue to argue for the introduction of a minimum unit price, claiming that this would have more of an impact on alcohol-related harm than the ban on below cost selling. A minimum unit price of 50p per unit has been in place since May 2018 in Scotland and since March 2020 in Wales.

4.7 Price ceilings may be intended to protect consumers from producers with market power but there may be less restrictive means of delivering this objective. Educating consumers and providing sources of comparative information, establishing disclosure requirements and standards for presenting information, or mandating cooling-off periods are less restrictive alternatives. If a price ceiling is still judged desirable, care should be taken that it is sufficiently flexible to accommodate different business models.

The CMA's view of price caps in the payday lending sector

In 2015 the CMA concluded its market investigation into the payday lending market. As part of the investigation, it considered the impact of the Financial Conduct Authority's (FCA) price cap on the features of the market that the CMA had identified as giving rise to competition concerns.

The CMA considered the price cap would lead to some advantages:

- The price cap may have led to some simplification of the products on offer in the market (for example, in relation to late fees and charges), which might have increased the comparability of different payday products, making it easier for consumers to identify the best-value loan for their requirement.

- To the extent that the cap – together with the FCA's enhanced regulation of the payday lending sector more generally – improved the reputation of the sector and offered borrowers additional protection, it may have reduced the risk perceived by consumers of switching lender.

However, the CMA did not expect these effects of the cap to be sufficient to address the competition concerns it found. So further competition-enhancing measures were required because:

- Features of the market which limited consumers' responsiveness to prices would be expected to continue to restrict competition between lenders even in the presence of the price cap. For example, the cap was highly unlikely to reduce the perceived urgency underpinning many borrowers' decisions to take out a payday loan, or remove the uncertainty that many consumers face when deciding which lender to borrow from.

- The cap was also unlikely to mitigate any of the characteristics of the payday lending market which limit the constraint that lenders face from the threat of entry and expansion.

The CMA also identified some potential negative impacts of the price cap on competition.

- The cap may have weakened the competitive constraint in the market if, by reducing expected post-entry profitability, the cap reduced the incentive for new lenders to enter and increased the resources and time required by a new entrant to overcome its initial disadvantages and establish itself in the market.
- The cap may also have further dampened price competition between lenders by providing a 'focal point' or 'going rate' for payday loan pricing. It was possible that lenders priced up to the level of the cap, facilitated by the barriers to entry and expansion in the market.

However, while the CMA acknowledged the possibility that the price cap might become a 'focal point' for coordination, it also noted that the significant variation in market shares, efficiency, costs and products offered by different lenders would likely frustrate coordination efforts, particularly if the obstacles to competition we have identified were addressed effectively.

Source: CMA (2015), Payday lending market investigation – Final report.

In 2017 the FCA published a feedback statement on high-cost credit, including a review of the high-cost, short-term credit price cap. The findings indicated that the cap protected consumers from excessive charges as:

- Consumers paid less for loans and were more able to repay loans promptly.
- Consumers who couldn't access products because of the cap, had not generally turned to other forms of high-cost credit or illegal money lending.
- Although the market declined post 2014, at the time of the feedback statement, there were signs of recovery.

Source: FCA (2017), Feedback Statement - FS17/2: High-cost credit

Will the policy measure control or substantially influence the quality and characteristics of the products supplied?

4.8 Policies may be introduced to safeguard consumers from products that are of poor quality, or restrictions set on the nature of the product or service to be supplied. The justification may be that consumers are unable to monitor the quality of products and may suffer harm as a result, or that certain content standards are required by consumers (for example, the provision of information in multiple languages).

4.9 Such policies may restrict the ability of suppliers to compete with each other by differentiating their products, and may prevent informed consumers from purchasing a lower quality, low cost product. Where safety is not an issue and if standards are set above the level that a well-informed consumer would choose, minimum quality levels may have the effect of removing the offer of certain products/services for which there is demand from certain customers, and reducing the choices available to them. For example, a policy requiring all airlines to provide all passengers with a hot meal on short-haul flights would require 'no-frills' airlines to offer customers hot meals when those customers may prefer a cheaper flight with no hot meal.

4.10 The specification of certain content or quality standards may also increase suppliers' costs. Higher costs incurred by businesses will typically translate into higher prices paid by consumers and reduction in the variety of products and services available.

Regulating the quality of bottled water

Imagine there was a concern about consumers being misled about the origins of bottled water. A group of consumers have written to your Minister expressing their concerns that they purchased bottled water assuming it was mineral water captured straight from the source. But when they read the small print on the bottle they found that they had purchased filtered tap water.

One solution to protect consumers might be to improve the quality of bottled water by regulating so that all firms selling bottled water have to sell directly sourced mineral water. Consumers would not be misled into purchasing lower quality filtered water in the future.

However, the effect of such a regulation would be an eradication of other types of bottled water, including table water and filtered water. Consumers who prefer these lower quality, lower cost options would no longer be able to purchase, resulting in a reduction of consumer welfare. In addition, the market for bottled water might become more concentrated as a result of the regulatory change (with producers of table and filtered water having to leave the market), potentially resulting in remaining bottle water producers having sufficient market power to raise prices.

An alternative to regulating water quality would be to introduce an information remedy which requires producers to clearly indicate the origins of the bottled water.

4.11 In considering the impact on the market of a minimum standard, it is important to take the nature of competition in the market into account. For example, a market with a high level of product or service differentiation will be impacted more by quality standards. If aspects of the product or service that are decisive for the competitive positioning of operators are harmonised, negative impacts on competition are more likely than with harmonisation of parameters over which operators do not compete. Policy makers should also consider if the standard could inhibit entry or innovation, for example by setting minimum interoperability standards which are very expensive for new entrants to comply with.

4.12 Hard restrictions on quality may not always be necessary to achieve the desired result. Seller reputation can safeguard quality, particularly where consumers can observe and understand quality and make repeat purchases. Ensuring the supply of information on product quality and safety may be sufficient to allow consumers to make informed decisions at the time of purchase.

4.13 Quality standards need not always be set by the government. Industry participants may be able to develop standards themselves through self-regulation. As the standard setters are specialists and have an incentive to reach a solution which minimises regulatory burden on them, this may result in a standard which is more fit for purpose and has less impact on competition. Self-regulation can be a lighter touch way of achieving a solution, but in some instances, industry may use self-regulation to further their own interests, and in these circumstances legislating might be a preferable approach to protect competition – for more detail on this, see paragraph 8.7.

4.14 If it is desirable to impose a minimum standard, the policy maker should consider carefully what form this should take. Ensuring quality through performance-based standards is preferable to prescriptive standards, and less likely to harm innovation, since suppliers are able to tailor their products to the standard, compete over efficient modes and methods of production, and ultimately provide more choice for consumers. For example, pollution controls on car emission limits are preferable to restrictions on engine capacity, since they provide incentives for producers to develop new technology that minimises pollution.

Will the policy measure limit the sales channels a supplier can use, or the geographic area in which a supplier can source inputs or operate?

4.15 Some policies may limit how products or services can be supplied, or place restrictions on the area in which they can be supplied. Both of these types of restriction may limit innovation or act as a direct restriction on the number of suppliers in an area, weakening the competitive constraints that existing suppliers face. Such restrictions are likely to be particularly harmful where there is limited inter-brand competition (i.e. competition between different manufacturers or different suppliers is weak).[22]

US motor vehicle manufacturers

In 2015, staff of the US Federal Trade Commission (FTC) commented in support of proposed amendments to a Michigan law prohibiting motor vehicle manufacturers from selling new motor vehicles to consumers except through independent franchised dealers. The restriction on sales channels was having the effect of preventing a prospective manufacturer from choosing to sell its new product through a direct distribution method that it believed would reduce the costs of distribution and be more responsive to consumer preferences.

Although the amendments were drafted narrowly to cover only the prospective manufacturer's new product category, the FTC staff recommended more broadly that all restrictions on sales channels for motor vehicles should be removed. Absent public policy considerations, the law should permit manufacturers to choose whether to distribute their products directly, through third parties, or a mixture of both. Distribution methods resulting in higher prices or poorer service to consumers would be weeded out through the process of competition, without the need for government intervention.

Source: US Federal Trade Commission website.

4.16 It is rare that a restriction such as government limiting supply channels or areas will be needed to meet public policy objectives. The primary justification for the restriction in the example above was to protect independent dealers from the excessive exercise of market power by their suppliers. However, the FTC noted that a narrowly crafted provision to protect franchised dealers from abuse in their franchise relationships could achieve this goal without stifling competition.

Will the policy measure substantially restrict the ability of suppliers to advertise or market their products?

4.17 Advertising provides an important means by which suppliers promote their products and by which they differentiate their product from those of their rivals. Restrictions on advertising may limit competition, particularly if they deter new entrants unable to make consumers aware of their new products.

4.18 Advertising restrictions may be imposed as part of a mechanism to ensure quality or to moderate consumption of goods or services which may be

[22] Government intervention to limit sales channels or areas should further be distinguished from circumstances where suppliers choose to limit sales or distribution channels of their own volition (eg through vertical integration), which is likely to bring efficiency benefits.

harmful (such as problem gambling and irresponsible lending). Whilst these policy objectives may be worthwhile, consideration should be given to the effect on competition to ensure the restrictions are not overly restrictive.

4.19 In some cases, industries or professional bodies may support restrictions on advertising as a way of softening competition. Historically, many professions have restricted advertising tightly. There has since been considerable liberalisation of advertising across a wide range of professions.[23] Advertising of professional services is now generally permitted, subject to limitations in relation to advertising which is held to be misleading or harmful to the reputation of the profession.

4.20 By contrast, restrictions on *misleading* advertising are generally pro-competitive in that they ensure suppliers compete on equal terms and that consumers are protected from false claims.

4.21 In order to determine what effect an advertising restriction might have on competition, it is useful to understand:

- To what extent are firms dependent on advertising in this 'window'? Are there other routes to attracting customers and competing to win market share, and what could be the cost implications of investing in alternative routes?

- Would the restriction affect new entrants in particular? Is there any evidence that building market share via advertising in this window is particularly important for new entrants or innovative products?

American opticians

A US study into opticians advertising restrictions compared cities with advertising restrictions for opticians with those without. The study found that, on average the price of an eye test in the most restrictive cities was 33.6% higher than in the least restrictive cities with no appreciable difference in quality.

Original source: Bond, Ronald S, Kwoka, John E Jr, Phelan, John J, and Whitten, Ira Taylor (1980) 'Staff Report on Effects of Restrictions on advertising and commercial practice in the professions: the case of optometry.' Washington, DC: FTC, Bureau of Economics.

Summary, OECD (2004), *Enhancing Beneficial Competition in the Health Professions*.

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[23] Trade associations, professions and self-regulating bodies. OFT408 (2004)

Will the policy measure impose restrictions on suppliers' production processes or choice of organisational form?

4.22 Policies that restrict the production process may have legitimate social objectives such as the protection of employees. Such policies may, however, limit the freedom of producers to operate as efficiently as possible, leading to higher prices for consumers. They may also weaken incentives to innovate. This is discussed further in Chapter 7.

4.23 Policies may also limit organisational forms. For example, as mentioned above, in 2016 the CMA conducted a market study into legal services. The report found that consumers may avoid using unauthorised providers even in situations where they might benefit from using them. The importance of titles (e.g. solicitor) for consumer decision-making and trust may reduce the ability of unauthorised firms to compete, due to regulatory restrictions on solicitors practising in unauthorised firms. The CMA found that these restrictions may unnecessarily reduce the availability of lower cost options for consumers, and so proposed to remove them. [24]

[24] Legal Services market study CMA (2016). Earlier work by the OFT in 2001 looking at competition in the professions more broadly found that where certain professionals (such as accountants) are prevented from organising themselves as public limited companies, or were restricted from forming partnership with other qualified professionals, the regulations limited the development of their services, and inhibited innovative competition restricting choice and quality. Competition in professions OFT328 (2001)

5. Competition checklist question 3 – will the policy measure limit suppliers' incentives to compete?

5.1 The essence of competition is that suppliers compete against each other by offering lower prices, better service, or higher quality products or services to win customers and market share. It is important for policy makers to consider whether proposed measures may reduce suppliers' incentives to compete in this way. This could happen for example, where a measure:

- incentivises suppliers to coordinate their behaviour; or
- exempts suppliers from competition law.

5.2 It may be that a policy measure also reduces suppliers' incentives to compete by increasing the costs to customers of switching between suppliers. This is covered in the following chapter paragraphs 6.25-6.27.

Will the policy measure incentivise suppliers to coordinate their behaviour or publish competitively sensitive information and thereby dampen competition?

5.3 Policy measures can create a situation in which it is in suppliers' commercial interests to coordinate their activities in an anti-competitive manner. Such policies may be introduced with the aim of helping consumers. For example, in some markets, particularly where the product or service on offer is highly differentiated (such as mobile telephone contracts), consumers may find it difficult or costly to compare prices. This difficulty may be resolved by a policy requiring the publication of prices which aims to reduce search costs and making it easier for consumers to compare alternative offers. In most cases where this is being done to overcome barriers to searching and switching, it should be positive for competition.

5.4 However, there are also possible anti-competitive effects associated with information sharing. Suppliers may use information on prices, costs, customers, sales or outputs to coordinate behaviour amongst themselves to the detriment of consumers. The publication of prices may lead suppliers to raise their prices to those achieved by others.

5.5 Some seemingly harmless information may also dampen competition. Publication of market share information, or capacity utilisation information, may give suppliers an insight into the competitive constraints faced by their rivals. The table below sets out the broad level of risk presented by categories of commercial information.

5.6 The likelihood of information disclosure and exchange leading to collusion is more likely if there are few suppliers in the market, the product is relatively standardised, and entry barriers are high. It is less likely where the information is made available to consumers publicly and there is no asymmetry between firms and consumers.

5.7 It should be noted that in some circumstances a degree of information exchange (for example, to set a technical standard) may be preferable from a competition perspective than a centrally-mandated standard

Table 1: Risks of collusion presented by information sharing[25]

Higher risk from information being shared	Lower risk from information being shared
Firm-specific information	Aggregated information
Individualised information	Anonymised information
Non-public information	Genuinely public information
Future information/plans	Historic information
Information disclosed frequently	Disclosure of information is a one off
Information is sent directly by competitor	Information is sent by an independent source
Quantitative information	Qualitative information

5.8 Other types of policy measures can create incentives for suppliers to coordinate their activities in an anti-competitive manner. For example, policy makers may encourage the formation of trade associations, encourage the setting of best practice rules for members or encourage suppliers to coordinate on product design and compatibility. Whilst there may be legitimate reasons for encouraging these types of coordination, an unintended side-effect may be that competitors are better able to exchange commercially sensitive information and collude.

5.9 In addition to sharpening suppliers' incentives to coordinate their behaviour, policy measures may also affect market conditions, which in turn may make

[25] For further details refer to CMA guidelines on *Trade associations, professions and self-regulatory bodies*, OFT408 (2004).

collusion more likely and sustainable. To collude effectively, firms must be able to reach an agreement, to detect breaches of the agreement, and to impose costs on firms that breach it. A variety of market characteristics make collusion more likely, for example:

- there are relatively few firms in the market, they are relatively similar, and their cost base is broadly equivalent;
- stable geographic or customer allocations between firms;
- products are standardised. Fewer differentiating variables in terms of design, innovation, quality or service, make it easier to reach a common pricing scheme;
- there are low switching costs and consumers move around in response to price changes;
- fewer products make it easier to coordinate;
- there are frequent, repetitive bids for specific goods; and
- competitors regularly socialise with each other, through personal connections or trade associations.

5.10 Policy measures which result in or increase the presence of these conditions may increase the likelihood of collusion.

5.11 Whilst not all policy measures that incentivise suppliers to coordinate their behaviour will result in suppliers breaching competition law,[26] policies that do so are particularly likely to harm competition and consumers. UK competition law prohibits anti-competitive agreements between undertakings, and dominant undertakings from abusing their market power.[27] The fact that an agreement is sanctioned by government (national or local), or that discussion takes place in the presence of government officials, does not necessarily prevent it from falling foul of competition law. The types of policy that raise greater risk of suppliers breaching competition rules are set out in the box below.

Are you encouraging suppliers to break competition law?

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[26] In the UK, anti-competitive agreements and abuses of dominance are prohibited under the Competition Act 1998 (CA98).
[27] For further details refer to the CMA guidelines on *Agreements and concerted practices*, OFT401 (2004). CMA guidelines on *Abuse of a dominant position*, OFT402 (2004) adopted by the CMA board. CMA guidelines on assessment of market power in the Market investigations guideline: CC3.

CA98 almost certainly infringed

- Government encourages or brokers an agreement between businesses to raise/fix prices, set minimum prices or allocate customers or areas.

Relatively high risk of CA98 being infringed

- Government acts as a mechanism to co-ordinate the otherwise independent commercial decision-making of businesses through non-mandatory means, effectively substituting individual/unilateral decision-making with a coordination of economic activity (including on price and non-price factors).

- Government encourages or facilitates the sharing of commercially sensitive information from one business to another (directly or indirectly) including information on individual retailer's future commercial policies or intentions.

Relatively low risk of CA98 being infringed

- Government imposes legal requirements that businesses must comply with (although government should consider any potential adverse impact of legislation on competition and seek to mitigate that as far as possible).

- Government disseminates to a business a public policy message (eg explaining potential social health and safety benefits of business activities) and invites business to make unilateral commitments to address the concern.

- Government seeks the views of business, for example through a meeting at which businesses make high-level suggestions to inform government policy.

6. Competition checklist question 4 – will the policy measure affect consumers' ability to engage with markets and make choices that align with their preferences?

6.1 Consumers have an important part to play in stimulating rivalry between suppliers. They do this by making informed decisions which reward those firms that best satisfy their needs or preferences. To make such decisions, consumers need to be able to **access**, **assess**, and **act** on information to select the goods or services that offer the best value, and to **resolve** problems when things go wrong.[28] Policy measures can affect – positively or negatively – consumers' ability to engage with markets in this way,[29] and thereby influence the strength and effectiveness of competition.

6.2 Factors that can indicate the extent to which consumers can engage effectively with markets include:

- the extent to which consumers research options or compare suppliers before making a purchase;
- whether and how regularly consumers switch suppliers;
- the extent to which consumers return unwanted goods or complain when there is poor service;
- levels of consumer satisfaction;
- the prevalence of consumer vulnerability,[30] including "market-specific" vulnerability (e.g. products typically purchased in emotionally difficult circumstances);
- whether suppliers engage in practices that might inhibit consumer engagement or cause them to make choices against their interests (such as obfuscating product information or prices);
- the existence of market features that make it difficult for consumers to make informed choices: for example, product complexity may make it

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[28] OFT (2010), *What does Behavioural Economics mean for Competition policy?* Walker (2017), *Behavioural economics: the lessons for regulators*

[29] In practice, consumer engagement with markets can manifest itself in, for example, consumers researching options and comparing suppliers before purchasing; switching between suppliers; and 'post-sale' activities such as returning unwanted goods, making complaints, etc.

[30] The CMA's work on consumer vulnerability has focused on four characteristics associated with consumer vulnerability: mental health problems; physical disabilities; age; and low income. CMA (2019) Consumer Vulnerability: Challenges and potential solutions.

difficult to compare offers from different providers; or the nature of the product may make it difficult to gauge the quality of what is being offered before, or even after, the good or service has been purchased.

6.3 The existence of such factors might lead policymakers to conclude that measures are needed to help improve consumers' engagement and enable them to make more informed decisions. In deciding on the merits of such measures, policy makers need to ensure that they do not make the functioning of the demand side of the market worse. Such effects may arise if the policy:

- limits ability of consumers to decide from whom they purchase;
- changes the information available to consumers but does not improve their ability to make informed decisions; and/or
- reduces the mobility of consumers by increasing the cost of changing suppliers.

6.4 These considerations are also relevant to policy makers who are introducing measures with aims other than to improve consumer engagement, but where the potential exists to make it more difficult for consumers to find a good deal.

6.5 There are a number of reasons why the demand side of a market might not work well. For example:

- The characteristics of some goods and services may make it difficult for consumers to make informed choices (such as when the product is an 'experience' good) such that the value of the product can only be fully appreciated after consumption.
- The characteristics of consumers may mean that they do not have the time or capability to make informed decisions.
- Actions taken by providers (such as to obfuscate product information), can impede consumers' ability or willingness to access, assess and act on the available information.

6.6 For example, some financial services are inherently complex or require consumers to make difficult judgements about their future circumstances (for example, knowing what type of mortgage will best suit future circumstances). Market factors may present challenges to consumer action, e.g. markets where products are only bought once (such as a pension), or where a purchase is very emotional (such as a funeral). These complexities can make it difficult for consumers to make the best decisions and, in some cases, can deter consumers from trying altogether.

6.7 Such complexities might result in policy makers considering that a market intervention is needed to help consumers navigate complex products and make more informed decisions. In doing so, policy makers need to ensure that they do not make the functioning of the demand side of the market worse. Such effects may arise if the policy:

- limits ability of consumers to decide from whom they purchase;
- changes the information available to consumers but does not improve their ability to make informed decisions; and/or
- reduces the mobility of consumers by increasing the cost of changing suppliers.

6.8 It may be counterproductive to aim for all consumers in a market to engage fully. Detailed information disclosure will be of minimal use to most consumers trying to access, assess and act, and may lead to information overload and poor outcomes. A more measurable realistic goal would be that consumers can distinguish whether they would be better off keeping their current provider or switching. Consumers must understand why the information is relevant and be willing and able to use it in this way.

Will the policy measure limit the ability of consumers to decide from whom they purchase?

6.9 Policy measures that limit the sales channels a supplier can use (as outlined in paragraphs 4.15 - 4.16) may also restrict the suppliers from whom a consumer can purchase. Restrictions of this nature may reflect a concern that it is important that consumers get specialist advice at the point of sale where, for example, certain health products or complex financial products are being supplied. However, the effect of the regulations may be to protect the traditional businesses from competition and may restrict choice at the point of sale, to the detriment of consumers and potentially public policy objectives.[31] Consumers may not receive the desired price or quality for a service as they are forced to purchase from higher cost suppliers or products that are not their preferred choice.

[31] The FSA/FCA's retail distribution review is a good example. Getting rid of a commission funded model implied they were prepared to tolerate reduction in the numbers of financial advisers in the interests of impartial advice.

6.10 For example, rules on what pharmaceutical products can be supplied over the internet may be justified on the basis that consumers would then obtain advice from the pharmacist on how to take the medications. However, in certain countries, long-distance pharmacies have proven track records of safe and effective operations and so such restrictions may unduly restrict consumer choice.

6.11 Further, not all products require the provision of specialist advice. For example, in 2013 the European Parliament considered imposing a requirement to sell electronic cigarettes – generally thought to be safer than normal cigarettes – only through pharmacies. Such a restriction in the availability of electronic cigarettes would have impacted on competition between electronic cigarettes and cigarettes. The proposal was rejected by the European Commission as this reduction in competition could have had negative health consequences.[32]

Will the policy measure affect consumers' ability to make informed choices?

6.12 It is important that consumers have the information they need to make choices. Without some key information being made public, consumers may struggle to compare suppliers. For instance, in the legal services market, the CMA has made recommendations to increase transparency of price, service, and quality information for consumers before the point of purchase.[33]

6.13 However, policy makers also need to take account of consumers' behavioural biases if they are to design measures that does not distort the ability of consumers to make well-informed and well-reasoned purchase decisions. It can be easy for policy makers to apply an information remedy that merely diverts attention from the problem if it has not been tested first. In particular, consumers may:

- Face limitations on how much information they can analyse and, when faced with more information than they can analyse, consider only a sub-set. When prices are presented in parts, consumers may anchor on the first piece of information and discount add-ons.

- Overweight the present and be too optimistic. Consumers may over-estimate how much they will use a good or under-estimate how much it will cost them.

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[32] Financial Times website.
[33] CMA (2016), Legal services market study.

- Be overconfident about their ability to act in the future. For example their propensity to cancel automatically renewed contracts, creating inertia and a failure to act today.

6.14 Research for the FCA has identified ten behavioural biases that affect consumers in retail financial markets.[34]

Table 2: Behavioural biases and effects in retail financial markets

Our preferences are influenced by emotions and psychological experiences	**Rules of thumb can lead to incorrect beliefs**	**We use decision-making short cuts when assessing available information**
Present bias eg spending on a credit card for immediate gratification	***Overconfidence*** eg excessive belief in one's ability to pick winning stocks	***Framing, salience and limited attention*** eg overestimating the value of a packaged bank account because it is presented in a particularly attractive way
Reference dependence and loss aversion eg believing that insurance added on to a base product is cheaper because the base price is much higher	***Over-extrapolation*** eg extrapolating from just a few years of investment returns to the future	***Mental accounting and narrow framing*** eg investment decisions may be made asset-by-asset rather than considering the whole investment portfolio
Regret and other emotions eg buying insurance for peace of mind	***Projection bias*** eg taking out a payday loan without considering payment difficulties that might arise in the future	***Decision-making rules of thumb*** eg investment may be split equally across all the funds in a pension scheme, rather than making a careful allocation decision
		Persuasion and social influence eg following financial advice because an adviser is likeable

6.15 Consumers' tendency to frame their decisions with respect to certain reference points means that they often focus on a few headline rates and ignore the additional information about features or charges that is provided to them. As a result, the provision of extra information may be ignored or may lead consumers to make poorer decisions by increasing the likelihood that they are made on the basis of incorrect beliefs using rules of thumb.[35]

6.16 Several of these biases can result in consumers remaining with their current supplier or the default option. The default can be a form of anchor, and consumers can be overconfident in their ability or willingness to switch away from a contract once they have entered into it. Choosing the default can be encouraged through the way choices are framed (e.g. by being automatically renewed) and be consistent with a rule of thumb (such as only searching if

[34] FCA (2013), *Applying behavioural economics at the Financial Conduct Authority*.
[35] Choice architecture (i.e. the way in which customers are presented with information and choices) and context are often more important than information-based remedies.

the price rise exceeds a certain level). One reaction to overwhelming information or choice overload is to keep with the current default option.

6.17 Consumers that continue to remain with their default or current provider for several years (possibly due to inertia) can pay more as a result (sometimes termed a “loyalty penalty”). The loyalty penalty is where companies penalise longstanding customers by charging them higher prices than new customers, or those who renegotiate their deal, for the same goods or services. The CMA has considered different aspects of loyalty penalty pricing, such as automatic renewal of services as found in the broadband or home insurance market. Such practices increase the risk that customers that get rolled over yearly will pay a loyalty penalty.[36]

6.18 A 2018 joint report by the FCA and the CMA finds that effective demand-side interventions rely on predicting and influencing consumer behaviour under a range of complex circumstances, against a background of many other factors competing for people’s attention. The report provides a framework for designing market interventions.

Helping people get a better deal: Learning lessons about consumer facing remedies FCA and CMA 2018

The paper lays out specific lessons learned about the selection, design and testing of different types of interventions, and summarises them into a set of high-level principles, which are briefly explained below:

- **Understand the problem** – Significant problems can arise on both the demand and supply sides of the market and a combination of supplier and consumer-facing interventions may be needed to deliver better outcomes for consumers.
- **Be bold in identifying possible remedy options** – Think broadly about a range of options and do not rule out radical solutions too quickly.
- **Let consumers stay in control** – The most successful remedies we looked at are those which recognise that consumers are not to ‘blame’ for poor market outcomes, but provide them with the necessary framework, support and tools to make their own robust decisions.

[36] The loyalty penalty can arise through a variety of ways. In some markets there is a sharp increase after the introductory price (‘price jump’) like in energy; in others there are successive price rises (‘price walking’) as in insurance; and elsewhere customers on older tariffs sometimes pay higher prices for similar services (‘legacy pricing’), as in broadband. CMA’s Loyalty penalty update July 2020.

- **Leverage the experience and resources of the private sector** – Try to learn from relevant private-sector approaches, both in terms of what works well and what does not. It may also be possible to directly involve the private sector in an intervention, by directing their commercial incentives to deliver better consumer outcomes.

- **Test the remedy** – The process of identifying and designing effective remedies benefits significantly from testing. Our initial assumptions about what is likely to work may be incorrect.

- **Good analysis is not enough** – Take account of real-life behaviour, pay careful attention to detailed implementation, use effective communication, demonstrate sound judgement in balancing needs of different groups, and act as advocates for policy reform.

- **Review effectiveness** – Ex-post evaluations of effectiveness can provide important insights and lessons for existing and future interventions, as well as helping other regulators if they encounter similar problems in the future.

Source: Helping people get a better deal: Learning lessons about consumer facing remedies (2018)

6.19 In addition, it is useful for policy makers to consider whether the policy will exacerbate behavioural biases and lead to worse outcomes for consumers. A report prepared for the Centre for Competition Policy notes that 'cooling-off' periods are often introduced by financial regulators to provide consumers with the opportunity to review and potentially reverse purchasing decisions made when they were in an emotionally 'hot' state and hence without adequate reflection.[37] However there is the potential for these to trigger even less reflection at the point of sale, leading to outcomes that are possibly worse compared to the situation in which there is no intervention at all.[38] "Cooling on" periods, where consumers have to make a later active choice to complete their purchase, serve as a possible alternative in high risk circumstances or where consumers may make impulsive choices that do not reflect their interests.[39]

6.20 Consumers may benefit if some basic information for comparing providers is made clear and easily accessible. The trade-off may be that other

[37] Behavioural Remedies and Cost Benefit Analysis: A Cautionary Note, Michael Harker and Judith Mehta, Chapter 7 Behavioural Economics in Competition and Consumer Policy, 2013.
[38] A study of an FTC imposed cooling off period (the 1970 rule on purchases made in the home) found that cancellation rates fell after the rule was implemented. Mulholland JP, December 12, 2007, 'Behavioral Economics and the Federal Trade Commission', available at SSRN: http://ssrn.com/abstract=1091745.
[39] For example, until 2005 in the UK, there was a mandatory 24-hour waiting period for casino membership, in order to prevent impulsive gambling.

information that some consumers used is made less salient – for example, if it is easy to compare providers' prices, consumers may pay less attention to quality factors – but overall consumers benefit from less confusion and can make better decisions.

6.21 In many markets, regulation has meant the information required to search and compare providers is made available by firms to all customers. For instance, all customers should be told their annual gas and electricity usage by their supplier. There are some markets where the information required for an equivalent comparison is so complicated that other means are needed to share this with potential providers. The CMA introduced Open Banking which should allow a customer shopping around for a bank account to authorise a digital comparison tool website to access their banking information and find out from their current provider what their usage of different account services (such as an overdraft) was and thus calculate how much other providers would have charged for that usage.

6.22 Particularly when dealing with behavioural impacts, regulators must be careful of unintended effects. If one piece of information (such as price in a home insurance policy) becomes more salient, there is a risk that competition in the market could turn into a race to the bottom. All the variety of value-added services, e.g. on insuring outbuildings or accidental damage, could be forgotten in a contest to offer the lowest headline price. One way to be alert to this risk is by detailed testing of any proposed policy or regulation that relies on affecting how consumers interact with a market.

6.23 Testing policy interventions could be done in several stages. There could be an experimental approach in a simulated test environment or survey which is designed to gain customer feedback on several different versions of the policy. Later, the preferred approach could be loaded onto a trial and consumers participating in the test could share their views on how easy or natural they found the process and how they felt they would respond in a real situation. There would also be the possibility of designing a randomised controlled trial (RCT). This would randomly allocate consumers that were about to go through the process under consideration (such as about to buy the product in question), into either receiving the control treatment (i.e. the default or previous choice options) or receiving the newly designed choice environment. The difference in response between these two equivalent groups experiencing different information content and presentation would provide a measure of the impact of the policy.[40]

[40] Fletcher (2016) The Role of Demand-Side Remedies in Driving Effective Competition A Review for Which?

Will the policy measure reduce consumer switching the by increasing the explicit or implicit cost of changing suppliers?

6.24 Policies that increase switching costs are likely to lead to a softening of competition.[41] For example, the government may introduce a new policy which requires consumers to provide more detailed information when applying for a mortgage. This will raise switching costs and may deter consumers from switching altogether, thereby reducing the need for providers to compete in order to hold on to customers.

6.25 In some cases, people may use rules of thumb or other shortcuts to mitigate the effects of switching costs. For example, faced with increasingly complex products and constraints on their time, behavioural economics has shown that consumers may (sometimes rationally, given the circumstances) choose to limit their search, and therefore not necessarily purchasing the best value package for them. They may defer to an intermediary for advice, employ a heuristic technique ('rule of thumb'), or forgo the purchase because of the time and effort required to fully research and evaluate the offer. It is important for policy makers in these circumstances to be aware of these difficulties and design policies accordingly.

6.26 Policy options that help consumers to make more informed choices and overcome behavioural biases could involve requirements to simplify tariff structures or to develop price comparison websites to aid transparency.

6.27 While reducing switching costs generally leads to competition benefits there can be cases where interventions to reduce switching costs may not always be welfare enhancing. For example, US research studied the impact of policies that nudge consumers towards better decision making by reducing inertia in the health insurance markets.[42] In these markets insurers have less information than consumers about their state of health and so are unable to price all risk characteristics. As a result it is those riskier consumers that take out the more comprehensive health plans, driving up the equilibrium price for these plans. In this situation giving consumers more information on which to make choices actually exacerbated the problem and resulted in still higher prices and a reduction in welfare.

[41] Paul Klemperer, Oxford University (1991), *Competition when Consumers have Switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics and International Trade*.
[42] American Economic Review, vol. 103(7), 2013, 2643-2682, *Adverse Selection and Switching Costs in Health Insurance Markets: When Nudging Hurts*..

7. Competition checklist question 5 – will the policy measure affect suppliers' ability or incentive to introduce new technologies, products or business models?

7.1 Chapters 3-6 focused principally on the potential effects of policy on so-called "static competition": that is, the ability and incentive of firms to compete on the basis of their current products and services. However, policy measures can also have important effects on "dynamic competition". Dynamic competition occurs when existing market participants face competitive pressure from a new product, technology or business model. Such competitive pressure forces firms to continue to innovate, to introduce new products and new technologies.

7.2 For example, in the UK, traditional television broadcasters have faced an increasing competitive challenge from video streaming services (such as Netflix, Now TV, Amazon Prime etc) for viewers' attention. They have responded by launching their own Video on Demand services (e.g. iPlayer, ITV Hub, All4, My5 and, most recently, BritBox) and offering those services across a range of fixed and mobile platforms.

7.3 There is a strong argument that dynamic competition can result in the greatest increases in consumer welfare.[43] It is therefore particularly important for policymakers to consider carefully whether measures could affect the ability or incentive of firms to engage in such competition. This is especially important against the backdrop of accelerating technological change and significant disruption to traditional markets and business models in many sectors of the economy.[44]

7.4 For this reason, policy makers should avoid measures which favour incumbents or firms with specific business models, or that disproportionately harms smaller scale businesses in a sector. Instead, policy makers should look for ways to promote dynamic competition by accommodating new services and business models. Such developments can challenge existing regulatory approaches and the assumptions behind those approaches, and it

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[43] Dynamic Competition, Online Platforms, and Regulatory Policy. Statement of Jerry Ellig, PhD (Senior Research Fellow Mercatus Center at George Mason University) submitted to the House of Lords Select Committee on the European Union, EU Internal Market Sub-Committee Call for Evidence: Online Platforms and the EU Digital Single Market; 9 December 2015.

[44] The government White Paper, *Regulation for the Fourth Industrial Revolution* (June 2019), refers to a Fourth Industrial Revolution that is "unprecedented" in terms of scale, speed and complexity and that it is characterised by a "fusion of technologies … that is blurring the lines between the physical, digital and biological worlds." The White Paper states that these changes "will disrupt nearly every industry in every country, creating new opportunities and challenges for people, places and businesses."

may be necessary to adapt the regulatory framework to accommodate such developments.

7.5 In markets where dynamic competition is important, it is also important that policy measures – and regulation in particular – can adapt to rapidly-changing circumstances. Policy makers should try to build into their regulatory approach flexibility and (ideally continuous) post-implementation review in response to a fast-moving market. Disruption and change may create the impetus (or the policy rationale) for a policy measure, but also makes any ex ante assessment of its effects highly uncertain. This places a premium on designing policy with the ability to adapt or unwind as new information is available, including through the use of sunset clauses.[45]

7.6 When designing regulatory interventions or consulting on changes to an industry, it is usually the incumbents that have the greatest resources to engage consistently and effectively and are most vocal in promoting their views. Policy makers are understandably keen to listen to them, not least because they have an in-depth understanding of their industry and can bring first-hand experience to bear. However, as well as taking note of the lessons from past experience and large firms, it is important to seek out and take account of the views of recent and potential entrants to an industry. These firms may have greater insight into what innovations could be introduced to improve consumer experiences and value in the future.

Will the policy measure affect markets in which innovation has been a key feature in recent years?

7.7 In order to determine the appropriate level of concern about dynamic competition in a competition assessment, the first step is to consider whether the industry is in a particularly dynamic stage of development. Policymakers will want to look at the regularity with which new products are released or new features are incorporated into existing products. In addition, there could be innovations that affect the production process, allowing rapid falls in prices, greater range or added services, or a product that is more customised to the individual purchaser.

7.8 Fast-moving markets include ones in which there has been significant technological innovation. Markets that are affected by technological change, automation, changing business models and practices, or markets in which there is disruption are likely to be particularly dynamic. It is useful to

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[45] A ‘sunset clause’ in a statute, regulation or legislation provides for that piece of law or regulation to be automatically repealed once a period has passed, or certain criteria have been met.

understand both whether the industry is one that is subject to significant innovation and what developments and new processes are being brought about by the innovation. Factors that policy makers can look at when considering whether the market is dynamic include:

- What proportion of industry sales is spent on R&D or investment in more advanced equipment or training?[46]

- How many patents have been filed or are there measures for their value and the industry growth of intellectual property and trade secrets?

- How many new entrants has the industry attracted?

- Has the market grown significantly in size in recent years?

- Have new entrants or previously small players grown at the expense of incumbents?

- Are new entrants using a different business model, technology or production process to incumbents?

- Have incumbents started to respond to the innovations introduced by others, for example by adapting their own products or services, making strategic investments or acquisitions, or lobbying for regulation to be applied to new entrants?

- Do market participants anticipate significant industry changes in the near future?

7.9 The experience of past innovations can indicate how supportive regulation is to dynamic competition. Once an industry has been found to be dynamic with certain innovations that are valuable to customers and competition, these innovations can be given special consideration in the competition assessment. In particular, policy makers should check how those products or firms are affected by the policy measure and pay particular attention to the outcome of the competition checklist questions 1 and 2 in respect of these firms. It may be appropriate to weight the impacts on innovative firms and products more highly than the weight placed on the effects on other firms. For example:

- A policy measure that would raise costs of some suppliers relative to other suppliers (part of question 1) may be particularly damaging if it

[46] The pharmaceutical industry claims to be the largest investors in R&D with 15% of net sales (https://efpia.eu/media/413006/the-pharmaceutical-industry-in-figures.pdf page 10).

raises the costs of firms using recent innovations relative to more established firms.

- A policy measure that would control product characteristics (part of question 2) could be particularly concerning if it required firms to modify or remove innovative aspects of their products.

Will the policy measure constrain the deployment of new technology or prevent firms operating a particular business model?

7.10 The development and growth of new technology or new business models often creates pressure for government to intervene, particularly through regulatory measures. This is especially the case when innovations have proven to be disruptive to established market participants.

7.11 While there may be legitimate public policy reasons for intervening in response to such developments, policy makers should design policies and regulations carefully, and take into account the risk of undermining innovations which could have substantial benefits to consumers.

7.12 The impetus to introduce or enhance policy measures in an industry where there has been recent entry may come from the industry incumbents, who may consider that entrants have achieved an unfair advantage by avoiding existing industry regulation. There may indeed be cases where an entrant is able to gain a competitive advantage simply because it has found a way to avoid regulatory obligations to which others are subject. However, there are also cases where the entrant does offer a genuinely different and lower cost model that consumers may value for a range of reasons, such as speed or flexibility. In such cases, regulators should consider whether the playing field can be levelled by reducing regulatory burdens on incumbents rather than tightening them on entrants.

7.13 For example, the growth of “peer to peer” businesses such as Airbnb and Uber has led to calls from incumbent accommodation suppliers and taxi operators for tighter regulation. In assessing the merits of such regulation, policy makers should take due account of the benefits that new business models can bring, in the form of a larger market size and competitive pressure on incumbent operators. Regulation that would prevent or inhibit firms form following these business models would limit this competition and so risk causing harm to consumers, as illustrated by the following example.

TfL Proposals for Private Hire Vehicles

In 2015, TfL launched a review of regulations relating to the licensing of private hire vehicles (PHVs) in London, in response to developments in the private hire industry, including the emergence of new technologies (and with that services such as Uber) and changes to the ways people engage and use private hire vehicles.

In September 2015, TfL published a consultation setting out a package of 25 detailed proposals.[47] According to the TfL consultation, the main purpose of these proposals was to improve passenger service and safety. Several of these proposals would have required firms using new technologies to adapt their services to be more comparable to traditional private hire providers.

In December 2015, the CMA submitted a response to TfL's consultation, expressing concerns about some of the proposals. The response acknowledged that private hire vehicle passengers need to be protected, and appropriate legislation is required to do so. However, the CMA was concerned that some of TfL's proposals went beyond what is necessary to protect passengers, and could have an overall detrimental impact on consumers, through reduced competition. For example:

- TfL proposed a mandatory 5-minute wait after booking before customers could start their journeys. This would have eliminated the speed advantage of innovative platforms such as Uber where the average wait for one of its drivers in London was 3.6 minutes. The CMA considered this proposal reduced the competitiveness of PHVs compared to black cabs by artificially hampering their service level.

- TfL proposed that a PHV operator must have a fixed landline telephone number available for passenger use at all times. The CMA considered this could raise barriers to entry (requiring a phone number and staff to handle calls) as well as restricting innovation (including platform-based business models), and that it was not clear why this specific form of contact should be mandated even if a real-time response standard was viewed as necessary for passenger safety.

As well as identifying specific concerns, the CMA stressed that a competition impact assessment could be undertaken for all of the proposals.[48]

In March 2016, TfL set out the final list of changes to the regulations which was approved by its board. Some of the recommendations the CMA had opposed were dropped (e.g. the 5-minute wait requirement), while others were modified (e.g. operators required to notify TfL of changes to operating models, and requirement to provide an estimate of the fare).

[47] TfL Private Hire Regulations review: Consultation Report. September 2015.
[48] The proposals the CMA was most concerned about were: (a) 2 (5 minute wait requirement); (b) 3 (approval for changes to operating models); (c) 8 (prohibition of displays of vehicle availability); (d) 10 (requirement to specify

7.14 The example above highlights the potential harm to innovation and competition from requiring businesses to deliver their services in a specific way that reflects the practices of traditional suppliers. More generally, questions policy makers should ask themselves when considering whether their proposals may constrain deployment of new technologies, products or business models could include:

- Do the proposals specify the characteristics of products or services or the way they are delivered in a way which might constrain new technologies or innovations?
- Will the proposals increase the costs of firms using the new technologies to a significantly greater extent than the costs of incumbents?
- Would the proposals undermine an aspect of recent entrants' offerings that is valued by consumers?
- Do the proposals simply extend existing regulations to new entrants?
- Have existing regulations constrained the growth of recent entrants, and if so, would the proposals strengthen this constraint?

7.15 If the planned policy measure is likely to constrain the deployment of new technologies, policy makers should consider whether there are alternative ways of achieving the proposal's objectives without creating the same impacts on innovation.

7.16 A proposal's objectives can often be achieved without stifling innovation by focusing on the desired outcome rather than the process through which this outcome is achieved. New business models or technologies may allow entrants to provide the same underlying attributes as incumbents, but in different ways. For example, if a regulation was aimed at ensuring responsive customer service, a digital firm could provide this through in-app messaging while a traditional provider may offer a dedicated phone line. A regulation that set outcome-based standards (e.g. speed of response) would allow both to operate in competition, whereas a regulation that required all providers to operate customer service phone lines would penalise the digital firm and inhibit competition.

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the fare in advance); and (d) 15 (drivers to only work for one operator at a time). Competition and Markets Authority response to Transport for London's private hire regulations proposals. December 2015

7.17 When the proposals under consideration would extend or strengthen existing regulation to cover new entrants, policy makers should avoid doing this mechanistically but should instead consider whether:

(a) differences in the technologies or business models of the entrants compared to incumbents mean that some parts of the regulations are not appropriate or necessary; or

(b) developments in the market since the implementation of the existing regulations justify adapting or removing parts of the regulations for all providers.

7.18 It is also important in dynamic markets to keep policy measures under review after it is implemented. That is, as well as considering the impacts of policy measures on competition at the point they are introduced, there should be a review process over time to ensure that thy continue to support innovation as the industry undergoes technological change. One approach is to design regulation to be flexible, such as through the sunset clauses discussed above, or to build in procedures for updating the regulation as are discussed below.

7.19 The Mortgage Market Review (see below) is an example of considering competition impacts as part of the policy development process. A positive assessment of the impact on new regulation on competition was made when the measure was initially introduced; but a subsequent review identified that the regulation was perceived to be having an unintended adverse impact on competition and innovation in the mortgage market, and changes were made to reflect this.

Financial Services Authority (FSA)/Financial Conduct Authority (FCA) Mortgage Market Review[a]

The FSA's[49] Mortgage Market Review (MMR)[50] was in part a response to the financial crisis, and the poor lending practices that occurred in the run-up to it. The aim of the review was to ensure the continued provision of mortgage credit for borrowers who could afford it, while at the same time preventing the re-emergence of poor lending practice which led to customer detriment. The MMR made proposals in a wide range of policy areas, including: responsible lending, distribution, disclosure, arears management, non-deposit taking mortgage lenders etc. We have not reviewed the competition analysis undertaken in relation to all the policy areas. Instead, we have focused on one of the areas which was subsequently highlighted as part of the FCA's Mortgage Market Study in 2016.

To inform its package of proposals, the FSA undertook a cost-benefit analysis, which was published alongside its proposals.[51] The CBA included a section on competition impacts, which looked at the possible impacts of the different proposals put forward in the MMR. The CBA found that most of the proposals were unlikely to have a material adverse effect on competition or lead to profound changes in the market. The CBA did acknowledge some areas where the new rules could lead to higher barriers to entry in the market (e.g. for nonbank lenders) but did not explore these in depth. The CBA also did not consider innovation in detail. Most of the MMR reforms were implemented in 2014[52], and significantly changed the regulatory regime for mortgages.

In December 2016, the FCA launched the Mortgages Market Study[53], the purpose of which was to investigate whether competition was working well in the mortgage sector in general. The final report from the Mortgages Market Study was published in March 2019. One of the findings of the market study, was that there was a perception within the mortgage market that some of the rules imposed through the MMR were acting as a barrier to innovation. For example, to avoid inadvertently breaching the FCA's rules, lenders and intermediaries were not developing tools to sell via execution-only channels (i.e. without advice). These perceived barriers appeared to restrict lenders' and (new and existing) intermediaries' ability to innovate to meet consumer demands for information and guidance in a non-advised, digital environment. The FCA committed to identifying changes to mortgage advice rules and guidance to help remove potential barriers to innovation.

[a] The FSA was replaced by the FCA and the Prudential Regulation Authority on 1 April 2013.

7.20 Technological change can occur after a regulatory measure has been implemented and rapidly impact the way competition or innovation operates

[49] The FSA was the regulator for the financial services industry until 2013, when it was restructured into the FCA and the Prudential Regulation Authority.
[50] The final rules were set out in a policy statement, following a number of consultations and working papers (the first one published in October 2009): Mortgage Market Review Feedback on CP11/31 and final rules, October 2012.

in that market. The way the market interpreted or perceived these new FSA regulations acted as a barrier to innovation in a market where significant technological change occurred.

Could the policy measure limit the prospect of future innovation?

7.21 As well as the risks discussed in the previous section of policies or regulations constraining recent innovative entrants from growing, they can also make it more difficult for future innovations to be brought to market.

7.22 If a policy measure is overly or unnecessarily prescriptive about how the firm satisfies the underlying objective this may cause particular barriers for innovative firms. In the example above PHV operators were encouraged to provide a landline telephone number in order to provide 'real time' customer service. A similar speed of response could be achieved by other means of communication. The focus for operators should be on whether they meet customer service and responsiveness requirements, not on the technology they employ to perform that service.

7.23 Another way that regulation can stifle innovation is through the costs of compliance. High administrative or compliance costs can deter potential entrants from entering because the costs are such that new entrants do not then expect to be compensated by the levels of profit in the market. High costs can also divert resources away from research and development for firms already in the market.

7.24 Policy makers should consider whether the regulation they are proposing has fixed or variable cost implications. Firms including any entrants may have to invest in setting up infrastructure (e.g. a separate telephone answering service). The regulation could also have a variable cost impact on each transaction (e.g. a tax or additional safety check, including a cost for customers such as waiting 5 minutes). A regulation that introduces a fixed cost burden may restrict new entry (particularly from small firms who are less well financed). A policy that introduces a variable cost burden that applies to innovative firms may impede the growth of entrants once they have entered. A policy can also have an impact on both fixed costs and variable costs at the same time.

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[51] Annex 1 to the proposed package of proposals. The FCA also commissioned two reports from consultancy Oxera, which looked at the compliance costs and indirect costs associated with MMR reforms (as set out in CP10/16 and CP10/28).
[52] To note that many of the reforms, like the arrears changes, were implemented ahead of this (see Mortgage Arrears Instrument FSA 2010/22 which came into force on 25 June 2010).
[53] Documents relating to the Mortgages Market Study are available here.

7.25 There are ways to allow regulations to fulfil their aim while being less prescriptive about how firms implement or adapt to the regulation. Policy makers should consider more flexible forms of regulation to ensure regulation is future-proof, proportionate and not unduly restrictive. Flexibility will minimise distortions to competition and innovation (particularly in fast moving markets subject to rapid technological change). Any ‘rules-based’ regulation should be targeted, appropriately risk-based and reviewed over time. Some more flexible approaches include:

(a) **Principles-based regulation**: this approach entails moving away from a reliance on detailed, prescriptive rules and relies instead on high-level, broadly stated principles to set the standards by which regulated firms must conduct business. This leaves firms with the flexibility to determine how they comply with those principles.

(b) **Codes of conduct**: a form of regulation that applies only to firms in an industry that satisfy certain criteria (e.g. the larger firms). The code of conduct will set certain restrictions or high-level principles on the behaviour of these firms, for example how they must treat their suppliers to give clarity; but it will give the regulated firms some discretion in how they comply with the code. A code can also be changed with industry agreement as circumstances and practices change. Where disputes arise, a code of conduct can also help to resolve those disputes and enforce solutions more rapidly.[54]

(c) **Participative regulation**: a form of regulation in which there is a greater degree of engagement between firms and the regulator in a market. Firms make formal proposals to the regulator and they would respond e.g. in relation to the introduction of new services or products. The regulator may be able to forbear from regulating, new entrants with new business models until there is a better sense of whether intervention is needed. In return for setting out their proposals, firms would benefit from reduced legal uncertainty. The regulator is not fettering its discretion: they would retain the ability to investigate the business practices at a later stage. The regulator could also develop guidance to share with the industry.

(d) **Regulatory “sandboxes”**: a regulatory sandbox[55] allows businesses to trial new products, services or business models in a live, real-world

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[54] For example, the Report of the Digital Competition Expert Panel, ‘Unlocking Digital Competition’ identified a code of conduct for firms with Strategic Market Status as an approach that would set up predictable rules in advance but would also allow competition and innovation to thrive in the digital space.
[55] This is an arrangement in which parts of the usual regulatory framework are temporarily suspended to give firms the opportunity to work with the regulator to trial innovative products, services and business models with

environment and with real consumers, without some of the usual rules and regulations applying. The Financial Conduct Authority and Ofgem are already making use of regulatory sandboxes to facilitate small, temporary trials which can help the regulator during future policy development. The "sandbox" approach also gives regulators the opportunity to identify appropriate consumer protection safeguards to build into new products and services while reducing the time and barriers to market launch.

7.26 While regulation is sometimes viewed as an alternative to competition, or indeed even as a barrier to competition, appropriately designed and implemented regulation can assist in the promotion of competition. Regulation can play a key role in preparing an industry for technological change.

7.27 Regulation to promote effective and 'healthy' competition may be introduced in circumstances where there is clear evidence of market failure and/or where there is scope to enhance competition. The ability of regulation to promote and unlock competition and innovation has been identified for example through the CMA's Open Banking remedies, in the Furman Review, and has been further detailed in the Online platforms and digital advertising market study final report. In the latter cases, regulation has the potential to limit anti-competitive actions by the most significant digital platforms while also reducing structural barriers that may currently hinder effective competition.

7.28 Regulation can make it easier for consumers to move their data securely across digital services, to build systems around open standards, and to make data available for competitors, offering benefits to consumers and also facilitating the entry of new businesses. Furthermore, the health and stability of markets can be promoted through pro-competitive best practices in relation to public procurement rules and government contracts.

7.29 The CMA's experience with the implementation of Open Banking is an example of a regulatory remedy that was designed to ensure that consumers benefitted from technological advances and that new entrants and smaller providers in the UK retail banking sector were able to compete more fairly.

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consumers. It offers firms the ability to carry out trials in a controlled environment without immediately incurring all the normal regulatory consequences of engaging in the activity in question.

Open Banking

In August 2016, the CMA published its final report following its investigation into the supply of retail banking services to personal current account (PCA) customers and to small and medium-sized enterprises (SMEs) (retail banking market). The CMA found that older and larger banks did not have to work hard enough to win and retain customers and that it was difficult for new and smaller banks to grow. To address these issues the CMA proposed a number of remedies including Open Banking, which enables customers to share their current account information securely with other third-party providers from January 2018.

Central to the CMA's open banking remedy were measures to require the largest UK banks to adopt and maintain common API standards through which they would share data with other providers and with third party service providers including Price Comparison Websites ("PCWs"), account information service providers (AISPs) and payment initiation service providers (PISPs).

The CMA's final report stated that: "Of all the measures we have considered as part of this investigation, the timely development and implementation of an open API banking standard has the greatest potential to transform competition in retail banking markets. We believe that it will significantly increase competition between banks, by making it much easier for both personal customers and SMEs to compare what is offered by different banks and by paving the way to the development of new business models offering innovative services to customers."

The latest Open Banking Impact Report in October 2021[56] found that:

- There was growing adoption and availability of open banking services.
- Services were easy to set up, and most consumers were planning to continue using them.
- Platforms helped consumers with budgeting, shopping around, cutting unnecessary expenditure and charges, and with building up their savings.

The Open Banking example highlights that regulation can help to promote the adoption of measures to open up markets and promote competition by making use of new technologies in designing market interventions i.e. working with the grain of industry developments. Open Banking has enabled the launch of app-based money management services, in particular, those that can securely access all of an individual's accounts across many providers. There has also been significant entry into payment services and individuals and businesses can now pay more easily without using a credit or debit card. This allows direct to account payments to be used for everyday purchases and without sharing confidential information.

[56] https://www.openbanking.org.uk/insights/the-open-banking-impact-report-oct-2021/

8. Considering alternatives

8.1 Policy makers are advised to consider alternatives should they conclude that their policy proposal has the potential to significantly distort competition. Ways to mitigate the detrimental impact of specific policy or regulatory interventions have been outlined in the previous chapters. This chapter draws these insights together and outlines a range of possible alternatives. The impact of such alternatives can be assessed and compared against the original proposal using some of the methodologies outlined in Chapter 8.

No new intervention/do nothing

8.2 In some circumstances policy makers may conclude it is not necessary to introduce new regulation. This does not necessarily mean accepting the status quo, and could also involve improving the use, clarity or enforcement of existing regulation. Unless existing regulations have significant impacts on competition and would benefit from replacement or revision, this approach would tend to be most competition-neutral.

8.3 Policy makers may also consider alternatives to the regulatory proposal. Alternatives can be conceptualised as rules based, incentives based, information based and self-regulatory, all existing in a framework of more and less distorting options, including options that increase innovation and entry.

Table 3: Spectrum of interventions[57]

Policy objectives	More distorting options		Less distorting options
Deliver natural monopolies	Exclusive permanent rights to supply	Time limited rights to supply	Competition for the market (plus economic regulation) Ensure competition in downstream markets
Oversee access to scarce resources	Permanent access to incumbents (grandfather rights)	Time limited access	Auction to grant access
Reduce negative externalities (eg pollution and congestion)	Fixed quota on the number of suppliers		Tradable permits
Limiting consumer consumption	Minimum prices	Tax on the product	Information and education
Bringing prices down and/or enhancing international competitiveness	Maximum prices	Subsidy	Opening up the market to greater competition
Ensuring quality of goods/services or improve business practice	Prescriptive standards	Performance based standards Self-regulation (but see caveats below)	Consumer awareness (so poor practices are punished through reduced demand)

Incentives based approach

8.4 The government can use more market-based mechanisms to deliver policy objectives. Economic instruments can be employed, such as taxes, subsidies, quotas and permits, vouchers and auctions to encourage business and citizens to change behaviour. Often these sorts of systems need regulation to establish the framework. Some forms of economic instruments are more competition-neutral than others.

- **Taxes**: taxes on end-products is one alternative that can be considered and may be less distortionary. For example, a significant element of the final purchase price for alcohol is duty, but suppliers still compete to

[57] Adapted from the National Audit Office (2014), *Using alternatives to regulation to achieve policy objectives* (full report).

supply it, launch new products, and increase their market share. The government to achieve health and social benefits may consider introducing a minimum alcohol pricing. For example, it could consider setting a minimum price per unit of alcohol sold. However in this context a rise in taxation may have a less distortionary impact on competition and be equally effective as it directly impacts on consumers. However, some taxes may affect small businesses disproportionately and therefore dampen competition and the extent of new entry (for example, tax exemptions, or differing rates of taxation which are easier for larger businesses to obtain).

- **Subsidies:** the government may choose to subsidise certain industries as a way of (for example) bringing prices down to maintain competitiveness or encourage the uptake of a certain technology, or for other public policy reasons such as creating jobs.

- **Auctions**: In industries where resources (such as essential infrastructure) are scarce and must be shared by companies in order to provide a service, the government may choose to make control of them subject to auctions or tender processes. This 'competition for the market' can ensure that companies are incentivised to offer good terms to secure provision of the service over other suppliers, and can go some way to compensating for a loss of competition 'in the market' if the number of suppliers active is necessarily limited. However, it is usually preferable to preserve competition in the market where possible.

- **Ownership**: Where there is an integrated network monopoly it may be possible to keep control of a given asset (eg a natural monopoly wires business) separate from the operators who use it in the provision of a service (eg competitive generation and supply). This is likely to result in better outcomes as the upstream owner has an incentive to ensure efficient use of the asset without favouring a particular downstream firm.

- **Quotas:** quotas are likely to have a negative impact on competition. Maximum quotas will often limit competition as they constitute a capacity constraint; minimum quotas may raise barriers to entry for potential new entrants.

8.5 These approaches can have advantages in principle over a government-driven rules-based approach if they result in the right incentives being created to change behaviour. However, these approaches can also have disadvantages. It may, for example, be difficult to determine the size of the incentive required to change the behaviour needed among businesses and citizens. Moreover, predicting the effects of incentives may be difficult and there is often uncertainty when the effects will occur. As noted above, some types of economic incentive may harm competition as much as would a rule-based regime.

Information and education

8.6 As set out in detail in Chapter 6, ensuring customers have the information they need to make purchasing decisions is part of competition working well. In some cases, direct regulation may not be needed if consumers would be able to make better purchasing decisions through easier access to information. For example, the display of health and safety cleanliness standards at restaurants allows consumers to avoid poor quality, while having less impact on the natural process of competition than direct quality regulation. The advantage of this approach is that it offers relative freedom for the consumer and does not intervene with the decision-making process. Instead it provides them with the information to help make a more informed decision.

Self-regulation and co-regulation

8.7 An industry or a profession can self-regulate, for example through the use of codes of conduct, customer charters, standards or accreditation. In many cases rules and codes of conduct will be formulated by a trade association, or other industry representative under their own initiative. In other cases, an industry or profession might self-regulate in response to delivering a stated government objective. In self-regulation, the industry is solely responsible for monitoring and enforcing members' compliance. This enforcement can be achieved either first hand, or through other bodies set up by the industry. In co-regulation, there is an element of government monitoring.

8.8 Self-regulation often has some benefits in terms of the lower costs it imposes on the industry, because the approach is decided collaboratively by industry specialists rather than imposed by non-specialist government and overcomes problems of information asymmetry. However, care should be taken when considering self-regulation as an alternative that self-regulation would not be likely to facilitate anticompetitive agreements. Concerns about self-regulation include the greater likelihood of price coordination, coordination to prevent new entry, restrictions on the range of services produced (to the detriment of consumers) and agreements to reduce product and process innovation. If the governance of self-regulation is wrong the policy maker may replace a neutral regulator acting in the public interest (an arm of government) with a self-interested collection of regulators (incumbent companies).

17th century French button makers

Guild masters of the weaving industry in 17th century France considered how they should respond if a cloth weaver intended to process a piece according to his own invention. The masters concluded that the cloth weaver would first need to obtain permission from the judges of the town to employ the number and length of threads that he desires, after the question has been considered by four of the oldest merchants and four of the oldest weavers of the guild.

Shortly after the matter of cloth weaving had been considered, the button makers' guild raised a cry of outrage. They were concerned that the tailors were beginning to make buttons out of cloth, an unheard-of thing. The government, indignant that an innovation should threaten a settled industry, imposed a fine on the cloth-button makers. But the wardens of the button guild were still not satisfied. They demanded the right to search people's homes and wardrobes and fine and even arrest them on the streets if they are seen wearing these subversive goods.

Source: Robert L. Heilbroner's book *The Worldly Philosophers*.

9. Methodologies

9.1 Once it has been decided that an in-depth competition assessment is required then it is useful to consider how the impacts on competition will be assessed and measured. This assessment can be performed through a combination of qualitative and quantitative methods. In practice, most decisions about which options to prefer are qualitative, that is, not based on quantitative comparisons of options. Relevant data for a quantitative comparison is not always available and, even when available, may not be amenable to analysis. This chapter will lay out techniques of both qualitative and quantitative comparison.

9.2 Qualitative analysis combines facts and economic argumentation to arrive at reasoned judgments about which options to prefer. Quantitative analysis involves careful and rigorous use of numbers to estimates benefits of particular options compared to others. Table 4 shows the pros and cons of qualitative and quantitative methods.

Table 4: Pros and cons of qualitative and quantitative methods

	Pros	**Cons**
Qualitative methods	Widely understood Requires little data Potentially quick	Does not identify the numerical impact of the regulation (eg impact on price and quantity produced) Require more reliance on judgment
Quantitative methods	Requires less need for judgment Provides estimates of the social impacts of regulation eg likely price rises or change to quality	Requires data to be available Requires more technical skills Requires more time

9.3 For particularly significant or controversial issues, quantitative analysis is preferred, when possible. However, the limit on data that is available or time to perform a comparison will often restrict the occasions on which quantitative analysis can be performed. It can also be difficult or impossible to quantify the consumer harm that will arise as a result a new policy measure. So while quantitative analysis can help in selecting regulatory options that have the least restrictive effect on competition, it will often have to be buttressed by qualitative evidence.

9.4 A useful guide to assessing impacts of regulations on competition is the OECD's Manual for Competition Assessment (OECD (2019)), which has been updated to include more detailed guidance on methodologies that can be adopted to assess impact and contains many practical examples of how to perform the competition assessment of regulations.[58]

Qualitative analysis

9.5 Policy makers will wish to be able to demonstrate that they have thought through in a structured way the likely impact of their policies on competition. For this reason argumentation based on economic principles is probably the most common form of qualitative analysis. In addition to the OECD's specific guidance on assessing impact of policy on competition it is worth looking at general guidance on impact assessment such as that contained in HM Treasury's Green Book.[59]

9.6 Qualitative analysis that uses "critical thinking" or "informal logic" to select among alternatives will:

- combine economic reasons, evidence and appropriate assumptions to reach conclusions;
- account for the credibility of sources, to ensure that no undue weight is placed on self-interested and biased argument;
- gather information to complete arguments and test plausible hypotheses;
- consider challenges that may be made to conclusions and have appropriate responses; and
- evaluate the quality of arguments about the strengths and weakness of alternative policies.

9.7 Examples of using arguments to compare options can be found in Annex B of the OECD's Competition Assessment Toolkit: Guidance.

9.8 The starting point of such analysis is to state the overall situation, including the reasons for developing the current proposals and establish a baseline. The analysis then states the objectives of the policy and sets forth the alternatives. Each option is analysed, considering its strengths and weaknesses, using any available evidence, including information about the rationale for a regulation, how each given option would achieve that goal and the likely impacts to different groups of consumers from each option based on economic principles. The analysis can identify assumptions, particularly

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[58] OECD Competition Assessment Toolkit.
[59] HM Treasury, *The Green Book: Appraisal and Evaluation in Central Government*.

where the assumptions may be questioned. Finally, a value judgment is made about which option is strongest, weighing the analyses of the options and considering the evidence and reasons, especially economic, to support each.

9.9 Information that is particularly useful for such analysis can come from comparison of regulations across different jurisdictions. This allows different ways that a policy can be delivered to be identified and draws on research that has already been done to the likely impact on competition. The usefulness of comparisons depends on having common features between the jurisdictions, such as common consumer preferences and responses.[60]

9.10 Stakeholder consultation may also be a useful way to find out about the likely impact of a proposed policy. Stakeholders may have a good knowledge of the sectors and of what alternatives can and cannot be implemented. Consulting with stakeholders can therefore provide a useful mechanism for ensuring that important facts have not been missed and that relevant options have not been ignored. However, companies that benefit or could benefit from a grant of market power via the regulation may be more likely to participate in stakeholder consultations and may also be more likely to argue in favour of an option that gives them market power, to the detriment of the public interest.

Quantitative analysis

9.11 Quantitative assessment is particularly useful for providing a clear line of reasoning to examine whether regulations should be changed and how much public value comes from such changes. Quantitative analysis can be particularly useful as a counterweight to arguments in favour of a regulatory change, which may come from certain stakeholder who would enjoy market power as a result of the regulation.

9.12 Simple methods of providing quantitative estimates often provide results that are comprehensible, testable and transparent. One of the advantages of simple methods is that they are typically easy to explain and consequently more convincing for decision makers than complex methods.[61] If simple methods are not available, quantitative estimates will often not be made at

[60] Common jurisdictions for comparison, depending on the focus of the regulatory framework, may include local authorities, England, Northern Ireland, Scotland, Wales, countries within the European Union, the OECD, and other countries that may be relevant for a particular regulation.
[61] Complex econometric methods which estimate the impact of a regulation on cost and demand functions underlie more sophisticated analysis.

all. Given the time constraints often present, this chapter focuses on simple methods for quantification.

9.13 Two particularly common sources of comparative quantitative information are quantification coming from predictive economic studies of a regulation's impact and quantification from before and after studies.

9.14 Economic studies that predict impacts of regulatory reform based on economic principles can show impacts of regulations under consideration. Often such analyses have estimates of impacts on price, cost or other variables of interest. Such studies can provide useful insight should the study have looked at the impact of similar regulatory proposals to those under consideration.[62]

9.15 Before-and-after studies show the impacts of a change in regulation, while adjusting or holding constant other factors. The intention of such studies is to identify the impact of a reform on variables of interest, such as price. The OECD in its Competition Impact Assessment Toolkit has produced a database identifying research studies of the impacts from pro-competitive regulatory reform, the vast majority of which are taken from developed countries that are members of the OECD. This database suggests the expected price reduction of moving towards more competitive outcomes.

9.16 Policy makers can use the OECD's assessment of average price impacts from different types of restriction (as outlined in the table below) as a rough 'rule of thumb' to estimate the price effect of introducing a regulatory restriction that harms competition. A rule of thumb is an alternative to a more detailed and precise analysis in specific cases. Rules of thumb may be faster and use available data. But the results should be considered a benchmark, recognising that detailed studies may come up with very different results, particularly if there are feasible ways to estimate elasticities and expected changes in variables like price. Policy makers may also wish to adjust the figures up or down if their qualitative analysis has given them reason to believe that the impact of the proposed restriction will be particularly high or low for a restriction of its type. Some impacts, such as the innovation impacts discussed in competition question 5, are not likely to be amenable to this type of analysis, and so policy makers should rely on a more qualitative assessment of these types of impact. When multiple restrictions are identified, a conservative approach is to select the restriction

[62] The variables that the study cover can depend on the product under consideration. For taxi services, for example, price is not the only variable of importance; quality matters to users, notably based on waiting time and quality of the vehicle. For retail sale of cars, price is again a variable of importance, but reliability of the vehicle may also be of particular importance for some users, with other characteristics of more importance to other users, due to the wide variety of users.

which has the largest price difference and use this as the basis for the percentage change in price.

9.17 The table can be used in the following way. Should a regulatory proposal to remove a licence as a requirement of operation be considered, for example, based on the average price effect from before-and-after empirical studies, a 23% price reduction could be anticipated (see the third row in the table below). These estimates can be used when there is a binding restriction from the regulation. So, for example, a rule that limits the number of taxis to 10,000 in a city is not binding if there are only 3,000 taxis operating in the area. The precise effect may depend heavily on how far below the free market level of entry the artificial limit is set.

Table 5: Mean price impact from removing a regulatory restriction that harms competition

Benchmark price change (ρ) (ratio of price change to less competitive price)	Category and sub-category of regulatory restriction
-0.20	**Competition question 1: Limits the number or range of suppliers**
-0.19	• Grants exclusive rights for a supplier to provide goods or services
-0.23	• Establishes a license, permit or authorisation process as a requirement of operation
-0.15	• Limits the ability of some types of suppliers to provide a good or service
-0.19	• Significantly raises cost of entry or exit by a supplier
-0.12	• Creates a geographical barrier to the ability of companies to supply goods, services or labour, or invest capital
-0.18	**Competition question 2: Limits the ability of suppliers to compete**
-0.19	• Limits sellers' ability to set the prices for goods or services
-0.14	• Limits freedom of suppliers to advertise or market their goods or services
-0.16	• Sets standards for product quality that provide an advantage to some suppliers over others or that are above the level that some well-informed customers would choose
-0.39	• Significantly raises costs of production for some suppliers relative to others (especially by treating incumbents differently from new entrants)
-0.20	**Competition question 3: Reduces the incentive of suppliers to compete**
-0.28	• Creates a self-regulatory or co-regulatory regime
-0.10	• Requires or encourages information on supplier outputs, prices, sales or costs to be published
-0.25	• Exempts the activity of a particular industry or group of suppliers from the operation of general competition law
-0.20	**Competition question 4: Limits the choices and information available to consumers**
-0.32	• Limits the ability of consumers to decide from whom they purchase
-0.12	• Reduces mobility of consumers between suppliers of goods or services by increasing the explicit or implicit costs of changing suppliers
-0.16	• Fundamentally changes information required by buyers to shop effectively

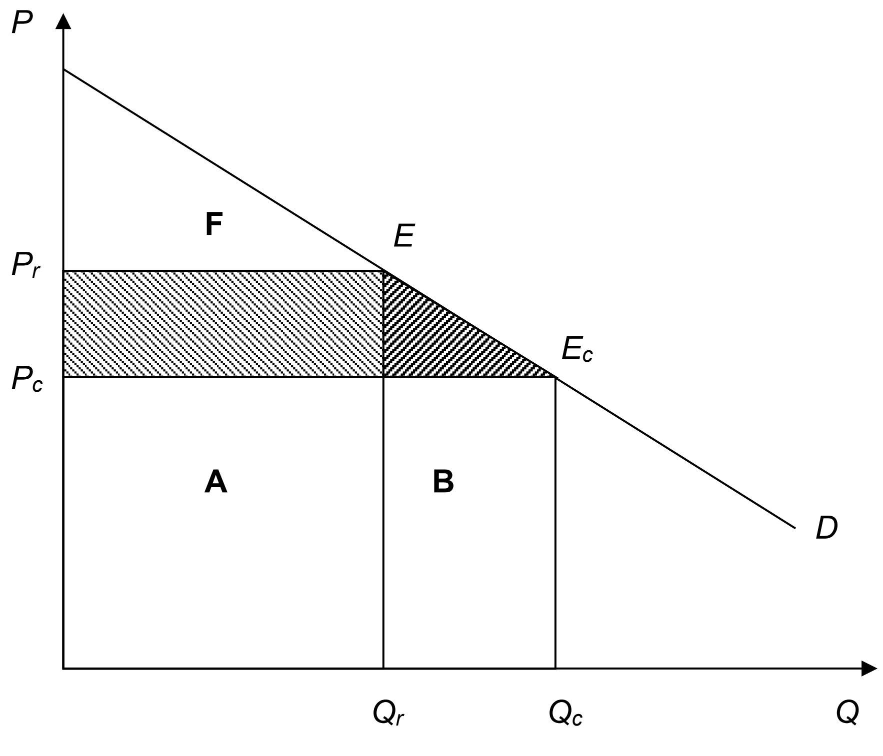
Source: OECD database of ex post studies of pro-competitive regulatory reform, 2019 version. This table will be updated as the database is updated, with new versions posted on the OECD website.

Measuring consumer harm

9.18 Competitive effects from regulation can often be examined by estimating the likely change from one point on the demand curve for a product to another. Where a proposed regulation has the effect of limiting supply or raising price, a rough estimate of the likely consumer harm can be calculated relatively easily. The benefit of estimating the likely consumer harm is that a monetary value (in terms of consumer welfare lost as a result of the regulation) can be allocated to the regulatory proposal. While this is not necessarily dynamic, the studies cited in table 5 would often include results from entry and exit and potential innovations, as they are before and after studies of reforms affecting competition.

9.19 The logic of change in equilibrium approach is captured in Figure 1. Figure 1 shows the impact of moving from a competitive equilibrium (E_c) to a restrictive equilibrium (E_r). The movement makes price rise from P_c to P_r and quantity decrease from Q_e to Q_r. The consumer harm is represented by the joint area of the shaded rectangle and triangle. Even when detailed information is lacking, these areas can be estimated using relatively simple and standardised, default techniques.

Figure 1: Consumer harm from introduction of a restrictive policy proposal



9.20 Policy makers can estimate impacts by measuring the consumer benefit that arises from not introducing a restrictive regulation (and thus conversely the consumer harm that will arise were such a restrictive regulation to be introduced). The OECD has set out a formula than can be utilised to perform this calculation. This requires the policy maker to know the total revenue, the expected price change following the introduction of the regulation (taken from Table 5 above) and the elasticity of demand.

$$CB = \left(\rho + \frac{1}{2}|\epsilon|\rho^2\right)R_r$$

Where:

CBs: standard measure of consumer benefit

ρ : percentage change in price related to restriction[63]

R: sector revenue

| ε |: absolute value of elasticity of demand

9.21 This formula can be divided into two parts, with the first part (ρR_r) effectively representing the shaded box in Figure 1 and the second part ($\frac{1}{2} |\varepsilon| \rho^2 R_r$) approximating the shaded triangle in Figure 1.

9.22 Where the elasticity for the sector is known, this should be used in the calculation. If the elasticity is unknown, the assumption of | ε |=2 can be assumed, for a reasonably typical market with competitors, some consumers willing to cease purchases in response to higher prices and no price regulation, to yield an estimated benefit from not introducing the restriction of:

$$CB = (\rho + \rho^2)R_r$$

9.23 Revenues are a valuable measure because they are often readily available and, even if not, less confidential than the two constituent elements of revenues, price and quantity sold.

9.24 The revenues should be those in the market directly affected by the regulation. More distant, but related markets would typically not have their revenue included in the revenue figure. Some judgment must be exercised in determining the bounds of the market for the purpose of the revenue estimate. Suppose revenues are known for a national market, but the regulation has only a local effect. The local revenue can be estimated from national revenue, for example by making per capita revenue calculations, per outlet revenue calculations, or calculations per unit of geographic area.

[63] Note that expected price changes will often be given by ranges of percentage price changes.

9.25 Revenues are measured in currency units, allowing for the calculation of benefits that arise from not introducing a regulation that restricts competition measured in £s.

A restriction on tyre imports

Imagine you have to assess the impact of a regulation that would introduce a license process to limit the number of authorised importers of automotive tyres to three suppliers. The purpose of this restriction is allegedly to make it easier for the government to ensure high quality of tyres; there is also an alternative of testing tyre durability on special machines for this purpose.

Annual revenue from sales of imported tyres is £1.4 billion. You have searched for but could not find any studies of the elasticity of demand for automotive tyres. To estimate the consumer impact from this regulation, you would therefore review the types of effects from Table 5 and note that price reduction from removing a license process is approximately 23%. So you could then apply the formula above to calculate an estimated annual consumer harm of:

$$CH = £\ (0.23+0.23^2) * 1.4b = £\ (0.283) * 1.4b = £\ 396m$$

9.26 Eliminating competitive restrictions from a policy proposal often yields price changes but can also impact on output and jobs. Many studies have been performed that examine the price impact of different types of changes in regulation. The OECD database of outcomes in ex-post studies has been averaged to provide rough benchmark figures for estimating the value of restrictions in different areas. The benchmarks are listed in Table 5.

9.27 To find the appropriate rough benchmark, identify the type of restriction that has been identified. For each restriction, the table lists a benchmark effect. If more specific figures are known, for example from sector specific studies, these may be more appropriate than the rough general benchmark. In absence of appropriate studies, the benchmark serves as a useful first approximation.

9.28 Benefits from not introducing competitive restrictions may be measured in other ways than through price. For example, at times prices are regulated, but the quantity supplied is restricted. This restriction of quantities also harms consumers. In fact, a 1% reduction in quantity supplied, even with prices fixed, may harm consumers more than a 1% price increase.[64] This is because the 1% price increase will result in those consumers with the lowest marginal benefit from the product stopping their purchases. In contrast, a

[64] This covers cases like price regulation combined with entry limits (taxis), where non-equilibrium outcomes may be enforced via regulation.

decline of quantities will not necessarily be allocated to those consumers with the lowest marginal benefit, but can equally likely apply to all consumers, including those with very high personal benefit from consumption.

9.29 There are many benefit-related variables that can be used in addition to price and quantity. The best variables to measure will depend on the product, the sector, what matters to consumers, and the available data.

9.30 More technical methods to estimate impacts can be used when very detailed information is available about pricing, firm sales and consumer preferences, allowing for an estimation of the demand curve.[65] Commonly, such detailed data is not immediately available. [66]

9.31 Once benefits and costs have been quantified a cost-benefit analysis can be undertaken. In many cases, benefits and costs provided by proposed measures will occur over years, and the timing of benefits and costs generated by different options may vary. In such cases, discounting is often required to correctly compare proposed options. Discounting can allow for costs and benefits that occur over time to be compared based on societal preferences for receiving benefits earlier, and other factors, such as the opportunity cost of funds and inflation. Where benefits and costs occur over time, selecting the appropriate discount rate can be critical to the selection of the best option. Guidance on how to undertake option appraisal and the choice of the underlying real discount rate to be used has been set out by HM Treasury in the Green Book. It is common in estimates of competitive benefits to truncate the benefits (by limiting the length of time considered, eg, to five years) to account for the imperfect foresight of regulators.[67]

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[65] These sources could have helped to determine the supply curves that would apply in the baseline and under alternative policy proposals.

[66] The standard measure assumes a market elasticity of -2 (or $|\varepsilon|=2$, in a constant elasticity demand function). It is intended to represent a typical product's elasticity with moderate competition and distant but feasible alternatives. The measure may be made more accurate if further information is available, or if there are reasons to believe the demand is either particularly inelastic, as with electricity or insulin, or particularly elastic, as may be the case with certain basic commodities.

[67] For more detailed discussion see section 4.4.3.1 of Volume 3 of the OECD Competition Assessment Toolkit.