



Evaluation of the impact of the Enterprise Act 2002 provisions covering market studies and market investigations

**A REPORT PREPARED FOR THE DEPARTMENT FOR BUSINESS,
INNOVATION AND SKILLS**

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Executive Summary

The market studies/investigations (MS/MI) regime began with the Enterprise Act 2002. It gave the Office of Fair Trading (OFT) the power to conduct market studies and, where necessary, refer markets to the Competition Commission (CC) for further investigation.

Given the time that has elapsed since its inception and the wider interest in its success, the Department for Business, Innovation and Skills (BIS) is carrying out an initial review of the regime's effectiveness. Frontier Economics has been commissioned to assist BIS in this review.

This report presents our findings in relation to the impacts of the regime to date and indicative lessons for improving its effectiveness.

Impacts of the regime

The impacts of the MS/MI regime are wide reaching.

The OFT has previously estimated its annual costs of administering the MS regime are £8million¹. This estimate does not include the costs of any remedies proposed or the costs to business of participating in the investigations/studies or complying with any remedy. While uncertain, our case study reviews suggest that these additional costs have the potential to be more significant than the OFT's study costs.

Against these costs, the benefits of the MS/MI regime are often uncertain and non-monetisable but potentially very large. The OFT has estimated substantial annual consumer savings from the MS/MI regime of £358m² of which £132m could be apportioned to the OFT. These consumer gains are likely to equate to smaller total welfare gains (excluding any dynamic effects), once they have been discounted to take account of any transfer of benefits from producers. The MS/MI regime also has the potential to deliver significant dynamic benefits over the longer term which would add to its more immediate static benefits.

Indicative lessons for the regime

Effectiveness of informational remedies

MS and MI can be categorised as mostly addressing market failures on the demand-side or supply-side of markets. No clear conclusion could be drawn

¹ OFT, (2008) "Positive Impact 2007/8", July 2008, p41.

² This estimate is calculated as an annual average consumer saving for the period 2006-2009 based on ex ante estimates and ex post estimates for those MS subject to in-depth evaluation (source: OFT, "Positive Impact 2008/9", July 2009, p40).

from the MS or MI reviews in regards to the relative effectiveness of addressing these different market failures.

One reason for this is that there was relatively little evidence available (from the case studies or more broadly) on the success of informational remedies in addressing demand side concerns in different markets and circumstances. Informational remedies, such as pricing transparency and disclosure requirement and awareness campaigns, are often employed by the OFT and CC. Therefore, improving the understanding of their impacts may aid in improving the regime in the future.

Effectiveness of industry and government targeted recommendations

Where a MS's recommendations are not acted upon its benefits will be reduced. One of the key implementation risks for the OFT is whether recommendations made to industry and Government are followed up.

Only one MS subject to evaluation (New Car Warranties) involved significant recommendations targeted at industry associated with voluntary changes to its code of conduct. In this case this approach appeared to be successful.

The proportion of MS's that included key recommendations to Government is significant. There do appear to be circumstances that can increase the likelihood of the Government intervening in accordance with the MS's recommendations:

- where the issues are already of concern to Governments;
- there is an area of Government (or an authority) able and interested in championing any ongoing work; and
- the recommendations have fewer fiscal and/or broader public policy implications.

However, it would not be advisable for the OFT to only make recommendations that it knows can be quickly or easily implemented at the risk of missing complex but important issues.

If these favourable circumstance are not present the OFT will have to work harder to present the merits of its case to increase the likelihood of its recommendations being acted upon. Where the OFT is addressing market failures that are complex or relate to broader government policies and legislation, the OFT should identify implementable or transitional steps that link to the areas set out above, as well as setting out the ultimate goals and longer term actions.

Other factors that could affect success

Other factors that may affect the relative effectiveness of a MS or MI have also been considered. In particular, we have considered the source of a MS (super complaint, Government or internally generated by the OFT) and the market size.

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We could draw no firm recommendations for the regime by looking at these factors.

Total welfare vs consumer welfare standard

The OFT has an objective associated with maximising consumer welfare³. Therefore, under the OFT performance framework these costs do not need to be quantified. However, some of the MS and MI reviews seem to involve significant transfers of producer surplus to consumers and in some cases ongoing compliance cost for industry.

Under a standard cost-benefit analysis framework the MS/MI regime (and the associated individual remedies) would be judged on the basis of all the costs and benefits involved, including both the costs to industry and the long term dynamic benefits. However, the nature of the MS/MI regime is that, while the costs may be more easily defined and estimated, some of the associated benefits may be difficult to measure. Therefore, a total welfare analysis of the regime (or particular interventions) may rely on weighing up potentially large but immeasurable dynamic benefits against more certain implementation costs.

On this basis and given the objectives of the OFT seem to extend to considering the balance of power between consumers and firms, the choice of a consumer welfare objective over a total welfare objective appears to be a pragmatic one.

We would recommend that future MS and MI seek to identify all costs and benefits of the remedies proposed and also articulate the rationale and likelihood for any dynamic benefits claimed. However, there are difficulties associated with quantifying the dynamic effects of increased competition on innovation and long term productive efficiency. Given this, the regime should not be solely judged on the basis of the costs and benefits that can be easily estimated. Consideration should be given to how best to articulate and assess the success of the regime.

Dynamic benefits

Dynamic benefits may be associated with increased innovation and productivity improvements or result from increased deterrence of anti-competitive conduct which may otherwise have affected market outcomes.

We have been unable to provide evidence of dynamic benefits from individual case studies. We have sought to identify circumstances that would lead to higher dynamic benefits. The literature suggest that remedies aimed at resolving issues

³ Under the OFT's CSR performance framework it has an objective of making markets work well for consumers. In each annual report the OFT must provide quantitative evidence of how it delivers direct financial benefits to consumers of at least five times that of its cost to the taxpayer across the spending review period.

on either the demand or supply side both have the potential to lead to dynamic benefits.

Based on our review of the literature, the following are necessary conditions for achieving dynamic efficiencies:

- on the supply-side — markets with limited barriers to entry/exit of suppliers; and
- on the demand side — consumers being able to switch and compare product offerings.

The theoretical literature is not conclusive on the relative importance of these conditions.

We recommend that future MS and MI should seek to articulate the rationale and likelihood for any dynamic benefits claimed as a result of any proposed intervention. The presence of the above characteristics should be regarded as necessary conditions. We also recommend that further evidence be collected on the impact of demand side remedies on dynamic benefits as part of any further work on the broader impact of informational remedies.

Limitations and constraints

The methodology adopted in this project has involved:

- evaluating a small selection of diverse market studies;
- reviewing the OFT's existing evaluations; and
- reviewing at a high level five of the six market investigations where remedies have been fully implemented.

The MS case studies and MI reviews were not intended to represent a statistical sample and mostly drew on qualitative information. As such this data can not be built up to give a quantitative estimate of the regime's impact. Also evaluating the studies so soon after they have been undertaken could result in impacts being missed, unattributed and potentially undervalued. We recognise the uncertainties inherent in the methodology adopted. Although cautious we still consider that the case studies can be used to draw out indicative lessons for the regime.

1 Introduction

The Enterprise Act 2002 gave the Office of Fair Trading (OFT) the power to conduct market studies and, where necessary, refer markets to the Competition Commission (CC) for further investigation.

The market studies/investigations (MS/MI) regime is part of the wider UK competition regulatory framework. Given some time has elapsed since its inception and the wider interest in its success, the Department for Business, Innovation and Skills (BIS) is carrying out an initial review of the regime's effectiveness. Frontier Economics has been commissioned to assist BIS in this review.

This report presents our findings. It is structured as follows:

- Section 2 provides some background and context to the study.
- Section 3 provides an overview of our approach.
- Section 4 summarises the MS case study reviews conducted.
- Section 5 draws out some lessons for the MS/MI regime as a whole.

There are also two attachments:

- Attachment 1 details the outcomes of the MS case study reviews.
- Attachment 2 details the outcomes of the MI reviews.

We would like to thank the OFT, CC and BIS staff who have assisted in the preparation of this report.

2 Background and context

2.1 The Enterprise Act

The Enterprise Act 2002 (EA) includes a range of measures designed to enhance the UK's competition policy framework. This includes the market study and market investigation (MS/MI) regime. The OFT was established as a corporate body under the EA and given powers to undertake MSs. If the OFT considers that a market has features which prevent, restrict or distort competition, it can refer the market to the CC for further investigation.

2.2 Market studies

The objective of the OFT's MSs are to identify and address "all aspects of market failure, from competition issues to consumer detriment and the effect of government regulations"⁴. From the EA's inception to June 2009 the OFT investigated around 30 markets.

The power for the OFT to undertake a MS stems from the EA. They can be generated by the OFT in line with its 'Prioritisation Principles'. They may also arise from a super-complaint under section 11 of the EA⁵.

The study outcomes available to the OFT, include:

- giving the market a clean bill of health;
- publishing information to help consumers;
- encouraging firms to take voluntary action including developing consumer codes of practice;
- making recommendations to the Government or regulators;
- taking enforcement action (or undertaking further investigation) against companies or individuals suspected of breaching consumer or competition law; and,
- making a reference to the CC for a market investigation.

⁴ OFT (2004), 'Market studies, Guidance on the OFT approach'.

⁵ The following bodies have been designated as super complainants under the EA such that they can bring super complaints to the OFT and other sectoral regulators — The Campaign for Real Ale Limited, The Consumer Council for Water, The Consumers' Association, The General Consumer Council for Northern Ireland, The National Association of Citizens Advice Bureaux, The National Consumer Council and The Scottish Association of Citizens Advice Bureaux.

Following any reference to the CC, the OFT is also responsible for monitoring compliance with any remedies imposed by the CC following its investigations.

2.3 Market investigations

If the OFT suspects a market of having features which prevent, restrict or distort competition, it can refer the market to the CC for further investigation under section 131 of the EA. The OFT can make a reference:

- following a MS;
- in response to a super-complaint under section 11 of the EA; or
- following a review of undertakings or CC Orders following an earlier merger or market investigation reference, under section 92 or 162 EA (respectively).

Once a market has been referred to the CC, it must then conduct a MI to determine whether there is an adverse effect on competition (AEC) and, if so, what action should be taken to remedy the AEC. This may result in the CC issuing an order or recommending that action be taken by others.

In considering these matters the EA requires the CC to “have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any detrimental effects on customers so far as resulting from the AEC”⁶.

⁶ Section 134(6) Enterprise Act 2002

3 Approach

Our approach to evaluating the MS/MI regime has involved:

- Categorising the MSs based on some key characteristics in order to identify a sample that was then subjected to more detailed review.
- Undertaking more detailed case study reviews of the four selected OFT's MSs and previous evaluations undertaken.
- Reviewing the CC's MIs, where remedies have been implemented.
- Identifying the impacts of the regime and drawing out indicative lessons for improving its effectiveness.

This section provides further details of our approach.

3.1 Categorising studies and selecting case studies

As a first step the 30 MS were categorised according to:

- the nature of the market failure (demand or supply side concerns); and
- the target of the remedies (industry, government, references to the CC or the OFT i.e. to conduct an awareness campaign).

These classifications guided the choice of case studies. It was intended that the case studies cover a diverse range of MS in order to draw out some indicative messages for the regime.

3.1.1 Market failure

The MS conducted by the OFT have covered a range of different market failures.

HMT's Green Book⁷ identifies four types of market failures: public goods, externalities, imperfect information and market power. Government policy (in this area) is primarily concerned with issues around public goods and externalities. As competition regulators the OFT and CC generally focus on addressing issues around market power and/or imperfect and asymmetric information. By extension, the issues that may be considered in any particular MS/MI have been classified as relating to:

- Demand or consumer side market failures — which generally relate to problems of incomplete or asymmetric information or behavioural biases,

⁷ HM Treasury, "The Green Book, Appraisal and evaluation in central government", Annex 1.

which prevent consumers from making informed decisions. The Extended Warranties, Sale and Rent Back or Store Cards studies and investigations would fall within this category.

- Supply side market failures — which could include barriers to entry, highly concentrated markets and barriers to switching. For example the Commercial Use of Public Information (CUPI) or Taxis MSs.

It is worth bearing in mind that any particular market may display market failure on both the demand and supply side. As such a MS/ MI may include remedies relating to both⁸.

3.1.2 Target of proposed remedies

The OFT can choose to address market failures by:

- conducting an awareness campaign to address minor information gaps;
- making recommendations to industry in the form of suggested voluntary actions or developing a formal consumer code of practice;
- making recommendations to Government in order to reduce distortions from existing regulations or to recommend new legislation; or
- referring the matter to the CC for a full market investigation.

The CC has the power to compel evidence and impose remedies by way of enforceable orders that the OFT does not have. As a result, the impact of OFT's MS often depends on the extent to which their recommendations are implemented or acted upon.

3.1.3 Summary

Table 1 shows how the MS (and associated MI) are distributed by type of market failure and the target of the proposed remedies. A MS can have multiple recommendations; therefore some studies may appear in more than one row.

Those studies that have a single asterisk were selected as case studies for further review. Those with a double asterisk have previously been the subject of an evaluation.

⁸ This could be considered an important feature of the MS/MI regime.

Table 1. Distribution of OFT MS by main market failures and target of remedies

Target of remedies	Demand side	Supply side	Both
OFT action	Consumer IT Estate Agents Debt Consolidation Doorstop Selling	New Car Warranties** Public Sector Procurement Payment Systems	Homebuilding Personal Current Accounts Internet Shopping
CC market investigation	NI Banking PPI Home-collected Credit	UK Airports Classified-Ads Groceries Roscos	Extended Warranties** Store Cards
Recommendations to Government	Care Homes Doorstop Selling Estate Agents Sale and Rent Back*	PPRS* Taxis** Public Subsidies Pharmacies Property Searches CUPI* School Uniforms Medicines Distribution	Private Dentistry*
Recommendations to Industry	Consumer IT Ticket Agents	Liability insurance New Car Warranties** CUPI*	Homebuilding

* Indicates selection as a case study for review; ** indicates existing OFT evaluations.

3.2 Case study reviews

The MS case studies were selected based on ensuring that the studies evaluated included MSs relating to different market failures and that targeted remedies at different parties, rather than by their impact.

The MS selected as case studies for review were Private Dentistry, Sale and Rent Back, Commercial Use of Public Information (CUPI) and Pharmaceutical Price Regulation Scheme (PPRS). The outcomes of these reviews are contained in Attachment 1 and summarised in Section 4.

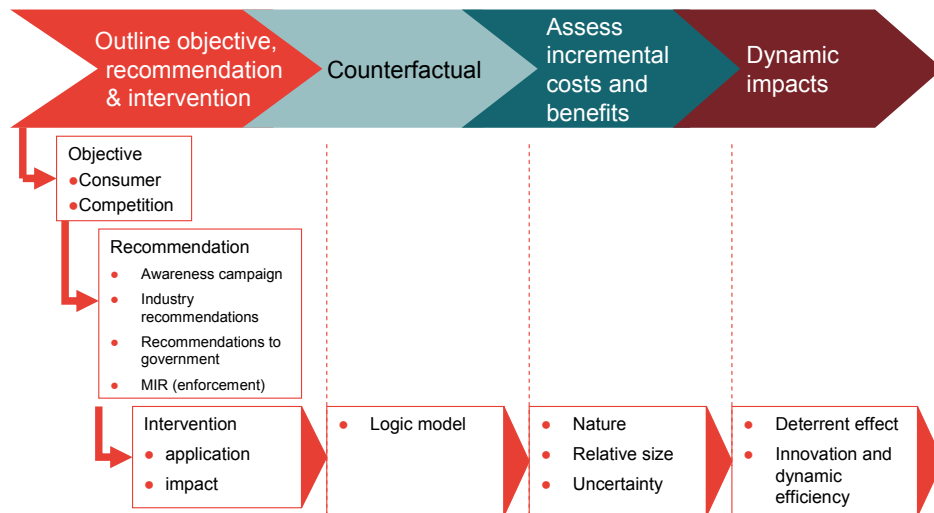
For each case study we have:

- outlined the objectives, recommendations and the resulting interventions in the market;
- set out a logic model that identifies the steps leading to the expected outcomes of each study and determines a counterfactual for considering future impacts;
- investigated any trends or evidence of incremental impacts using publically available data;
- assessed the incremental impacts (costs and benefits) and quantified or otherwise described these in the context of the framework; and
- identified the possible dynamic effects of the MS.

Evidence for the reviews was obtained from a desk based literature review of publicly available information and interviews with OFT and BIS staff involved in the MS. In assessing the MS's impacts we drew on some quantitative evidence, but also qualitative information⁹.

Figure 1 below summarises our approach.

Figure 1. Summary of approach to conducting the case study reviews



Source: Frontier Economics

⁹ Qualitative evidence sometimes involved taking a view on the extent to which government or industry implemented recommendations; or developing an informed preliminary judgment as to whether certain interventions were likely to be effective.

We did not attempt to explicitly quantify the impact of all studies on total welfare or consumer welfare basis. However, we did consider this matter when evaluating the MS and when reviewing the regime as a whole (see section 5.4).

3.3 Review of market investigations

To date there have only been six MI where remedies have been fully implemented¹⁰. We reviewed these five investigations¹¹ at a high level in order to draw out general lessons on the effectiveness of the regime. The final MI was too recently completed to be included. The outcomes of our reviews are contained in Attachment 2.

In reviewing these MI we considered each investigation's:

- objectives and recommendations;
- interventions and logic model;
- impacts; and
- circumstances where the remedies may be more effective and risks to achieving the desired outcomes.

The MI reviews have been conducted at a higher level when compared to the OFT MS case studies¹². These reviews did not involve any attempt to gather views or evidence the impacts. Clearly, such data is required to draw robust conclusions, and so we have been cautious in drawing conclusions from these reviews.

3.4 Impacts of the regime and lessons for improving its future effectiveness

The objectives of the MS case studies and MI reviews were to build up evidence to aid in identifying impacts and isolating lessons for improving the MI/MS regime's effectiveness.

From the outcomes of the case studies, the MI reviews and previously commissioned evaluations we have built up an understanding of the impacts of the regime. We have also looked to draw out lessons for the regime. This

¹⁰ Another four MI have been undertaken but remedies have not yet been implemented.

¹¹ The Market Investigations reviewed were Store cards, Liquefied petroleum gas (LPG), Home credit, Classified directory advertising services, Northern Ireland Banking.

¹² Less detail was thought to be available on the MIs outcomes and there were a smaller total number of MIs. Therefore our approach was to look at all of those where remedies have been put in place but with slightly less detail.

involved considering the relative effectiveness of various types of studies and remedies based on:

- their objectives or market failure rationale;
- the target of the recommendations; and,
- other influencing factors.

From this we have developed lessons for the regime associated with:

- the information that should be collected to facilitate future evaluations;
- the OFT's prioritisation and escalation processes; and
- other lessons for improving the regime's effectiveness.

These lessons are contained in Section 5.

The methodology adopted, which involved reviewing a small selection of diverse studies, has imposed some limitations on the ability to identify the impact of the regime and draw out lessons for improving its effectiveness. In particular evaluating studies close to when they are undertaken could result in impacts being missed or unattributed and potentially undervalued. These matters are further discussed in section 4.4.

4 Summary of case study reviews

Four of the OFT's MS were selected as case studies for review. These were Private Dentistry, CUPI, PPRS and Sale and Rent Back.

The MS into the private dentistry market was initiated in response to a super-complaint received from the Consumers' Association. Concerns existed around the level of pricing transparency, the failure of new entry into the market and the lack of a consumer complaints mechanism. The study concluded in 2003 and made recommendations relating to these consumer and supply side competition concerns.

The MS relating to the commercial use of public information (CUPI) was initiated by the OFT as a result of internal concerns, backed by complaints, about the operation of the market for Public Sector Information (PSI). It concluded in December 2006 and made various recommendations related to addressing supply side competition concerns. These were associated with industry lacking information on available PSI and some PSI holders restricting the accessibility of PSI.

The Pharmaceutical Price Regulation Scheme (PPRS) is one of the main instruments used by the Government to control NHS expenditure on branded drugs. The OFT's MS into the PPRS was initiated as a result of internal concerns about the efficiency of its operation, following related investigations under the Competition Act. It concluded in February 2007.

In 2008 the OFT completed a study into the Sale and Rent Back (SRB) market on the request of government. Under SRB agreements, homeowners sell their property at a discount to the market rate in exchange for a continuing tenancy arrangement. The MS primarily addressed consumer protection issues arising from the irrational behaviour of consumers in financial distress and the presence of asymmetric information in the market (associated with SRB providers holding better information on market values).

The detailed MS case studies are contained in Attachment 1, and a summary of the costs, benefits and limitations of these reviews is identified below. The details of the MI reviews are contained in Attachment 2.

4.1 Impact of the regime

The OFT has estimated its annual costs of administering the MS regime to be £8million¹³. This estimate does not include the costs to business of participating in the investigations/studies, the direct costs of any remedies implemented or the

¹³ OFT, (2008) "Positive Impact 2007/8", July 2008, p41

ongoing costs to industry of complying with these remedies. While uncertain, our case study reviews suggest that these additional costs have the potential to be orders of magnitude higher than the OFT's direct costs (see table 2).

Against these costs, the benefits of the MS/MI regime are often uncertain, non-monetisable and potentially large. The OFT has estimated substantial annual consumer savings from the MS/MI regime of £358m¹⁴. Of which £132m could be apportioned to the OFT¹⁵. These consumer gains are likely to equate to much smaller total welfare gains, once they have been discounted to take account of any transfer of benefits from producers. That said the MS/MI regime has the potential to deliver significant dynamic benefits over the longer term which would add to its more immediate static benefits.

Further details of the costs and benefits of the case study reviews follow.

4.2 Costs

Table 2 identifies the potential costs associated with the case studies and the relative size of these costs compared to the other case studies reviewed. Where evidence of the magnitude of these costs exists we have identified this along with the recommendation to which the impact relates.

The cost and duration of the MS varies, but on average they last just over 12 months, and have an average direct cost of £380,000¹⁶. The costs associated with setting up and running remedies and the costs to industry of complying with these remedies appears to vary. However, these can be significant.

For the purposes of this report we have identified in table 2 where we consider that a transfer from producers to consumers is likely to exist. This would be counted as a benefit under a consumer welfare standard.

¹⁴ This estimate is calculated as an annual average consumer saving for the period 2006-2009 based on ex ante estimates and ex post estimates from those MS subjected to an in-depth review (source: OFT, "Positive Impact 2008/9", July 2009, p40)

¹⁵ OFT, (2008) "Positive Impact 2007/8", July 2008, p30

¹⁶ National Audit Office, (2009) "The Office of Fair Trading, Progress report on maintaining competition in markets", March 2009.

Summary of case study reviews

Table 2. Potential costs and transfers associated with the MS case studies¹

	Sale and rent back	Private Dentistry	CUPI	PPRS
Agency (OFT) study costs	Low (<£0.5m)	Medium (£0.5m)	Medium (£0.5m)	High (£>0.5m)
Industry study costs	Low	Low	Medium	Low
Remedy set up costs	Medium	Low	High	-
Remedy running costs	Low	Medium (£1m) ²	Low	-
Industry compliance costs	High (£3m+ £1.3m pa) ³	Medium (£3m) ⁴	High	-
Lower economic profit (from consumer welfare gains associated with a transfer from producers)	Yes	Yes	Yes	-
Static- Indirect decline in efficiency	-	-	-	-

Source: Frontier Economics

1. This table identifies the potential costs associated with the case studies and the relative size of these costs compared to the other case studies reviewed. Where no judgement about relative size could be reached we have simply identified where these cost might be relevant.

2. Associated with the GDC complaints handling facility

3. One-off industry costs associated with FSA regulation of £3m + ongoing costs of £1.3m

4. Based on one-off costs to industry of introducing pricing transparency requirements

4.3 Static benefits

The benefits of the MS/MI regime are often uncertain and non-monetisable. Table 3 identifies the potential static benefits of the case studies reviewed. Where evidence of the magnitude of these benefits exists we have identified this. Given data constraints we have not attempted to judge the relative size of these benefits.

Table 3. Potential benefits associated with the MS case studies¹

	Sale and rent back	Private dentistry	CUPI	PPRS
Improvement in consumer welfare associated with reductions in prices paid and any additional consumption	✓	✓ Uncertain ²	✓ (£590m)	-
Improved consumer trust	✓	✓	✓	-
Improved access to goods & services	-	-	✓	-
Reduction in consumer transaction costs	Minimal	Minimal	✓	-
Static	Improvements in quality of goods or services	✓	✓	-
	Improvements in optimality of consumers choice	✓	✓	✓
	Increased choice	-	-	✓
	Direct improvements in productivity	-	-	-
Indirect efficiency improvements in other markets	-	Minimal	✓	-

Source: Frontier Economics

1. This table identifies the potential static benefits relevant to the case studies reviewed. We have not attempted to compare the relative size of these benefits across MSs. Although we have indicated where we consider the benefit might be minimal or insignificant relative to the other benefits of the same MS.

2. Refer to section 5.1 for discussion around the relative effectiveness of informational remedies particularly in the health sector

4.4 Dynamic benefits

Dynamic benefits may be associated with increased innovation (product or process), productivity improvements over time or result from deterring anti-competitive conduct which may otherwise have affected market outcomes.

Table 4 describes how the MS may lead to dynamic benefits for the various case studies. Given data limitations we have not attempted to quantify these benefits.

Summary of case study reviews

Table 4. Examples of dynamic benefits that may arise from market studies

Market study	Dynamic benefits rationale
<p>Private dentistry</p>	<p>This OFT market study resulted in a complaints and redress mechanism for private dentistry patients and improvements in the guidelines relating to the transparency of pricing.</p> <p>A complaints and redress mechanism can help in identifying poor performance and enable customer to seek redress in these instances. This directly incentivises poorly performing practice to either improve their service offering (either by reducing the price or improving quality) or exit the industry if they can not, leading to overall efficiency improvements in the market.</p> <p>Improvements in pricing transparency may help consumers to make more optimal choices. Where patients are making better choices, practices that better meet patient’s needs will be rewarded. This can lead to productivity improvements, and increase the potential for product or process innovations throughout the dentistry supply chain.</p> <p>This dynamic benefit would not need to be large to cover the costs of the study. For example a 0.25% fall in prices as a result of these dynamic effects could be associated with dynamic benefit close to £5 million¹⁷.</p>
<p>Sale or rent back</p>	<p>Under sale and rent back (SRB) agreements, homeowners sell their property at a discount to the market rate in exchange for a continuing tenancy arrangement. These agreements are aimed at people in financial difficulty that can no longer afford their mortgage repayments but wish to remain in the property.</p> <p>The OFT’s market study recommended regulation of the market. This included requiring firms to make consumers clearly aware of:</p> <ul style="list-style-type: none"> □ the sale price, market value discount, rent and tenancy terms; and □ independent advice on the market valuation of the property. <p>These interventions are likely to have improved consumers understanding of SRB products and their price, enabling them to better compare their available financing options. This may help consumers make more optimal choices. Where consumers are making better choices, firms that are unable to meet consumers needs will be more likely to exit the market improving the efficiency of the market.</p>

¹⁷ Estimate based on private dentistry revenues of £2 billion.

CUPI Public sector information holders (PSIHs) are monopoly suppliers of public sector information (PSI). In many instances PSIH's compete with commercial companies to provide value-added information.

The OFT market study in this area concluded that commercial firms lack information on available PSI and that some PSIHs may restrict or otherwise only make PSI available to commercial firms on a discriminatory basis (i.e. at unduly high prices). As a result of the study the Office of Public Sector Information began monitoring this area and the government published guidance on pricing methods.

If the OFT's study results in increased commercial use/re-use of PSI this may lead to commercial firms retailing, reusing or packaging this information in a more efficient or innovative manner. In addition they may introduce new products/services that use PSI as an input that may otherwise not have been developed. Therefore, by removing restrictions on entry into the market, productivity may be improved and innovation encouraged.

PPRS The dynamic effects that can be attributed to this case study will be somewhat limited as the majority of recommendations did not lead directly to any interventions.

However, the MS did make recommendations associated with encouraging the uptake of new drugs. The resulting patient access scheme enables companies to negotiate with DH to reach an agreement on discounts that can be applied to a drug to make it cost-effective such that this can be prescribed on a limited basis where not yet fully approved for inclusion in the NHS. Increasing access to new drugs could encourage the development of new and innovative drugs in the longer term.

Source: Frontier Economics

4.5 Limitations and constraints

The project methodology has involved reviewing a small selection of diverse MSs. The objectives of these case studies were to identify the varying impacts of the MS regime and isolate lessons for improving its effectiveness.

The case studies were not intended to represent a statistical sample and mostly drew on qualitative information¹⁸. As such this data can not be built up to give an estimate of the regime's impact. Also it constrains the lessons that can be extracted for the regime. We recognise the uncertainties inherent in the methodology adopted.

¹⁸ Qualitative evidence may involve taking a view on the extent to which government or industry implemented recommendations; or developing an informed preliminary judgment as to whether certain interventions are likely to be effective.

There are also some specific issues (further discussed below) that limit the ability to adequately evidence some impacts and may add to this underlying uncertainty. Although cautious we still consider that the case studies can be used to draw out some indicative lessons for the regime.

4.5.1 Timing limitations

There is a risk that any evaluation, particularly if conducted too soon, may miss or undervalue the longer run effects of competition interventions. This is particularly true in relation to dynamic benefits which may develop over a significant period of time. This is a problem for all MS evaluations and reviews conducted to date. While looking for evidence in this area we also looked to develop an informed preliminary judgment as to whether certain interventions are likely to be effective.

The MS reviews must also be considered in the context of their timing relative to the actual MS. Older MS and MIs are more likely to have evidence available to quantify costs and benefits. However, the OFT is likely to have refined its approach to conducting these studies so that conclusions based on older studies may not reflect current practice. These constraints have in some instances limited our conclusions.

The OFT appears to have developed their practices and approach over time. This was acknowledged by the NAO who indicated that the OFT had “made significant progress in embedding impact estimation and evaluation of outcomes into its work”¹⁹. For example, the OFT did not conduct an awareness campaign as part of the Sale and Rent Back MS as it was not considered to be beneficial given the small number of customers involved. This approach was consistent with learnings from the previously conducted New Car Warranties MS. In addition there is greater focus on providing ongoing advocacy and engagement with stakeholders following the completion of the study.

4.5.2 Pricing data

We were not able to find reliable, publically available data on pricing in any of the markets considered. In addition, robust use of pricing data requires significant investigation into the workings of the industry. The pricing of goods or services, in any market, will vary over time for numerous reasons unrelated to changes in market power or resolution of market failures. For example, the capacity of suppliers can have a large effect.

As a result, short-run pricing data may be very difficult to assess ex post. Consequently, inferences regarding the impact of a MS or MI can only be drawn

¹⁹ NAO, (2009), “The Office of fair trading, progress report on maintaining competition in markets”, March 2009, p 24.

from short term price data by considering additional information. This might include data on the longer term historic industry prices and costs, market conditions and supplier constraints, profitability and broader economy wide data.

4.5.3 Choice of counterfactual

For the MI and MS reviews²⁰ we assumed as a counterfactual that no action might have been taken in a market without the study or investigation. This is the simplest counterfactual to apply, but may not always be the most likely. For example, in the absence of a MS or MI some action to reduce consumer detriment could have been taken by the government. These alternative scenarios might imply a lower level of benefits than we assume in our choice of counterfactual. These issues might be relevant for some of the MI, such as Store Cards, where there had been some public and parliamentary debate about the performance of the market prior to the reference. In the case of the MS case studies we have attempted to identify the activities which could be considered to reduce the impacts of the MS.

In some cases the most likely counterfactual could be a Government review, followed by direct Government intervention. This may be relevant for the MSs initiated by Government, such as Sale and Rent Back. In these instances the net benefits of the MS/MI regime could be considered to relate to how much more effectively the OFT and CC carry out this task when compared to Government. The question of which body is best placed to conduct a study or investigation has not been considered as part of this study.

²⁰ In the case of the MS case studies we have attempted to identify the activities which could be considered to reduce the impacts of the MS.

5 Lessons for the regime

5.1 Relative effectiveness of informational remedies

A MS or MI's objectives will be based on the market failure it is intending to address. For the MS/MI regime these can be categorised as relating to either demand side or supply side concerns.

In assessing the impact of the regime we have looked to confirm whether any conclusions can be drawn from the MS or MI reviews in regards to the relative effectiveness of addressing different market failures.

We found very few ex post evaluations which investigated the success of informational remedies and in particular the circumstances where they have been more or less effective in addressing demand side issues. This has previously been identified as an information gap in reports commissioned by the OFT²¹ and both the CC and OFT have considered how they can address this through ex ante 'road testing' of remedies²². Building on this approach, considering the impacts of informational remedies in any ex post evaluations may also improve the understanding of their effectiveness and improve the regime in the future.

The details of our analysis follow.

5.1.1 Breakdown of studies by market failure

The breakdown of the OFT's studies by market failure suggest that consumer demand side concerns have traditionally been less of a focus. Table 1 in section 3.1.3 shows that the MS conducted have been somewhat weighted toward addressing supply-side concerns. Of the MS generated in house by the OFT 61% have related primarily to supply side concerns and 22% to demand side concerns, and 17% to both²³. That said a large proportion of these MSs appear to include some recommendations relating to the provision of information even if this is not the main focus.

The CC also relies on information remedies as part of its toolkit of potential remedies. With the exception of the CDAS investigation each of the five MI's

²¹ ESRC Centre for Competition Policy (2008) 'Assessing the effectiveness of potential remedies in consumer markets' prepared for the OFT, OFT publication 994, p15.

²² London Economics (2009) 'Road testing of consumer remedies' prepared for the OFT and CC, OFT publication 1099.

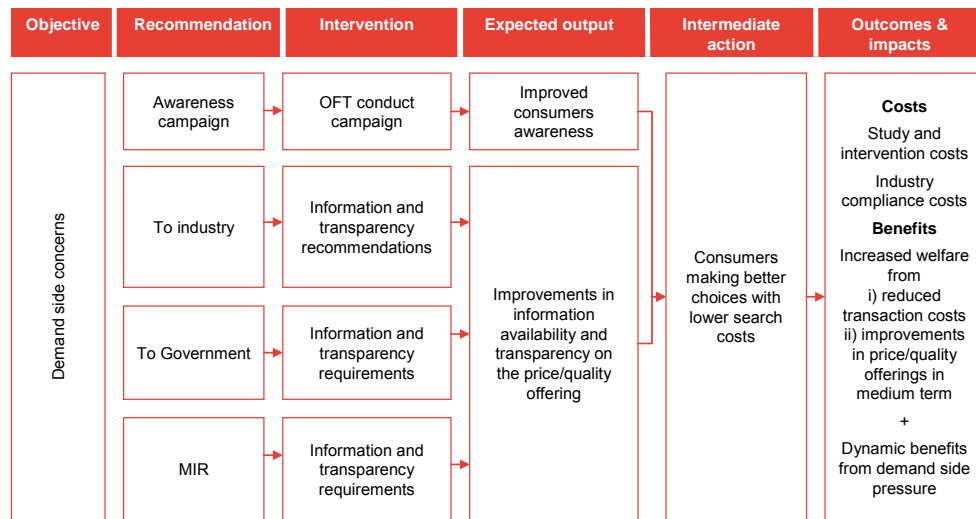
²³ These figures are based on the classification of the studies shown in Table 1, for only those generated internally by the OFT (based on classification in the OFT's market work database). When looking all market studies in Table 1 the breakdown is as follows — 52% primarily relating to supply side concerns, 22% to demand side concerns and 17% to both.

reviewed included a remedy associated with requiring suppliers to provide information around prices and/or other attributes of the products/service.

5.1.2 Possible remedies and their anticipated impacts

Figure 2 below shows a simplified and stylised logic chain relating to remedies commonly used to address demand side concerns.

Figure 2. Logic chain for informational remedies associated with addressing demand side concerns



At a high level, informational remedies can be considered to:

- make consumers more aware of how to exercise choice and address issues with suppliers; and/or
- improve the information on price and quality available to consumers (by increasing the quantity of information or its transparency).

This in turn may lead to consumers making better choices which improve efficiency as consumers seek products from more productively efficient suppliers. There are also likely to be further dynamic benefits, resulting from those suppliers that better match the needs of consumers being rewarded (see section 5.5).

The typical remedies applied fall into two main categories — awareness campaigns and pricing/quality transparency or disclosure requirements. There is a body of literature that explores the rationale for these remedies and their anticipated impacts. This includes work recently commissioned by the OFT and

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CC²⁴. However, empirical evidence on the circumstances where such remedies are more beneficial is scarce.

5.1.3 Literature on informational remedies

Price and quality transparency is generally considered to benefit consumers²⁵. Anything that helps consumers obtain pricing information, and understand a good's attributes more easily, will enable them to make useful comparisons of costs and benefits of alternative choices. The buyers' ability to choose whatever offer suits them best will put pressure on sellers to lower prices, improve quality, or both. Also, increased information on offers and prices could facilitate entry and exit in an industry. Both these mechanisms suggest informational remedies can lead to dynamic benefits in a market.

Impact on prices depends on market conditions

Informational remedies can be advantageous for producers also. This information may help businesses make informed decisions about the prices at which they will offer their products, eliminating the need for a more costly "trial and error" process²⁶. In practice, this may not always unambiguously be beneficial for consumers²⁷. It is possible that pricing transparency may facilitate collusion (either explicit or tacit). Although, this is more likely in those markets which are already susceptible to it²⁸. Research commissioned by the OFT has included exploration of this²⁹.

While economic theory suggests that increased pricing information and transparency leads to lower and more uniform prices, this may not apply to all markets in all circumstances. For example this may not be true for the health sector (see text box).

The success of informational remedies may also be limited by consumer behavioural constraints. For example consumers may have limits to how much information they can process. Therefore, information overload may actually

²⁴ ESRC Centre for Competition Policy (2008) 'Assessing the effectiveness of potential remedies in consumer markets' prepared for the OFT, OFT publication 994. London Economics (2009) 'Road testing of consumer remedies' prepared for the OFT and CC, OFT publication 1099.

²⁵ M. Armstrong, "Interactions between Competition and Consumer Policy", Munich Personal RePec Archive, Papers No. 7258, 19th February 2008.

²⁶ Nitsche, R. and N.von Hinten-Reed, "Competitive Impacts of Information Exchange", Bruxelles: Charles River Associates, June 2004.

²⁷ OECD Policy Roundtables, "Price Transparency 2001", Paris: OECD.

²⁸ These are typically markets characterised by features such as high concentration, high barriers to entry, symmetric sellers' costs and inflexible demand and cost conditions.

²⁹ ESRC Centre for Competition Policy (2008) 'Assessing the effectiveness of potential remedies in consumer markets' prepared for the OFT, OFT publication 994, p127.

reduce the optimality of consumers' decisions. Similarly an excessive number of choices and option may also reduce consumer welfare³⁰.

Informational remedies in health markets

Several aspects of health markets³¹ point to price being a less important signal than in other markets, these include:

- The heterogeneous nature of the product — the same health condition can affect different patients in different ways leading to different treatments. This makes it difficult for patients to assess the offering in terms of price and quality.
- Price discrimination practices — brought about partly by government policies which justify different charges on the ground of fairness (consumers with larger incomes are charged more), partly due to the bargaining power of insurance companies.
- The existence of intermediate agents who make decisions – e.g. the physician who recommends whether a patient should receive further treatment and which specialists to see; and
- Third-party payments through insurance, which induce a moral hazard effect on patients who, once insured, do not worry about the cost of treatment.

In the case of private health care services, such as private dentistry, few consumers will have a clear idea of what the services will cost, or understand how these charges are determined. In this setting the impact of price transparency on market outcomes may be limited. This may be relevant to the Private dentistry MS where the market would share many of the characteristics of the broader private health sector.

5.1.4 Evidence from evaluations and reviews

Awareness Campaigns

The New Car Warranties MS led to the OFT carrying out an information campaign to improve consumers' awareness of their opportunity to choose where to have their cars serviced.

³⁰ London Economics (2009) 'Road testing of consumer remedies' prepared for the OFT and CC, OFT publication 1099, p24.

³¹ Austin, D.A. and J.G. Gravelle, "Does Price Transparency Improve Market Efficiency? Implications of Empirical Evidence in Other Markets for the Health Sector", CRS Report for Congress, Washington, 29th April 2008.

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While the subsequent evaluation concluded that the estimated consumer benefits were large they mostly relate to the dropping of the warranty conditions rather than the awareness campaign. That said the total present value static consumer benefits arising from the awareness campaign were estimated to be £2 million which still compare favourably to the OFT's direct costs of £300,000 associated with carrying out the market study and follow up implementation work³². In addition these benefits were considered likely to continue to materialise.

The New Car Warranty awareness campaign was a one-off. Evidence collected through surveys suggested that the OFT's campaign influenced the understanding of over half those who saw it. However, it only reached six per cent of new car buyers. Therefore, the evaluation suggested that significant consumer detriment remained (£40-£90 million per annum). This was associated with consumers being unaware of their servicing options and therefore failing to take advantage of the opportunity to search out alternates.

The evaluation, therefore, recommended that for future information campaigns particular attention should be paid to the length of time required to achieve a significant impact and to the targeting of the campaign. Some stakeholders suggested that the information should be targeted at individuals at the point when the car is sold.

Interestingly the OFT did not conduct an awareness campaign as part of the Sale and Rent Back MS. This was not considered to be beneficial because of the small number of customers involved. Instead the recommendations focussed on information remedies at the point of sale, consistent with learnings from the New Car Warranties MS.

In CUPI an awareness campaign was not considered necessary as at the time The Guardian was running a campaign that reported weekly on this matter.

Pricing transparency and disclosure requirements

The evaluation of the Extended Warranties MS/MI³³ considered the impact of pricing transparency remedies. In the first instance they looked at the intermediate output anticipated and sought to evaluate the impact of the CC's remedies³⁴ on the availability of information and consumer awareness, and whether this led to a change in consumer shopping patterns.

Through the results of a mystery shopping exercise and a consumer survey they suggested that there had been an increase in the information available to

³² Europe Economics (2006) 'Evaluating the impact of the car warranties market study', prepared for the OFT, OFT publication 852, June 2006, p3.

³³ LECG (2008), "Evaluating the impact of the Supply of Extended Warranties on Domestic Electrical Goods Order 2005, Prepared for the Office of Fair Trading", October 2008

³⁴ Supply of Extended Warranties on Domestic Electrical Goods Order 2005

consumers and their awareness of the new requirements on businesses. The evaluation also suggested there had been a small, but positive change, in consumers' warranty purchasing behaviour, with slightly fewer consumers buying from the 'point of sale' supplier.

The evaluation noted the difficulties and uncertainty associate with translating this change in buying behaviour to market outcomes (price, non price attributes and new entry). Although the evaluation collected evidence on changes in market outcomes; it was unable to conclude on whether the changes were caused by the CC remedies or by other factors, noting the possibility that the impact of the remedies had not yet fully materialised. We also noted this issue (see section 4.5).

5.1.5 Lessons for the Regime

The remedies with the most easily identifiable (but not necessarily the largest impact) are those that directly remove inefficiencies. For example requiring bulk LPG companies to transfer ownership of tanks to one another, rather than physically replacing them, when people switch. The mechanisms by which informational remedies lead to benefits may be more indirect. As a result they are associated with greater levels of uncertainty around the costs and benefits. This makes commenting on the relative effectiveness of remedies focussed on addressing demand vs supply side concerns difficult.

There have been very few studies which investigate, ex post, the success of informational remedies; and in particular the circumstances where they have been more or less effective in addressing demand side issues. In conducting both the MS case studies and the MI reviews we found very little publically available data that could be used to evidence the impact of informational remedies.

Recent work commissioned by the OFT identifies that more robust evidence on the effectiveness of some of these remedies across industries would be beneficial³⁵. This still remains an area of considerable uncertainty. Given that addressing demand side issues represents a substantial focus of the regime, further work in this area would be beneficial.

The competition regulators have considered how they can be more certain of the impact of their informational remedies through ex ante 'road testing'³⁶. We recommend building on this approach through increasing the focus on informational remedies any ex post evaluations undertaken.

³⁵ ESRC Centre for Competition Policy (2008) 'Assessing the effectiveness of potential remedies in consumer markets' prepared for the OFT, OFT publication 994, p15.

³⁶ London Economics (2009) 'Road testing of consumer remedies' prepared for the OFT and CC, OFT publication 1099.

Further work on the impacts of informational remedies (such as pricing transparency and disclosure requirements and awareness campaigns) and the circumstances in which these accrue should be undertaken.

This would involve:

- using ‘road testing’ methods (such as consumer research) where feasible to evaluate the impact of informational remedies prior to their implementation; and
- increasing the focus on informational remedies in any ex post evaluations and building in the capacity to measure their effectiveness by:
 - setting out a logic chain for any recommendations and remedies upfront which includes the target interventions and outcomes;
 - collecting pre intervention data where informational remedies are used to provide a benchmark for future evaluations;
 - collecting post intervention data (including on consumer reactions and costs of measures to industry); and
 - conducting ex post evaluations of informational remedies and reviewing evaluations conducted looking for situations in which they are more or less effective.

5.2 Relative effectiveness of industry and government targeted recommendations

The impact of a MS will also depend on the extent to which its recommendations are implemented or acted upon. The target of a MS’s recommendations are likely to influence this.

A MS may target recommendations at the Government, industries or identify actions that the OFT can undertake itself. In addition it may refer a matter to the CC if the statutory test for making a reference is met. We can not say anything conclusive from the reviews conducted on whether recommendations targeted at certain bodies are more effective than others. However, we have been able to draw out broader recommendations for the regime.

We suggest that more investigation on the benefits of ‘light touch’ industry focused recommendations (voluntary industry codes of conduct) would be useful and aid in improving the regime in the future.

Also, where the OFT is addressing market failures that are complex or relate to broader government policies and legislation, the OFT should attempt to identify ultimate goals but also implementable, interim steps.

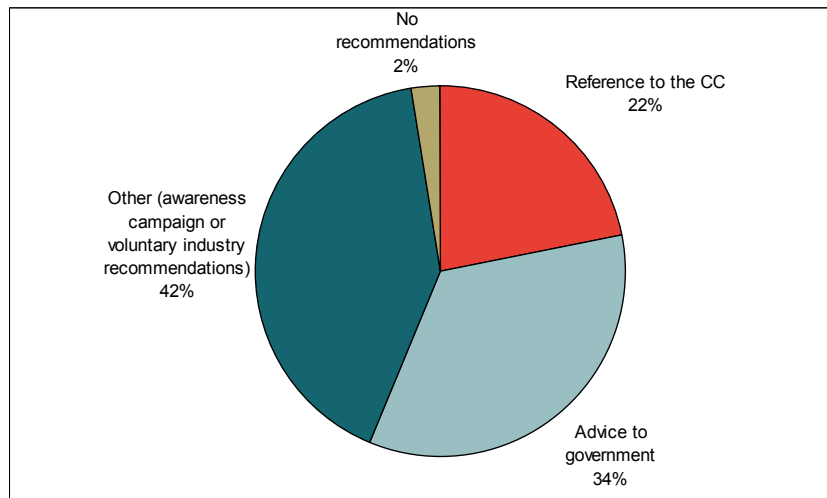
5.2.1 Breakdown of studies by recommendation form and target

The OFT can choose to address market failures identified through a MS by:

- conducting an awareness campaign to address minor information gaps;
- making recommendations to industry in the form of suggested voluntary actions or developing a formal consumer code of practice;
- making recommendations to Government in order to reduce distortions from existing regulations or to recommend new legislation; or
- referring the matter to the CC for a full market investigation, where the CC can use its powers to compel evidence and impose remedies.

Essentially the OFT can target recommendations at itself, industry, government or refer matters to the CC. A breakdown of MS conducted to date, by key target and the form of the recommendations, are shown in Figure 3 below.

Figure 3. Breakdown of MS by the key target and form of recommendations



Source: OFT data on markets work

This breakdown shows that only around 1 in 4 of the MS undertaken have led to a reference to the CC. This suggests that the OFT is playing a role in filtering matters that go before the CC. Although it should be acknowledged that MS focussed on consumer protection matters could not be referred to the CC under the relevant statutory test.

Of the MS that were not referred over half had key recommendations that could be considered, from an industry perspective, to be 'lighter touch' interventions. These would include OFT awareness campaigns or voluntary codes of conduct

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for industry. These interventions may create less costs for industry but more ongoing costs for the OFT.

Recommendations to government are also common. These may relate to:

- reducing the impacts on competition from existing regulations; or
- making recommendation for new legislation; to address competition or consumer concerns.

Recommendations to government can lead to the removal or creation of more onerous statutory regulation. But to get this outcome the OFT recommendations must be acted upon by Government.

5.2.2 Evidence from evaluations and reviews

The OFT conducted a review of its market studies in 2007 which examined, amongst other things, the response to studies' recommendations. It found that in around three fifths of studies all or some of the recommendations were implemented. While in a fifth of cases the OFT judged them to have been unsuccessful, and in the remaining fifth, it was considered too early to tell³⁷.

The key risk areas for the OFT, in terms of implementation, will be recommendations made to industry and Government.

Recommendations to industry

The OFT's New Car Warranties MS involved some recommendations targeted at the industry. Specifically it called for manufacturers to drop conditions on warranties that require a car to be serviced at a garage in its network. Following the study the OFT entered into discussion with trade associations to improve their codes of practice. It also carried out an information campaign to improve consumers' awareness of their opportunity to choose where to have their cars serviced.

The subsequent MS evaluation estimated that the total consumer benefits from the MS were in the order of £120-£170 million, most of which related to manufacturers dropping the warranty conditions. From a consumer welfare perspective this compares favourably to the cost of £300,000 for carrying out the market study and follow up implementation work. Therefore, it appears that the OFT successfully used the threat of formal enforcement action to achieve change in the industry through a 'lighter touch' approach.

³⁷ NAO, (2009) "The Office of Fair Trading, Progress Report on Maintaining, Competition in Markets" March 2009, p16

Recommendations to government

The OFT would be likely to make recommendations to Government where legislative interventions are considered necessary and the issues:

- relate to the impact of existing legislation;
- are complex such that the CC powers may be insufficient; or
- relate to areas where there may be broader public policy objectives.

In these instances the analysis of the potential range of interventions is likely to be more complex. This means there is scope for the MS's recommendations to differ in the extent to which they address these complex or broader public policy issues. And indeed the case studies, whose primary recommendations were targeted at Government, varied in terms of the complexity, practicality and implementability of their recommendations.

The PPRS and to a lesser extent the Taxis and the Private Dentistry MSs seem to have been less successful in getting some of their recommendations implemented by Government. CUPI and Sale and Rent Back could be considered more successful when judged in this way. Possible reasons for the latter studies success could relate to the following circumstances³⁸.

- Many of the issues raised in the MS were already at the forefront of the Government's mind due to public attention on the issues
- There was an area of government (or an authority) available and interested in championing any ongoing work required on the proposed interventions.
- The recommendations had fewer fiscal and/or broader public policy implications.

In addition these MS appeared to have one or more of the following characteristics.

- The recommendations made were less radical or more cognisant of government's broader constraints such that the recommendations may have been more achievable.
- The MS more clearly spelled out the specific details of the interventions recommended.

³⁸ All of these circumstances exist for the CUPI and Sale and Rent Back MSs. This is was not true of the other evaluated MS.

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- The case made for interventions was stronger in terms of describing and valuing the benefits.

The OFT's previous evaluation of the Taxis MS³⁹ which related to the existing regulations governing taxis and private hire vehicles provides evidence of the importance of some of these factors⁴⁰. The OFT's key recommendation was to suggest the repeal of legislative provisions that allowed local authorities (LA) to impose restrictions on the number of taxi licences.⁴¹ While the Government broadly agreed with the OFT's findings, they did not pursue legislative change. Instead, the Department for Transport initiated a review of LAs' policies and placed the onus on LAs to justify any quantity restrictions. By August 2005, 30% of LA had quantity restrictions on taxi licences, down from 45% at the time of the OFT market study, while other LAs were still in the process of reviewing their policies.⁴² There was an increase in the number of taxis operating in LAs that removed quantity restrictions relative to those that had not⁴³.

The evaluation suggested that consumers were likely to have benefited from shorter wait times for taxis⁴⁴ and reduced upward pressure on fares. However, the evaluation also suggested that there was evidence of a decrease in the productive efficiency of the taxi industry (through reduced utilisation). And this was estimated to have exceeded the benefits to consumers in terms of decreased waiting times.

The evaluation highlighted the complexity of interactions involved in the market for taxi services. While the MS acknowledged this complexity, Europe Economics suggested that a "more detailed analysis of different elements in the market would have given the OFT a better understanding of the welfare implications of the changes it proposed" adding to the credibility of its recommendations⁴⁵. Three of the evaluations most pertinent recommendations were that:

³⁹ The regulation of licensed taxi and PHV services in the UK, November 2003.

⁴⁰ Evaluating the impact of the taxis market study, A report for the OFT by Europe Economics, October 2007.

⁴¹ The Transport Act 1985 for England and Wales (excluding London) and the Civic Government (Scotland) Act 1982. Transport for London and the Department for the Environment in Northern Ireland do not have equivalent powers for their jurisdictions.

⁴² [OFT press release: Taxi numbers increase since OFT report](#), August 2005.

⁴³ The number in LAs that had not removed restrictions remained unchanged over the same period.

⁴⁴ Which reduced by a greater extent in de-restricted LA.

⁴⁵ Evaluating the impact of the taxis market study, A report for the OFT by Europe Economics, October 2007, p7.

- When making recommendations related to regulated sectors the OFT should take account of interactions between different regulations, particularly in cases where a partial deregulation is being recommended.
- Although the OFT's principal focus is on consumers it should also take into account the wider welfare effects of any proposed changes. Where changes may create significant losses to the producers of goods or services, not related to the exercise of market power, this may increase resistance to change and act as an obstacle to beneficial longer term developments.
- Consideration of transitional arrangements may be necessary.

The Pharmaceutical Price Regulation Scheme (PPRS) MS could also be considered complex as it involved a number of broader government actions and policies. The MS looked into concerns around the operation of the Government's PPRS — a collective buyer scheme. The OFT's main concerns were that the Government was paying excessive prices for some drugs, relative their therapeutic value and that insufficient use was being made of generic and new drugs. The OFT called for fundamental reform of the PPRS based on a shift from existing company-wide restrictions on profits and price levels to 'value-based pricing', where prices for individual drugs would be set to reflect their therapeutic benefit and/or the price of generics. The study's key recommendations were not adopted by Government, although the 2009 PPRS did include alternative provisions to encourage generic drug substitution and the uptake of new drugs.

In some respect the uptake of the OFT's recommendations were affected by broader timing issues— the Government was forced to bring forward the PPRS ahead of the intended schedule due to unconnected legal matters. This made any overhaul of existing arrangements unlikely. However, it is not clear that the Government will necessarily adopt the OFT's recommendations in the future.

It could be argued that the lack of commitment to the OFT's recommendations is due to the extent and significance of the changes proposed. Also the report lacks interim recommendations that may have otherwise made the move towards the more aspirational proposed changes easier for Government.

The MS proposed linking the price of out-of-patent drugs to generics. However, the government favoured the use of demand side measures which focussed on enabling pharmacists to make generic substitutions. This suggests that a strong case for the benefits of the OFT's recommendations over alternate options was not made.

Putting these matters aside it is possible that the MS acted to inform and move forward the debate on the structure and future operation of the PPRS. Its timing and the fact that its recommendations were possibly seen as a threat by

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pharmaceutical companies may have resulted in the Government negotiating a better pricing outcome than may otherwise have occurred in the 2009 PPRS.

The success of the Private Dentistry MS is considered mixed when judging it on the basis of the extent to which its recommendations were implemented. The recommendations of the MS focussed on consumer issues and led to interventions in the market. However, its recommendations aimed at removing barriers to entry where not acted upon, largely due to the Department of Health's (DH) concerns around the impact on standards in the industry.

If the OFT wants to pursue competitive reform in an area where there are broader policy concerns, then more work may be needed to put forward the merits of the case. This could be either during or after the completion of the MS.

5.2.3 Lessons for the regime

Where the OFT's recommendation are not acted upon the benefits of the MS will be reduced. The key risk areas for the OFT, in terms of implementation, will be recommendations made to industry and Government.

Only one MS evaluation (New Car Warranties) has involved significant recommendations targeted at industry through voluntary changes to its code of conduct. Certainly in the case of this MS this approach appeared to be successful and was probably aided by the threat of alternate more onerous action if there was no movement on the matter of concern.

The proportion of the OFT MS that included key recommendations to Government is significant. Indeed the OFT clearly has a remit to consider the impact of regulation on competition through its effect on market structures and barriers to entry or innovation⁴⁶. The Government has committed itself to considering the advice, but ultimately must balance competition concerns against other public policy considerations. As a result it can not be expected that any recommendation made by the OFT or CC's would necessarily be acted upon.

There are circumstances that can increase the likelihood of the Government intervening in accordance with recommendations (see section 5.2.2).

Favourable circumstances should not be unduly considered by the OFT in prioritising its MSs. Certain competition issues may not be at the forefront of the Government's or the public's consciousness, but the OFT may have recognised it as having a large impact on market outcomes. It would not be advisable for the OFT to only seek to make recommendations that it knows can be quickly or easily implemented at the risk of missing complex but important issues and moving forward the debate on these matters.

⁴⁶ Paragraph 4.15 of the Government's White Paper "A world class competition regime"

What can be said is that if the favourable conditions mentioned are not present the OFT will likely have to work harder to present the merits of its case to increase the likelihood of its recommendations being acted upon. We note that there appears to be some uncertainty around the OFT's role in this regard. Where the OFT is contributing to a debate that involves broader policy as well as competition concerns, it is not clear whether its role is as a champion of competition or a provider of broader policy advice.

On this basis we recommend addressing the following.

Where the OFT is addressing market failures that are complex or relate to broader government policies and legislation, the OFT should identify implementable or transitional steps, as well as setting out the ultimate goals and longer term actions.

5.3 Other factors that could affect success

Other factors that may affect the relative effectiveness of a MS or MI have also been considered. In particular we have considered:

- the source of a MS — super complaint, Government or internally generated by the OFT; and
- the market size.

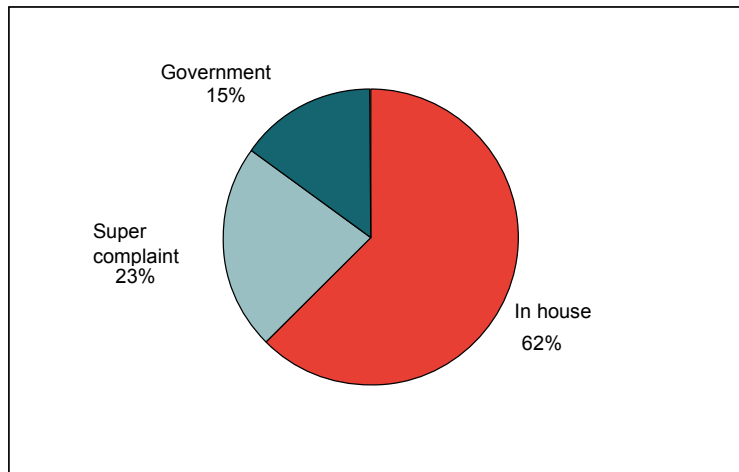
We could draw no firm recommendations for the regime by looking at the above factors. However, further details of our analysis is provided below.

5.3.1 The source of a study

We have investigated whether there is a systematic link between the source of an investigation and the outcome. For instance, some issues may be more apparent to the competition regulators, while others to consumer groups. If correcting certain types of market failures leads to greater net benefits then this would result in a systematic variation in the success of the investigation based on its source.

The majority of MSs are generated in house by the OFT, where it applies its Prioritisation Principles to assist in determining which matters of concern it should investigate further (see Figure 4). Over a third of the OFT's MSs to date are generated by Government requests or super complaints. Some of this work is likely to represent policy advice which, in the absence of the MS/MI regime, would have been conducted by Government.

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Figure 4. Source of market study

Source: OFT data on market work

It appears the link between a MS's origin and the nature of the market failure, and therefore certain remedies, is tenuous. For example the Private Dentistry MS was raised by a super complainant who highlighted both consumer and supply side competition issues in the market.

What can be said is that Government requested MS may find a more receptive environment for any Government targeted recommendations. This appeared to be the case in relation to the Sale and Rent back study. In this instance the OFT was essentially playing a policy advice role.

5.3.2 The size of the market

All other things being equal, studies of larger markets have the potential for greater positive impacts in both static and dynamic terms. Although the final impact will also depend on the size of the existing detriment in the market and the extent to which the MS or MI remedies correct for this.

In larger markets even ineffectual remedies can have a large impact on consumer surplus from only a slight impact on prices. For example only a 10% reduction in detriment resulting from the CC's Store Cards MI would lead to over £5million per annum in consumer surplus. However, the same reduction arising from the LPG MI would only lead to £400- £800,000 of consumer benefit against a similar level of costs (see Attachment 2 for details). Market size is also relevant to the extent of dynamic benefits generated from a study.

However, as recognised in the OFT's Prioritisation Principles and by the NAO in a recent report,⁴⁷ maximising the impact of the regime requires a portfolio which is appropriately balanced between interventions in markets of different sizes. This is to ensure that firms in smaller markets know that their actions are not being ignored.

While this is clearly very important in regards to competition enforcement it is less clear how important this is in relation to the MS/MI regime (see section 5.5.1 for further discussion). However, there is a risk that were the OFT and CC only to target larger markets in its MS and MI a perception may develop that as a whole they are less interested in smaller markets. This in turn may undermine the extent to which their existence acts as a deterrent to anticompetitive conduct in these markets.

Aside from this there may be a question of equity. The Sale and Rent Back MS was pushed by Government, at least in part, because the consumer detriment in the market fell heavily on a small group of vulnerable consumers. Anytime the consumer detriment is highly concentrated in this way equity consideration could come into play.

5.4 Total welfare vs consumer welfare standard

The Government's White Paper on the competition regime suggests its aim is "to increase the level of competition in the economy, to improve the UK's productivity performance and to make markets work well for consumers"⁴⁸.

Using competition as a means to improve the UK's productive performance suggests that the aim of the regime should be to improve total welfare. However, increasing competition to make markets work well for consumers suggests a consumer welfare objective.

Under its CSR07 Performance Framework Agreement⁴⁹ the OFT have an objective, in relation to the MS/MI regime, of maximising consumer welfare. Similarly the EA requires the CC to remedy detrimental effects on consumers⁵⁰.

Many of the remedies in the MSs and MIs reviewed would have involved transfers of welfare from producers to consumers. The case studies suggest that

⁴⁷ NAO, (2009), "The Office of Fair Trading, progress report on maintaining competition in markets", March 2009.

⁴⁸ "A world class competition regime", Paragraph 4.39

⁴⁹ One of the objectives of the OFT's CSR07 Performance Framework Agreement (for 2008–11) with the Treasury is to "Make markets work well for consumers by delivering high impact work efficiently, focused on priority areas, and spanning the OFT's enforcement and non-enforcement functions."

⁵⁰ Section 134(6) Enterprise Act 2002

the regulators do not attempt to estimate these transfers⁵¹. From a consumer welfare perspective, according to which the regime is judged, these transfers are seen as a benefit. However, from a total welfare perspective — where a reduction in producer rent is not seen as a benefit, but as a neutral transfer between consumers and producers — the impact of these MS and MI would be considered lower.

Under a consumer welfare objective, even a small reduction in prices can lead to customer benefits which imply a net positive outcome when set only against the costs of remedies and the inquiry. However, the static reduction in total welfare (i.e. deadweight loss) is typically much smaller than the total consumer detriment. And so under a total welfare standard a MS or MI which was clearly beneficial from a consumer welfare standard could fail to have a net positive impact.

For example from a total welfare perspective the Private Dentistry MS may have had a lower impact, as a large proportion of any resulting consumer surplus gains would be associated with a transfer from dentists. Assuming total expenditure on private dentistry in the UK of £2bn per annum and that the market study led to a 1% fall in prices benefits to the consumer were £20million. This compares to preliminary figures for the one-off costs of £4million and ongoing annual costs of £1million. However, assuming the MS did not lead to any productivity improvements, the reduction in deadweight loss from the study would be about £60,000⁵². This result will be heavily affected by the elasticity of demand and supply.

Applying a consumer welfare objective instead of a total welfare objective is pragmatic, given the increased complexity and significant uncertainty associated with estimating total welfare. In addition the objectives of the OFT seem to extend to considering matters of equity, such as the balance of power between consumers and firms. The Sale and Rent Back MS is a good example of this.

Under a standard total welfare framework the MS/MI regime would be judged on the basis of all the costs and benefits involved, including the costs to industry, short run consumer benefits and long run dynamic benefits. In the same way that individual remedies are judged under an impact assessment in this way.

However, the nature of the MS/MI regime is that while the costs and the short run consumer benefits may be relatively easily defined and estimated, the associated dynamic benefits may be uncertain and non-monetisable. Therefore a

⁵¹ Although regulators do look to make remedies proportional, they do not, in all cases, quantify all producer costs. This may be associated with uncertainty or lack of data.

⁵² This calculation assume a flat supply curve and a demand elasticity for private dental service of -0.6, this is based on estimates of the elasticity of white females for general dentistry (source: Willard G. manning and Charles E. Phelps, "The demand for dental care," *The Bell Journal of Economics* 10, Autumn 1979, 503-525). This result will be heavily affected by the size of the market and the elasticity in the market.

total welfare analysis of the regime (or particular interventions) would largely rely on weighing up potentially large but hard to measure dynamic benefits (see section 5.5) against more certain short run costs and benefits. In this way the presence of dynamic benefits would be crucial to securing a net positive impact under a total welfare standard.

For all these reasons it is assumed that the regulators have focussed on estimating direct consumer benefits when assessing whether they are meeting the 5:1 target agreed with the Treasury.

We would recommend that future MS and MI seek to set out, as transparently as possible, all costs and benefits of the remedies proposed and also articulate the rationale and likelihood for any dynamic benefits. However, given there are difficulties associated with quantifying the dynamic benefits the regime should not solely be judged on the basis of the costs and benefits that can be easily estimated. Consideration should be given to how best to articulate and assess the success of the regime.

Future MS and MI should seek to identify and set out as transparently as possible all costs and benefits of the study and in particular:

- identify and where possible quantify the costs to industry of any remedies proposed; and
- articulate the rationale and likelihood for any dynamic benefits claimed.

There are difficulties associated with quantifying the dynamic benefits of increased competition on innovation and productive efficiency in the longer term. Therefore, the regime should not be solely judged on the basis of the costs and benefits that can be easily estimated. On this basis further consideration should be given to how best to articulate and assess the success of the regime.

5.5 Dynamic benefits

Dynamic benefits may be associated with increased innovation and productivity improvements or result from increased deterrence of anti-competitive conduct which may otherwise have affected market outcomes.

Competition can be considered to drive productivity improvements over time via three mechanisms⁵³:

⁵³ OFT (2007) "Productivity and competition, An OFT perspective on the productivity debate", Publication No. 887

- Within firm effects — Competition can pressure firms to increase their productivity through internal process changes or new technology.
- Between firm effects — Competitive pressure can reallocate resources between firms by ensuring that higher productivity firms increase their market share at the expense of the less productive firms.
- Innovation — Innovation increases dynamic efficiency through technological improvements of production processes, or the creation of new products.

We have looked to determine whether the reviews conducted can shed light on the circumstances and remedies that lead to higher dynamic benefits.

No clear conclusions can be reached from the case study reviews conducted except to say that changes in the market may not need to be large for the dynamic benefit to cover the costs of the study.

While we have been unable to provide evidence of dynamic benefits associated with individual cases, we have looked to identify circumstances that would lead to higher dynamic benefits. The literature suggest that remedies addressed at resolving issues on either the demand or supply side both have the potential to lead to dynamic benefits.

In particular the following condition may be necessary to encourage dynamic efficiency:

- Markets with limited barrier to entry/exit of suppliers; and
- Consumers being able to switch and compare product offerings.

However, the theoretical literature is not conclusive on the relative importance of these conditions. What can be drawn from this, for the regime, is that future MS and MI should seek to address these matters in order to enhance dynamic benefits (these may need to be highlighted through the OFT's prioritisation process). In addition care should be taken to claiming a study or investigation leads to significant dynamic benefits where these preconditions are not present and are not addressed as part of the MS or MI.

Finally to increase the certainty around these matters further evidence should be collected on the impact of demand side remedies on dynamic benefits in particular (see section 5.1).

5.5.1 Evidence from the literature

Dynamic effects associated with competition and consumer regulation can arise from:

- Supply side competitive pressures associated with new efficient or innovative suppliers entering the market; or poorly performing suppliers exiting the market.

- Demand side pressure arising from consumers making more optimal choices. As a result suppliers that better match the needs of consumers are rewarded.

Improvements or structural changes affecting either of these areas can put downward pressure on costs, upward pressure on quality or encourage product or process innovation throughout the supply chain.

In addition a market study may deter anti-competitive conduct by highlighting areas of concern.

The larger the market and the larger the MS/MP's impact on the demand or supply side pressures, or deterrence, the greater the dynamic benefits that would arise.

Supply side pressure

Competition can drive increases in efficiency by putting pressure on firms to reduce costs and become more efficient. This enables highly productive firms to increase their market share at the expense of less productive firms. It can also encourage innovation through technological improvements in production processes, or new product development.

On this basis actions to improve the competitiveness of the market can be considered to lead to dynamic benefits. Furthermore, competition can deter other market participants from acting in a non-competitive manner.

The literature suggests that the relationship between the concentration of an industry and innovation is complex and must be assessed case by case⁵⁴. As an industry becomes less concentrated it will not necessarily become more innovative. The literature suggests that industry concentration (as a proxy for competitiveness) and innovation are associated via a U shaped relationship⁵⁵. In less competitive industries there may be high pre-innovation rents. As a result more intense competition may encourage firms to invest in innovation in order to differentiate themselves from the competition. However, in highly competitive industries increased competition can reduce incentives for innovation by incumbents by reducing post-innovation rents⁵⁶.

Putting aside the behaviour of existing firms, and focussing on new entrants, one would expect new efficient suppliers to enter where there exists excessive rent that they can erode. This may be because they have a new product or technology which they can exploit or because existing firms in the industry have been

⁵⁴ Productivity and competition: an OFT perspective on the productivity debate, January 2007

⁵⁵ Competition and innovation: an inverted-U relationship, Aghion et al, QJE 2005

⁵⁶ Salop (1977), Dixit & Stiglitz (1977), Romer (1990), Aghion and Howitt (1992), Grossman and Helpman (1991)

underachieving. What may lead to these conditions is unclear, but the existence of barriers to entry would have a detrimental effect on efficiency, as it prevents the regenerative effects of new entry from occurring. Furthermore, there is strong evidence that removing these barriers increases productivity⁵⁷.

In the same way barriers to exit would limit the extent to which inefficient firms depart, possibly preventing new firms replacing them.

Demand side pressure

Consumers can also drive innovation and dynamic benefits through their choices.

An implicit assumption in the previous discussions are that consumers are able and willing to switch products in order to further drive this regeneration. Where there are barriers to switching or consumers are unaware of the advantages, the most efficient producers may not be rewarded.

In the same way information problems may lead to consumers making sub-optimal choices and therefore blur market signals which in turn distort decisions by not only consumers but also firms.

However, as indicated by the OFT and others, there is very little evidence on how and when consumer policy lead to increased productivity⁵⁸.

Certainly removing unnecessary and inefficient barriers to switching may enable consumer to move towards more efficient suppliers offering better choices. We note that some barriers to switching may be efficient and necessary such as those associated with ex ante long term contracts. These arrangements give suppliers the revenue certainty necessary to encourage efficient levels of investment.

Similarly market studies that result in the availability of adequate and accurate information about products and services may also improve the optimality of choice. This would be true where the nature of the market and the product is such that this information aids the consumer. For example, for low value, non-durable goods, where the quality is observable, informational remedies may not aid a consumer's choice (i.e. batteries). In these instances the costs of trialling alternative suppliers may be low, making information prior to purchase less valuable. However, for credence goods⁵⁹ (such as vitamins) or durable, one off experience goods (such as cars) information remedies may be far more beneficial to the consumer and hence lead to far greater dynamic benefits.

⁵⁷ Productivity and competition: an OFT perspective on the productivity debate, January 2007

⁵⁸ NAO, (2009), "The Office of fair trading, progress report on maintaining competition in markets", March 2009.

⁵⁹ A good for which the value of the quality/price offering is difficult for the consumer to ascertain either before or after consumption.

Deterrence of anti-competitive conduct

Competition policy will be a deterrent when the risk of being caught outweighs the gains for firms from any anti-competitive behaviour. Firms could be considered to internalise the likelihood and the consequence of punishments attached to any competition policy instruments when deciding whether to engage in this behaviour.

Deterrent effects may be larger than direct effects⁶⁰, but they are difficult to quantify, especially for light handed policy instruments such as MS or MI.

Firms in a market subject to a MS may not actually incur any punitive action. Instead the eventual cost of punitive actions weighs on the entire market, rather than on a single participant. Thus individual firms may not have any incentive to change their behaviour as a result of the threat of a MS/MI. If firms consider MSs present a low probability of heavy punishment relative to other regulatory instruments, MS may have a weaker deterrent effect on individual firms.

Though this free-rider effect means that firms do not internalise the full cost of any MS/MI remedies in their individual decisions, this cost could be significant for the overall market. For example MSs' can lead to investigations and more onerous regulatory intervention in a market. Ultimately this may encourage industry bodies to control their members more carefully.

5.5.2 Evidence from the case studies

The implications of the theory for the MS/MI regime review is that dynamic effects can be considered to exist where the study leads to some improvement in the necessary conditions for dynamic efficiency. Namely by:

- reducing any barriers to entry, exit or expansion; and
- improving the ability of consumers to switch and make optimal choice.

Also the dynamic benefits will be greater the larger the market size, the larger the MS's impact on these necessary conditions and on deterrence of anti-competitive conduct. These matters are further discussed below.

Deterrence of anti-competitive conduct

No clear conclusions can be reached from the reviews in relation to the effect of the MS/MI regime on deterring anti-competitive conduct.

Although contrary to expectations firms in markets subject to MS have incurred punitive action. In the case of Sale and Rent Back and Private Dentistry, the MSs did identify anti-competitive conduct. In the case of Sale and Rent back this led

⁶⁰ Deloitte, "The Deterrent Effect of Competition Enforcement by the OFT", Office of Fair Trading, November 2007.

to prosecutions. However, it is not clear that this necessarily strengthens the extent to which a MS or MI deters anti-competitive conduct.

Market size

In many case the MS does not need to lead to a large improvement for the dynamic benefit to cover the costs of the study. For example, if the Private Dentistry MS pricing transparency recommendations were to lead to a 0.25% fall in prices (due to increased competitive pressure), given the current size of the market, the total dynamic benefits would be close to £5 million per annum⁶¹. Based on very preliminary cost estimates this dynamic benefit would cover the one-off cost of the market study. In other words a small improvement in a large market will have a big effect.

Summary

Table 5 presents our review of the case study reviews based on the factors that may be relevant to the existence and size of any dynamic benefits.

Table 5. Dynamic Benefits

Case study	Market size*	Removal of entry/exit barriers	Improvement in optimality of choice
Dentistry	Medium (£1bn)	-	✓
Sale and rent back	Small** (£800mn)	✘	✓✓
CUPI	Small*** (£600mn)	✓✓	-
PPRS	Large (£8bn)	-	✓
Taxis	Large (>£2bn)	✓	-
New car warranties	Medium (£1.4bn)	✓	✓
Extended warranties	Medium (£1bn)	-	✓✓

* Based on OFT estimate of annual market turnover at the time of the study **Estimate based on 5,000 transactions with a value of £158,000 ***Based on OFT estimates of turnover pa

Key: ✘ MS likely to have had a negative impact on this condition
 ✓ MS likely to have had a positive impact on this condition
 ✓✓ MS likely to have had a strong positive impact on this condition as the focus of more than one of the primary remedies was on addressing this matter.

⁶¹ This is based on an assumed turnover in the industry of £2bn per annum.

On the basis of the assessment presented above, it is not clear which of the case studies evaluated would be most likely to have led to larger dynamic benefits.

It is worth remembering that the Private Dentistry MS could have been expected to lead to greater dynamic efficiency had its recommendations in relation to the removal of entry barriers been implemented.

5.5.3 Lessons for the regime

Our indicative lessons for the regime are as follows.

Future MS and MI should seek to articulate the rationale and likelihood for any dynamic benefits claimed, particularly in relation to how the remedies are expected to increase dynamic efficiency by:

- reducing any barriers to entry, exit or expansion; and
- improving the ability of consumers to switch and make optimal choice.

Further evidence should be collected on the impact of demand side remedies on dynamic benefits in particular (see section 5.1).

Attachment 1: Market study case studies

CUPI market study

CASE STUDY REVIEW

The OFT's market study into the commercial use of public information began in July 2005 and concluded in December 2006. The impacts of this market study are considered in this case study review.

Objectives and recommendations

Source

The OFT initiated the market study into the commercial use of public information (CUPI) because of internal concerns about the market, which arose during a more narrow market study into property searches, as well as in response to complaints to the OFT. The use of public information was also relevant to one of the OFT's 'priority themes' for 2005-2007— the interaction between government and markets.

Market

Major public sector information holders (PSIHs) earned nearly £400 million from supplying information in 2004/05, and the OFT estimated the economic value of the sector to be £590 million.⁶² We note the difficulty in estimating the value of public sector information due to current data limitations and consider this estimate conservative.

Market failure rationale

PSIHs are monopoly suppliers of public sector information (PSI). In many instances PSIHs compete with commercial companies to provide value-added information. The OFT market study concluded that commercial firms lack information on available PSI and that some PSIHs may restrict or otherwise only make PSI available to commercial firms on a discriminatory basis (i.e. at unduly high prices). The market failures identified in the study primarily relate to supply side competition concerns. Although the OFT also identified a lack of clear guidance and transparency for customers.

In terms of demand side issues the OFT identified that potential users or re-users of PSI did not have adequate information about the types of PSI available for

⁶² Economic value is measured as consumers' willingness to pay for different types of information less the cost to PSIHs of providing it. See Annexe G of the CUPI market study for a detailed explanation.

commercial use. In some cases, licence terms were not transparent or contained overly restrictive terms. A lack of pricing transparency makes it difficult for potential re-users to judge whether the quoted price is reasonable. Where this results in prices above marginal cost, this may cause inefficiencies. This could be affected by the presence of the following.

- Cost transparency issues – The collection of information generally has large fixed costs, which are often common to many products. Therefore, in order to recover these costs the prices charged by PSIHs are unlikely to correspond to the marginal cost of providing the information. Many PSIHs do not allocate costs and revenues by activity type, making it difficult for commercial users to determine whether they are being treated fairly.

The OFT also identified the following supply side concerns.

- Unclear and conflicting guidance – PSIHs are governed by numerous policies relating to the circumstance in which they can or cannot release public information and how much to charge, some of which are in conflict.
- Restrictions on access – Where a PSIH is the sole provider of information, it has the ability to restrict access to commercial users, which distorts ‘downstream’ competition for value-added products based on the restricted information. Monopoly PSIHs may also include overly restrictive contract terms, such as non-compete clauses.
- Discrimination on prices and terms – Monopoly PSIHs could be charging higher prices for value-added products than they would if other commercial users were able to compete. This may also be reflected in lower quality. For example, slow response times for information requests, inconvenient format of information. The OFT also found incidences of overly restrictive contract terms, including non-compete clauses.
- Unintentional market foreclosure – PSIHs may hold information that they are not using to develop value-added products, without realising the information’s potential for commercial use. Failure to exploit information is not a typical form of consumer detriment, but represents foregone opportunities for future benefits.

The scale of the potential consumer detriment resulting from supply side competition concerns were estimated to be £520 million. The OFT attributed £400 million of the estimated detriment to smaller PSIHs, which mainly reflects the inability of users to exploit information held by smaller PSIHs. Trading Funds accounted for the remaining £120 million of detriment from the distortion of downstream competition and, to a lesser extent, unduly high prices. This is slightly below estimates from the Cambridge Study, which concluded that

CUPI market study

moving to marginal cost pricing for the top six Trading Funds could lead to economic benefits of £165 million⁶³.

Key recommendations

As a result of the study the Office of Public Sector Information (OPSI) enhanced its monitoring in this area and the government published guidance on pricing methods. The study also generated momentum for related government initiatives, including the Power of Information Review, further research into pricing methods (the Cambridge Study) and a review of business models for major Trading Funds.

The OFT considered that requiring PSIHs to divest their value-added activities would be disproportionate relative to the likely scale of detriment. The OFT's study made several recommendations to Government designed to build upon the existing regulatory framework. The key recommendations are identified below, all of which were targeted at Government to progress with PSIHs:

- PSIHs should make as much unrefined data available for re-use as possible.
- Information should be made available to businesses at the earliest useful point.
- Where the PSIH is the sole supplier of information, it should provide it to commercial users on the same terms as to its own value-added operations.
- To demonstrate fair and non-discriminatory pricing to commercial users, PSIHs should separately account for costs and revenues for raw and value-added activities.

The OFT also committed to the following in order to address specific issues:

- working with Treasury to produce clear guidance for PSIHs on charging for public information;
- having ongoing dialogue with Ordnance Survey to address competition issues identified in market study (regarding access, contract terms, price discrimination); and,
- reviewing the market within three years to determine whether further action is needed.

⁶³ Models of Public Sector Information Provision via Trading Funds

These recommendations, while targeted at different bodies, could be categorised as relating to:

- addressing access and market foreclosure issues by enhancing existing regulation on pricing, price discrimination, other PSIH restrictions;
- improving pricing transparency through recommendations around accounting separation; and
- addressing restrictive and conflicting government policies.

Interventions and the logic model

The Government welcomed the report and agreed in principle with most of the OFT's recommendations, without immediately accepting all of them. In particular, the Government cited concerns about requiring PSIHs to:

- make unrefined data available for reuse; and
- account separately for raw and value-added activities and the specifics of the pricing method applied.

The Government acknowledged the need for greater clarity between the types of data provided by PSIHs, but emphasised that any changes to the definitions currently in use could have implications for the rules governing the pricing of the information. Under existing policy, PSIHs were to use marginal cost pricing for raw data and charge market prices for value-added products.⁶⁴ These changes would therefore have implications for PSIH revenue streams, particularly for the Trading Funds that do not receive central funding.

The OFT worked with HMT to produce *Managing Public Money*, published in July 2007, which includes an appendix on *Charging for information*. The guidance is comprehensive and is refreshed annually.

The OFT has been engaged in ongoing dialogue with the Ordnance Survey (OS) to address specific competition concerns related to OS. The Government recently published a consultation document on the OS's role in providing geographic information, seeking views on which data types the OS should make freely available and how to define the OS's public task.⁶⁵

The Information Fair Trader Scheme (IFTS), which is run by OPSI, was also revised to enhance verification criteria. The IFTS accredits PSIHs as being compliant with the UK's PSI regulations. The original version of the IFTS was

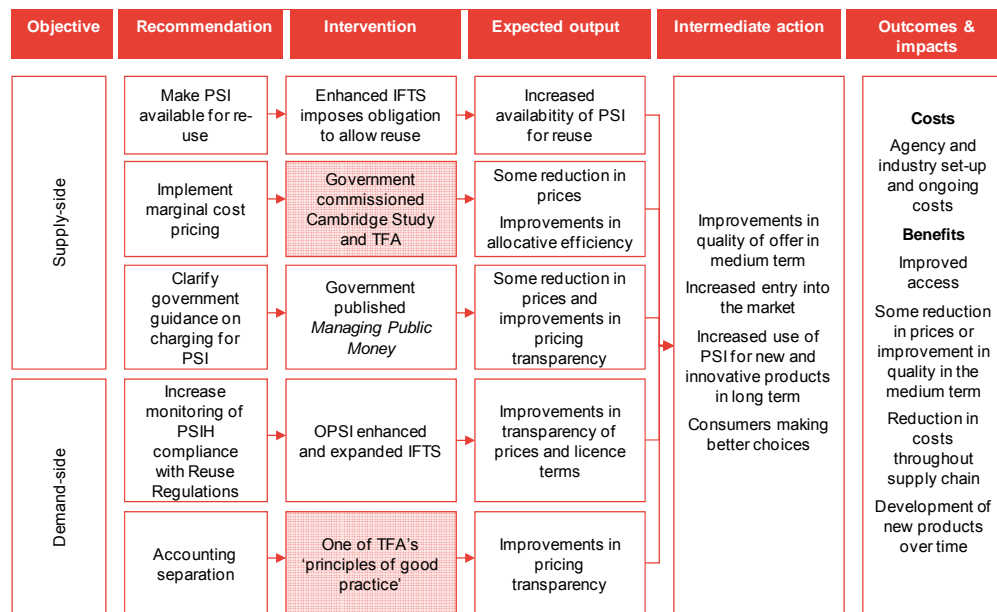
⁶⁴ [The Cross-Cutting Review of the Knowledge Economy](#), 2000

⁶⁵ [Policy options for geographical information from Ordnance Survey: Consultation](#), 2009

based on high-level principles of transparency, fairness and challenge. A number of PSIHs have gone through re-verification under the new scheme, which now carries an obligation to allow re-use. OPSI also introduced IFTS online, to widen the scheme to other public bodies

Figure 5 below outlines the interventions that have resulted from the OFT’s recommendations and the logic chain by which these recommendations can be considered to link to study outcomes. We note that some of the OFT’s recommendations were not implemented directly, but they may have acted as a catalyst for further policy changes.

Figure 5. Basic logic chain



Source: Frontier Economics
 Note: shaded boxes indicate recommendations not fully implemented.

Counterfactual

Existing developments in the market

The MS took place in the context of a number of other activities occurring in relation to these issues. Impacts of the MS needed to be considered in the context of these pre-existing developments, as they could be considered to reduce the impacts attributable to the MS. These are outlined below.

- The 2000 Knowledge Economy Review

- Recommended the use of marginal cost pricing for ‘raw’ information and market pricing for ‘value-added’ information (noted this was not feasible for Trading Funds).
 - Established OPSI as sector regulator.
 - Recommended the Government do further work on the economics of pricing information, but this was not pursued until after the CUPI MS (as part of the Cambridge study)
- 2005 Re-use Regulations — Implemented the EU 2003 Directive on reuse of public information⁶⁶. These regulations defined basic principles for facilitating the use and reuse of public information, but did not extend any obligation to make information available for reuse. There are significant gaps in the Regulations. For example, they do not apply to documents or to information falling outside an organisation’s ‘public task’, which is not defined in the Regulations.
- Free Our Data campaign (The Guardian) — Launched in March 2006, part way through the CUPI study. It could be considered to have raised awareness of the issues around use of PSI and maintained a high profile beyond the completion of the market study.

Certainly, any impacts from the opening up of the market arising post the MS should not wholly be attributed to it, particularly given the existence of the re-use regulations. However, the OFT found evidence of non-compliance with the Reuse Regulations and recommended that the Government should provide additional resources to OPSI to monitor compliance and enforce breaches. In addition, the OFT’s market study identified significant gaps in the regulations that undermined their effectiveness.

The OFT identified the lack of awareness of PSI available for re-use as an important factor impeding effective competition in value-added products, and pointed to an enhanced role for OPSI in promoting awareness through published asset registers. Any increased consumer awareness would need to be considered in the context of the impact of the Guardian’s *Free Our Data* campaign. While its aims were more far-reaching than the issue of commercial re-use of PSI⁶⁷ it helped maintain the profile of PSI beyond the completion of the market study. Arguably it contributed to the momentum that spurred subsequent developments.

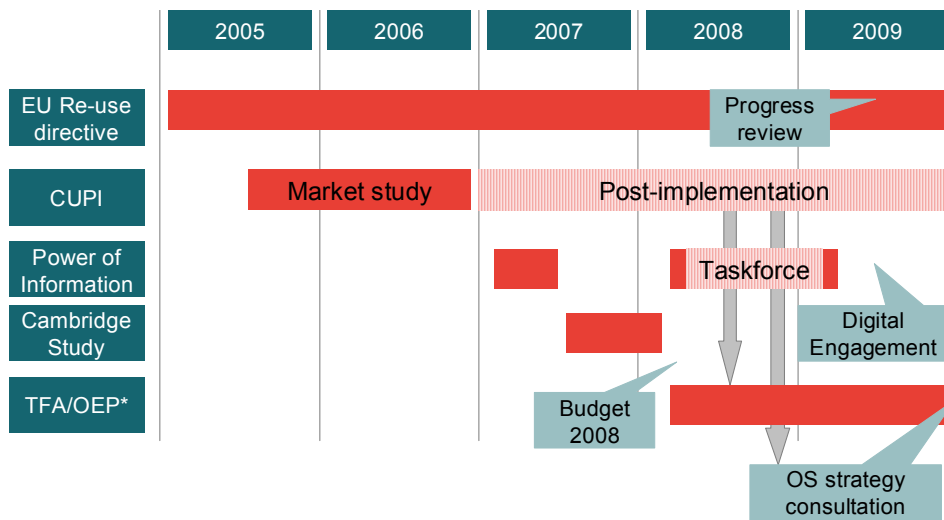
⁶⁶ The UK was one of only four Member States to meet the 1st January 2005 deadline for implementing the 2003 Directive and is regarded as a leader in this area. In December 2006, EU took five Member States to the European Court of Justice for failing to implement the Directive.

⁶⁷ In that it sought for free access to government data for everyone.

Subsequent developments

A number of developments took place in the market following the MS. These may not entirely be attributable to the MS, but were certainly influenced by it. These are summarised in **Figure 6**, with further details below. The grey arrows show subsequent workstreams in which the OFT post-implementation was directly involved, including the Trading Fund Assessment and OS commercial strategy.

Figure 6. Timeline of CUI-related developments



Source: Frontier Economics

* The Trading Fund Assessment (TFA) and Operational Efficiency Programme (OEP) were announced in Budget 2008.

The Cabinet Office’s Power of Information (PoI) Review (2007)⁶⁸ rejected that Trading Funds should be exempt from marginal cost pricing and reiterated the OFT’s recommendation for the Government to assess the implications of moving towards marginal cost pricing.⁶⁹ The Review also supported additional resourcing for OPSI to ensure it has sufficient resources to be an effective regulator.⁷⁰

68 The Government announced the PoI Review in February 2007, with the final report published in June 2007. An Interim Progress Report was published in March 2008. The PoI Taskforce was launched in April 2008 and published its final report in February 2009. The Government published its response, Digital Engagement, in May 2009.

69 [Power of Information: An independent review by Ed Mayo and Tom Steinberg](#), June 2007, para 110-111

70 Ibid, Recommendation 12, para 124-128; CUPI market study, Recommendation 9.17

It is not clear what prompted the PoI review, or whether it would have occurred without the CUI study. The PoI review was broader than CUI (for example, online communities as a way of sharing information), but did draw upon evidence from the OFT market study and reiterated some of its recommendations.

The Cambridge Study, *Models of PSI provision via Trading Funds* was published in February 2008 as part of the Government's response to the CUI study. It generally supported a move from average cost to marginal cost pricing. It also outlined evidence of substantial dynamic benefits from increased availability and use of public sector information. While such a study had previously been recommended by the Knowledge Economy Review in 2000, it had been put on hold until the CUI study (as acknowledged in the Government response). This study most likely would not have been commissioned without the CUI study and laid the groundwork for the Trading Fund Assessment and Operational Efficiency Programme.

The Trading Fund Assessment was announced in the 2008 Budget and launched in June 2008, with members of the OFT's post-implementation team serving on the steering group. The review examined the impact on the Trading Funds' business models of any changes to the current pricing, accessing and licensing regimes. It had the aims of:

- “distinguishing more clearly what information is required by Government for public policy; and
- “ensuring that this information is available as widely as possible in order to maximise the benefits to the wider UK economy, at a price that balances the provision of such access with the need for users to make a fair contribution to the cost of collecting the information in the long term.”⁷¹

The Assessment established accounting separation as one of the “principles of good practice” for PSIs⁷².

The Operational Efficiency Programme was announced in the 2008 Budget, launched in July 2008 and published in 2009. It covered asset management plans for several Trading Funds that are PSIs, including the Met Office, Ordnance Survey (OS) and the Land Registry.

One of the more targeted recommendation of the MS not explicitly identified in the logic chain above was for the OS to engage in ongoing dialogue with the OFT and OPSI as part of Trading Fund Assessment. The Trading Fund

⁷¹ http://www.hm-treasury.gov.uk/press_6508b.htm

⁷² [Operational Efficiency Programme: Final Report](#), April 2009

Assessment found that marginal cost pricing is not feasible for OS at this point. However, the Government announced plans to make some OS datasets available for free in November 2009, and published a consultation document on 23 December 2009.⁷³ The consultation sought to more narrowly define the OS's public task and specify which types of data OS will provide for free.

Emerging developments

There have also been a number of recent, emerging developments in the PSI market, which are outlined below.

- Making Public Data Public initiative — the Prime Minister announced in July 2009 the creation of Data.gov.uk, a 'one stop shop' for anonymous data collected by government.⁷⁴ The beta version was launched in December 2009 with limited access. The Government "hopes the data project will benefit the UK by creating jobs, driving new economic growth and allowing the re-use of government data to encourage the development of new, innovative information-based businesses and services."⁷⁵
- Other data initiatives
 - [London Datastore](#) – announced 6 January 2010, will launch 29 January 2010. Will provide single point of free access to over 200 raw datasets held by the Greater London Authority. Channel 4 has pledged £200,000 towards developing innovative uses of the Datastore.
 - [Met Office releases first weather widget](#), allowing website owners to generate script to host visualisations of weather data on their websites, December 2009
 - OPSI expansion of 'Click-use licence' – OPSI no longer charges for 'Value-added licences', as PSIHS should be providing access for free under the click-use licence

Impacts and outcomes of the market study

In considering the impact of the market study we have looked at the following:

- Costs — Agency and stakeholder costs associated with the study; remedy set-up, running and compliance costs; any indirect or secondary decline in

⁷³ [Policy options for geographic information from Ordnance Survey: Consultation](#), December 2009

⁷⁴ <http://news.bbc.co.uk/1/hi/technology/8311627.stm>

⁷⁵ <http://www.number10.gov.uk/Page20595>

productive efficiency; and any lost economic profit associated with a transfer between providers and consumers;

- Benefits— Reduction in prices (and/or increased consumption) due to removal of market power; improvements in consumer trust; improved access to goods and services; reduction in transaction costs borne by consumers; improvements in quality of goods or services; improvements in optimality of choice; increased choice; direct improvements in productivity and indirect efficiency improvements in other markets; and
- Likelihood of further dynamic benefits— Improvements in productivity resulting from increased competitive pressure; increased product innovation; increased process innovation; and deterrence of anti-competitive conduct.

Table 6 and **Table 7** that follow provide further details the potential costs and benefits of the CUPi market study respectively. Where evidence exists we have identified this in these tables.

Costs

We expect the direct costs of the investigation to the OFT to be somewhat above average, reflecting the length of the study and the amount of external work commissioned. The study also involved significant time costs for industry, including surveys of PSIHs and commercial users as well as detailed case studies of Trading Funds, Local Authorities and NHS organisations. The study led to further analysis by the Government and ongoing work for stakeholders which could be attributed to the OFT's recommendations. However, we have not attempted to quantify the costs of this subsequent activity beyond the conclusion of the market study and therefore the costs of implementing the OFT's recommendations. Some recommendations are not yet fully implemented and their ultimate form has not been determined. However, we expect the costs of implementing the remedies to be somewhat higher relative to those for other market studies, as they are somewhat more intrusive to the internal operations of PSIHs.

- The implementation of separate accounting for costs and revenues by type of PSIH activity is not straightforward and the complexity will vary across PSIHs.
- Similarly, PSIHs will face one-off costs associated with making more data available, for example by changing internal processes and procedures for storing data and handling requests. The nature of these costs will vary across PSIHs and we have not been able to quantify them.

CUPi market study

- The ongoing costs to PSIHs of making information available will be partly mitigated by the recent data.gov.uk initiative, which will provide a single point of access for government data.

The move from cost-recovery pricing to marginal cost pricing introduces some risks to Trading Funds, primarily in the form of potential fluctuations in revenue. Through the Trading Fund Assessment, the Government worked with the top six Trading Funds to assess alternative business models and the feasibility of marginal cost pricing. However, we have not attempted to quantify the cost of this exercise.

Benefits

The OFT estimated consumer detriment to be £520 million, largely due to foreclosure of a potential market, through the failure to exploit the available information and distortions in downstream competition.⁷⁶ This compares to a sector value of £590 million, suggesting that the market could double to over £1 billion if competition issues were addressed.

Data from OPSI relating to the IFTS suggests that there have been significant improvements in access to PSI. Between June 2008 and July 2009 four major information traders joined the new IFTS which carries an obligation to allow re-use. OPSI also created IFTS Online, a less onerous questionnaire-based verification system for smaller PSIHs, to which 49 organisations have signed up.

A separate assessment undertaken as part of the TFA concluded that 5 of the 6 major Trading Funds had good principles in place and were operating within IFTS. For the 6th - Ordnance Survey - OPSI and OFT contributed to developing a new business strategy with improved access to re-use, though this still does not fully implement all of OFT's recommendations. The Government has announced that some OS data will be available online at no charge and is holding a public consultation to determine which types of data should be included. This will provide an opportunity to assess the impact of opening up access to geographic information.

Dynamic benefits

The benefits of CUPI are largely dynamic and will arise from increased innovation resulting from greater exploitation of previously unavailable data.

If the OFT's study results in increased commercial use or re-use of PSI this may lead to commercial firms retailing, reusing or packaging this information in a more efficient and/or innovative manner. In addition they may introduce new products or services that use PSI as an input that may otherwise not have been

⁷⁶ Table 1.1, paragraph 1.26 in CUPI Market Study, 2006

developed. Therefore, by removing restrictions on entry into the market, productivity may be improved and innovation encouraged.

In **Table 7**, we have made the conceptual distinction between innovation that leads to new products and benefits from more efficient processes. Increased access to PSI at lower prices could lead to productivity improvements as firms are able to access data more easily to inform decisions. Greater access to PSI may also lead to the development of new products altogether. However, in practice this distinction is less useful, as new products may improve processes.

The Cambridge study suggested that “lower prices for data today, by increasing access and usage, might stimulate the rate of innovation by the producers of complementary goods....Alternatively, increased access to data due to lower prices may lead to or assist the development of entirely new products and services.”⁷⁷ In addition it suggested that Trading Fund data has attributes of an experience good, as increased usage today generates increased demand in the future, further adding to future consumer benefits.

Finally the study notes that access to information may spur innovation, which may in turn generate further innovation. Given the incremental nature of innovation while the benefits accruing to any individual innovation may not outweigh the cost, not undertaking this may forgo the whole chain of innovation.

Emerging observations

We have not been able to quantify many of the costs and benefits for this market study. While the static costs to industry of implementing the recommendations may be larger than other market studies (given they resulted in some changes to some PSIH's operations) the dynamic benefits are likely to be very large and significantly outweigh the costs.

The exercise of quantifying the costs and of the OFT's recommendations is complicated by both the number and diversity of public sector information holders. Quantifying the key benefits of the study, namely the dynamic benefits, is even more problematic. However, these are anticipated to be large. There have been a number of recent developments that are not yet fully realised and will contribute to the evidence base in the medium-term.

⁷⁷ p.23

Costs

Table 6. Potential costs and transfers derived from the CUPi MS

	Improved transparency	Clarifying government guidance	Improving access
Agency (OFT/CC) costs associated with conducting the study/investigation	Above average – assume approximately £500,000 ¹		
Industry costs associated with participating in the study/investigation.	Above average — assume approximately £175,000 ²		
Static	Remedy set up costs (enforcement/compliance) for OFT/CC/OPSI.	Significant – recommendations not fully in place (Government, Trading Funds and other PSiHs)	Minimal — consolidate numerous conflicting guidance documents into comprehensive document (OFT/HMT)
	Remedy running costs (enforcement/compliance) for OFT/CC/OPSI.	Minimal	Minimal – refresh annually
	Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy).	One-off costs of implementing accounting separation could be considerable (Trading Funds) Trading Funds may experience increased revenue fluctuations	Minimal – improved guidance makes it easier for PSiHs to determine appropriate charge

Potentially higher/lower consumption of environmentally damaging/beneficial goods	-	-	-
Lower economic profit	Lost revenues from any price reductions resulting from improved transparency (Trading Funds)	-	Lost revenues from reductions in prices and/or quantity resulting from greater competition for value-added products (Trading Funds, PSIHs)
Indirect or secondary decline in productive efficiency (i.e. affecting other markets)	-	-	-

1 Based on OFT markets database with figures rounded

2 Based on the number of responses to two surveys, participation in detailed case studies and stakeholder engagement throughout study, with average days spent per survey/interview of 1.5 and time value of money of £220/hr

Benefits

Table 7. Potential benefits derived from the CUPi MS

		Improved transparency	Clarifying government guidance	Improving access
Static	Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Recommendations may result in activities that reduce prices. These are likely to be in the medium term and will depend on compliance with guidelines		
	Improved consumer trust	Some contribution	Some contribution	Some contribution

CUPi market study

Improved access to goods and services	Some contribution	-	Significant improvements likely, particularly once ongoing developments completed. To date compliance data with IFTS suggests improvements in access to PSI (see discussions above)
Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	Reduction in costs of assessing price and terms of licence	May reduce time spent disputing price charged	Reduction in time and search costs in determining what information is available, simplified access procedures
Improvements in quality of goods or services		-	
Improvements in optimality of choice	Likely to be improvements as more efficient and/or transparent prices signal consumer wants to PSIHs and commercial users	Yes, likely to be significant	-
Increased choice	-	-	Likely to be increased choice for 'value-added' products', though not where PSIH is sole

CUPI market study

				supplier of unrefined information	
Dynamic	Direct improvements in productivity	May increase risk to Trading Funds, but reduces transaction costs and operational risks to commercial users	-	-	
	<ul style="list-style-type: none"> ▫ Reduction in operational, financial or systemic risks ▫ Reduction in transaction costs borne by producers 				
	Indirect efficiency improvements in other markets	These could be considerable, as information is an input into other goods and processes, and can facilitate better decision-making in a number of other markets/sectors. The develop of new products could reduce costs in other industries, or enhance the benefit of some consumer goods			
	Improvements in productivity resulting from increased competitive pressure (i.e. new entry)	Resulting from improved price transparency	-		Likely to be significant, as greater access will allow commercial users to develop products in competition with PSIH value-added products
	Increased levels of product innovation	Likely to be improvements in value-added products, due to more efficient pricing methods			Likely to be significant as firms develop competing products for value-added information.
Increased levels of process innovation	-	-		Likely to be significant (see indirect efficiency improvements in other	

CUPI market study

			markets)
Deterrence of anti-competitive conduct	Some contribution	Some contribution	Some contribution

Source: Frontier Economics

CUPI market study

PPRS market study

CASE STUDY REVIEW

The Pharmaceutical Price Regulation Scheme (PPRS) is one of the main instruments used by the Government to control NHS expenditure on branded drugs. The OFT's market study into the PPRS was initiated in September 2005 and concluded in February 2007. The impacts of this market study (MS) are considered in this case study review.

The PPRS is an agreement negotiated with Pharmaceutical companies which sets controls relating to:

- Profits — Company profit levels from the supply of branded drugs to the NHS are capped⁷⁸. If this is exceeded, excess profits are to be repaid to the Department of Health (DH). The profit control also enables companies to increase prices if their profits fall below a given minimum.
- Prices — While companies have the freedom to set the initial price of new active substances, the PPRS imposes limits on any subsequent price increases. It also sets price cuts, which are agreed at the time of scheme renegotiations. A seven per cent cut was imposed as part of the negotiation of the 2005 PPRS scheme, followed by a further five per cent cut in the current (2009) PPRS. Companies are given some flexibility in deciding which products to target in cutting prices. This is known as price modulation.

Objectives and recommendations

Source

The OFT initiated the PPRS market study as a result of internal concerns about its operation in the market. These were highlighted in the CA98 drugs case where the PPRS was considered to facilitate predatory pricing and price discrimination. The study also related to the OFT's priority theme of government interaction with markets.

⁷⁸ The PPRS covers all branded prescription medicines purchased by the NHS, including off-patent branded drugs, but does not apply to generic drugs or over-the-counter medicines.

Market

The NHS spends £9 billion per year on branded drugs⁷⁹, up from £8 billion at the time of the OFT's market study⁸⁰. The NHS purchases drugs on behalf of patients through two channels — drugs given to patients while they are in hospital and drugs prescribed to patients by doctors in primary or community care. The OFT identified over £500 million in potential savings for the NHS, primarily driven by price reductions for certain products with 'excessive' premiums over generic alternatives⁸¹. It is possible there may have been further savings in other drug classes not assessed by the OFT.

Market failure rationale

The market failures present relate to both demand-side and supply-side concerns and can be used to justify the existence of the PPRS.

On the demand side NHS patients do not choose a drug nor bear the cost of its purchase beyond nominal prescription fees. In addition, the prescribers (generally doctors) of these drugs do not bear the cost. Instead, the NHS ultimately pays even though it is not involved in individual prescribing decisions. Where those making purchasing decisions do not bear the cost of those decisions, they may not act in the best interests of the NHS.

On the supply side there are also competition concerns regarding the market power of pharmaceutical companies. The market study suggested that even with the existing PPRS the following concerns existed:

- Companies appeared to be charging prices for some drugs in excess of their relative to therapeutic value to patients;
- There was insufficient use of generic drugs which provide similar therapeutic benefits to patients; and
- a low uptake of new drugs, limiting UK patients' access to innovative treatments with greater therapeutic benefits.

Key recommendations

The OFT's main recommendation was for fundamental reform of PPRS. This would involve a fundamental shift from existing controls on company price and profit levels to value-based pricing (VBP). Under VBP prices for individual drugs

⁷⁹ DH (2009), [The Pharmaceutical Price Regulation Scheme: Tenth Report to Parliament](#)

⁸⁰ OFT (2005), "The Pharmaceutical Price Regulation Scheme. An OFT market study"

⁸¹ Savings estimates assume branded drugs are reimbursed at 50% above current generic prices. The five product groups used to calculate potential savings are Atorvastatin, Rosuvastatin, Proton Pump Inhibitors, Levocetirizine and Escitalopram, and Cardura XL.

would be set to reflect the therapeutic benefit to patients determined through periodic cost-effectiveness reviews for individual drugs or classes of drugs.

The OFT proposed two methods for implementing value-based pricing which differed in their treatment of new drugs:

- *Ex post value-based pricing* would allow companies to retain the freedom to set prices for new drugs.
- *Ex ante value-based pricing* would feature an initial fast-track assessment of cost-effectiveness for new drugs before they are launched.

The OFT maintained that VBP would reduce prices and incentivise more beneficial research. As many drugs are produced for sale worldwide this effect would depend on other countries following the UK's prices. A further benefit claimed by OFT was a reduction in drug marketing. The OFT believed this to be over-incentivised under the PPRS as essentially only prices were controlled as the profit caps rarely bit. The OFT found evidence that pharmaceutical companies relied on marketing to increase volumes of prescriptions.

The OFT recommendations represented major policy reform and outlined its vision for how the government could implement these reforms in the medium-to long-term. The OFT proposed an institutional framework to support value-based pricing, which outlined a possible way to allocate roles among NICE, SMC and AWMSG⁸². The OFT also recommended provisions for linking the prices of out-of-patent drugs to those for generics and that the PPRS should encourage the uptake of new drugs in other ways.

Interventions and the logic model

Figure 7 outlines the interventions that have resulted from the OFT's recommendations and the logic chain by which these recommendations can be considered to link to study outcomes. The OFT's key recommendations for value-based pricing and linking out-of-patent drug prices to generics have not been implemented. But the PPRS 2009 introduced 'flexible' pricing and included provisions relating to generic substitution and the uptake of new drugs, which are likely to have been affected by the MS.

The key interventions included in the 2009 PPRS included:

- The maintenance of the profit- and price-controls, with a 5% price cut imposed over the five-year life of the scheme.

⁸² National Institute for Clinical Excellence (NICE), Scottish Medicines Consortium (SMC), and All Wales Medicines Strategy Group (AWMSG) assess the cost-effectiveness of drugs for England, Scotland and Wales, respectively.

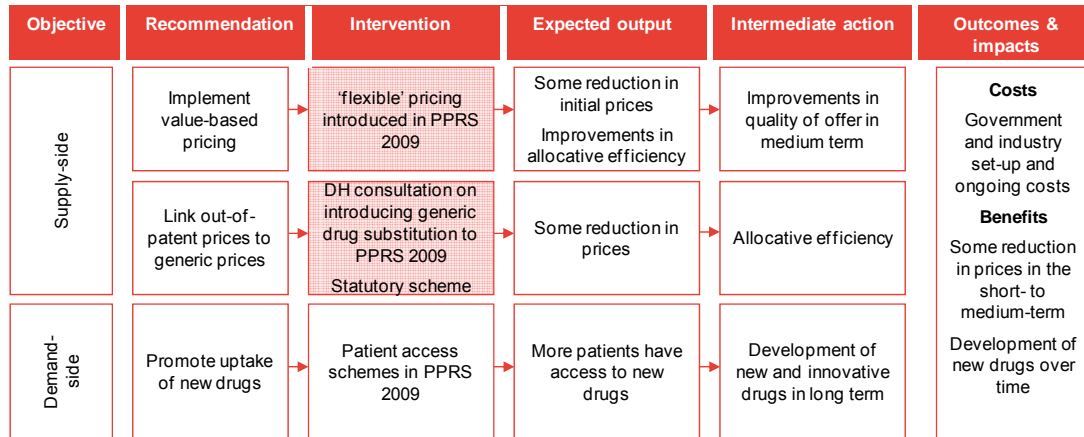
- Flexible pricing provisions — These will allow companies to raise prices in the future if the drug’s value is found to be greater than expected.⁸³ Pharmaceutical companies will submit proposed price increases to NICE, which will review whether the proposed price increase is justified. Under previous PPRS agreements, pharmaceutical companies freely set prices on new drugs, but were subsequently prohibited from raising prices. We would expect pharmaceutical companies to charge higher initial prices for new drugs under such a scheme relative to a system that allowed for future price increases. This provision is in line with the ex post value-based pricing option put forward by the OFT, although it stops short of subjecting all drug prices to periodic review.
- Generic substitution – While prescribers increasingly write prescriptions in generic terms, rather than using branded drug names, there was still considered to be room for improvement. Under generic substitution, pharmacists will be able to substitute generic equivalents for branded drugs, unless the prescriber indicates otherwise. DH launched a public consultation in January 2010, which included a proposed list of drugs to be eligible for generic substitution.
- Patient access schemes (PASs) – Where a medicine has been appraised by National Institute for Clinical Excellence (NICE) but not approved for use on the NHS, a company may apply for a Patient Access Scheme which allow companies to offer discounts or rebates to make the drug more cost-effective. Discounts may be linked to prescription volumes or patient groups. PASs are negotiated between companies and the DH before being reviewed by NICE. As of October 2009, DH approved 18 Patient Access Schemes.⁸⁴

The 2009 PPRS came into effect 1 January 2009, with some provisions not yet implemented. As such these interventions are expected to lead to savings to the NHS, although the economic benefits from changes in the supply of drugs may not be apparent for some time. The expected outcomes are shown in **Figure 7** below.

⁸³ DH (2009), ‘PPRS: Tenth Report to Parliament’

⁸⁴ DH (2009), ‘PPRS: Tenth Report to Parliament’

Figure 7. Basic logic chain for PPRS MS recommendations



Source: Frontier Economics
 Shaded boxes have been used to indicate interventions that we consider are not solely the result of the market study.

Counterfactual

Developments in the market

In assessing what proportion of any outcomes can be attributed to the market study we have considered existing developments in the market.

The OFT undertook its market study in the context of the existing, relevant institutional framework. NICE, Scottish Medicines Consortium (SMC), and All Wales Medicines Strategy Group (AWMSG) assess the cost-effectiveness of drugs for England, Scotland and Wales, respectively. Since 2005, the NHS has been obliged to fund medicines recommended by NICE. The OFT credited these institutions, as playing a crucial role in containing NHS spending, and recommended their roles be expanded to allow for cost-effectiveness assessments of existing drugs as well.

A previous review found evidence that competition among pharmaceutical companies was not working effectively. As part of the 1999 PPRS agreement, the DH and the Association of the British Pharmaceutical Industry (ABPI) carried out a study into the extent of competition in branded medicine in 2002.⁸⁵ The study found that the industry was not highly concentrated, though markets for some medicines were likely to feature a company with a dominant position.

⁸⁵ DH and ABPI (2002), [PPRS: the study into the extent of competition in the supply of branded medicines to the NHS](#)

However, originator drugs did not reduce price in response to entry by generic and maintained market share.

On the demand side, prescribers considered clinical efficacy, safety and tolerability and convenience for the patient in choosing medicines before cost. Moreover, survey evidence indicated that prescribers were not aware of the relative costs of clinical alternatives. Thus volumes prescribed were unresponsive to price changes⁸⁶. The lack of significant improvement in the interim may have influenced the OFT's decision to recommend fundamental reform to the PPRS.

Concurrent to the OFT market study, the National Audit Office (NAO) carried out a review of prescribing in primary care, which was published in May 2007⁸⁷. The NAO focused on the prescribing behaviour of general practitioners and concluded that the NHS could save £200 million per year. The NAO's main recommendations were for the Primary Care Trusts (PCTs) to use more effective commissioning practices to improve GP prescribing. The NAO published a follow-up study in May 2009, revealing that changes in prescribing behaviour saved the NHS £394 million in 2008. The NAO and OFT studies likely both contributed to the high profile of issues surrounding NHS expenditure on prescription drugs. The studies focused on different aspects of the issue and the recommendations did not overlap.

In June 2007, the High Court ruled that pharmaceutical companies could include branded medicines reimbursed at generic rates as part of the required 4.5% average price reduction required by PPRS 1999, contrary to DH's position⁸⁸. This ruling had implications for the ability of PPRS 2005 to deliver the agreed 7% reduction in prices. The Government signalled its intention to the ABPI to renegotiate the agreement for 2008, citing the OFT recommendations for reform, the High Court ruling and the 2007 Comprehensive Spending Review (CSR)⁸⁹, as reasons for this decision.

The Government published its interim response to the OFT market study in August 2007, broadly welcoming the recommendations and outlining principles for the next PPRS scheme.⁹⁰ In February 2008, the DH announced the termination of PPRS 2005, effective 31 August 2008. In June, the DH launched a

⁸⁶ DH and ABPI (2002), [PPRS: the study into the extent of competition in the supply of branded medicines to the NHS](#): "Over half of price changes triggered no response from competitors. In the majority of cases, the launch of new products provoked no price response from competitor products."

⁸⁷ NAO (2007), [Prescribing costs in primary care](#)

⁸⁸ [GlaxoSmithKline UK Ltd v Department of Health](#) (2007); see also CMS Cameron McKenna (2008), [A year in pharmaceuticals](#)

⁸⁹ The 2007 CSR called for ambitious efficiency savings from all departments.

⁹⁰ BERR (2007), [Interim Government response to the Office of Fair Trading \(OFT\) market study on PPRS](#)

consultation into a statutory scheme that would apply to companies not signed on to the voluntary scheme, or to all companies in the event that DH and ABPI did not reach agreement on a new voluntary scheme⁹¹. The DH and ABPI agreed on the key components to be included in the new scheme for 2009, with an interim agreement to be in effect from September 2008 to December 2008.

While the Government cited the OFT study and the Comprehensive Spending Review it was likely the High Court ruling provided the main impetus for the mid-term renegotiation. The High Court ruling did not just impact the 1999 PPRS to which it applied, but also undermined the 2005 PPRS agreement in place at the time of the market study. The ruling would have impeded the PPRS's ability to deliver the agreed 7% price reduction at a time when all government departments were committed to delivering the ambitious efficiency savings under the 2007 CSR. In our view, it is likely that the 2005 PPRS would have been renegotiated in response to the High Court ruling with or without the market study, while the market study on its own would have been unlikely to trigger a mid-term review.

In setting out its recommendations, the OFT did not consider the possibility of a mid-term renegotiation and focussed on how to implement reforms during negotiations for the next PPRS scheduled for 2010. That said, the market study appears to have influenced the renegotiation and strengthened the government's position, though the urgency in getting a new scheme in place by 2009 may have limited the scope for more fundamental reforms to the PPRS. However, the next PPRS was scheduled for 2010, so the court ruling only brought the next scheme forward by one year.

Relevant international developments

As highlighted in the OFT's MS, pharmaceutical companies are global and operate in many international markets. Ongoing developments in Europe and the US are potentially be relevant to the UK market.

The European Commission's (EC) Pharmaceutical Sector Inquiry published its final report in July 2009, which emphasised the importance of generic substitution in fostering price competition. The Commission is encouraging Member States to consider implementing automatic pricing and reimbursement status to generics.

The EC has also taken a number of enforcement actions against pharmaceutical companies recently.⁹² The sector inquiry was particularly concerned about patent

⁹¹ As of December 2009, 55 companies are covered by the new statutory scheme, *Health Service Branded Medicines (Control of Prices and Supply of Information) (No. 2) 2008, S.I. 2008/3258*. The remaining 150 pharmaceutical companies operating in the UK have signed up to PPRS 2009.

⁹² [Commission confirms surprise inspections in the pharmaceutical sector](#), 9 December 2009; [Commission opens formal proceedings against pharmaceutical company Lundbeck](#), 7 January 2010;

settlement agreements, under which originator pharmaceutical companies pay generic competitors to delay market entry of generic drugs⁹³.

The US Government Accountability Office (GAO) published a report on “Brand-name Prescription Drug Pricing” in December 2009, which found that the “lack of therapeutically equivalent drugs and limited competition may contribute to extraordinary price increases”⁹⁴. The lack of competition reflects patent protection and market exclusivity agreements, as well as small patient populations for some drugs.

Impacts and outcomes of the market study

In considering the impact of the market study we have been unable to consider the costs and benefits of the PPRS market study in any detail as the majority of recommendations have not been implemented.

The study led to DH undertaking further analysis and likely contributed to the 2009 PPRS negotiations. The current PPRS includes provisions to address some of the OFT’s concerns, however, it did not implement the OFT’s main recommendation of value-based pricing. However, these provisions are not yet fully implemented and their ultimate form has not been determined. Their eventual impact may not be known for some time.

The DH published a consultation on implementing generic substitution on 4th January 2010⁹⁵, which runs until the end of March 2010. As part of the consultation, the DH published an assessment of the costs and benefits of generic substitution, which also considered potential impacts on competition and patient health. **Table 8** and **Table 9** that follow provide some further details of the potential costs and benefits respectively.

Costs

We expect the overall investigation costs to the OFT⁹⁶, government and industry to be high for this MS relative to others. These costs reflect the complexity of the issue, number of stakeholders involved and the amount of external work commissioned. However, the PPRS study developed knowledge of the

[Commission launches monitoring of patent settlements concluded between pharmaceutical companies](#), 12 January 2010

⁹³ [Commission launches monitoring of patent settlements concluded between pharmaceutical companies](#), 12 January 2010

⁹⁴ GAO (2009), “Brand-name Prescription Drug Pricing”

⁹⁵ DH (2009), [The proposals to implement 'Generic Substitution' in primary care, further to the Pharmaceutical Price Regulation Scheme \(PPRS\) 2009](#)

⁹⁶ OFT data suggests that its direct costs were higher than average for this market study.

pharmaceutical industry within the OFT, which is likely to have contributed to lower investigation costs for the subsequent study into medicines distribution.

If considering the potential costs of the OFT's value-based pricing recommendations, the implementation costs could be high, as it would require a health technology assessment (HTA) of all drugs, new and existing. Also the reduction in prices implied in the OFT's recommendations for VBP would lead to a substantial reduction in profits for UK pharmaceutical firms (a transfer of welfare between companies and the NHS).

Benefits

No companies have applied for price increases under the new flexible pricing provisions. It is too early to assess the effectiveness of this provision and whether flexibility should be expanded.

The DH had approved 18 Patient Access Schemes as of October 2009. The effectiveness of these schemes in improving patient access to high cost drugs will be reviewed within two years. Outside of the PPRS, the "Innovation Pass" pilot is a £25 million scheme to make selected medicines available on the NHS before they have been appraised by NICE. The pilot programmes was announced by Office for Life Sciences in its [Life Sciences Blueprint](#) in July 2009. The DH launched a public consultation in November 2009⁹⁷; which is set to close March 2010.

Emerging observations

While full value-based pricing has not been implemented by government the flexible-pricing provisions have been introduced. These will take time to show evaluable results. We have not been able to quantify many of the costs and benefits for this market study as it is too early to assess the economic impact of the PPRS market study on the new PPRS agreement.

However, the PPRS MS has informed debate in the area and acted as a catalyst for considering an evolving approach to PPRS. As such, it may have resulted in a more positive outcome for the Governments in PPRS 2009. PPRS 2009 includes provisions that begin to address some of the OFT's concerns, but it remains to be seen whether these provisions will be effective and whether they will be expanded in subsequent versions of PPRS. Ongoing developments in Europe and the US will keep the industry under scrutiny, particularly in regards to anti-competitive market exclusivity agreements and excessively high premiums on branded drugs.

⁹⁷ DH (2009) [Innovation Pass Pilot: A consultation on proposals for an Innovation Pass pilot](#)

Costs

Table 8. Potential costs and transfers derived from the PPRS market study

		Recommendation 1 Value-based pricing	Recommendation 2 Generic substitution	Recommendation 3 Patient Access Schemes
Static	Agency (OFT) costs associated with conducting the study	Above average –based on OFT data		
	Industry costs associated with participating in the study/investigation.	OFT submitted questions to NAO survey of 1,000 GPs (rather than commissioning own survey) ABPI/DH officials met with OFT throughout market study (participating stakeholders are unknown)		
	Remedy set up costs (enforcement/compliance) for OFT/DH/NICE	NICE issued revised guidance on technological appraisals	Public consultation, change prescription forms (rather than change primary legislation)	NICE issued revised guidance on technological appraisals
	Remedy running costs (enforcement/compliance) for OFT/DH/NICE	Introduces risk to NHS of future price increases. No increases to date. Increased workload for NICE, but PPRS 2009 places limits on number of requests for reappraisal.		Increased workload for NICE, but PPRS 2009 places limits on number of requests for reappraisal (DH must agree to PAS before sent to NICE)

One-off industry compliance costs		£3.8m ¹ (for Pharmacies)	
Ongoing industry compliance costs and any increases in operational, financial or systemic risks or transaction costs borne by the producer.	Companies may incur additional costs of collecting evidence	Costs to pharmacies of £3.7m pa ¹	Companies incur additional costs of collecting evidence
Potentially higher/lower consumption of environmentally damaging/beneficial goods	-	-	-
Lower economic profit		£0.8m pa ¹	
Indirect or secondary decline in productive efficiency (i.e. affecting other markets)			

1. Generic substitution: [Partial impact assessment of the proposals to introduce 'Generic Substitution' in primary care](#) (December 2009). Note: The losses to shareholders have been discounted to reflect their relative wealth, in line with Treasury Green Book recommendations. We have reported losses to UK shareholders only, though the Impact Assessment also reports present value losses to foreign shareholders of £45 million over four years.

Benefits

Table 9. Potential benefits derived from the PPRS market study

	Recommendation 1 Value-based pricing	Recommendation 2 Generic substitution	Recommendation 3 Patient Access Schemes
Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Yes. Initial prices of new drugs should be lower than under previous PPRS	Yes. Dispensers likely to be more responsive to price than prescribers £20.5m pa ¹	Yes. PASs feature discounts/rebates to improve cost-effectiveness
Improved consumer trust	-	-	-
Improved access to goods and services	Yes. Should reduce time to market for some new drugs	Yes	Yes. Patients would not otherwise be able to assess these drugs
Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	Yes. Should reduce time to market for some new drugs	-	
Improvements in quality of goods or services	-	-	-
Improvements in optimality of choice (i.e. between customer wants & purchases)			
Increased choice			

Static

	<p>Direct improvements in productivity</p> <ul style="list-style-type: none"> ▫ Reduction in operational, financial or systemic risks ▫ Reduction in transaction costs borne by producers 	<p>Allows companies to establish an evidence base for future NICE appraisal</p>	
	<p>Indirect efficiency improvements in other markets</p>		<p>Yes¹</p>
	<p>Potentially higher/lower consumption of environmentally beneficial/damaging goods (i.e. improvements in allocative efficiency)</p>		<p>Yes - frees up NHS resources for other treatments.</p>
	<p>Improvements in productivity resulting from increased competitive pressure (i.e. new entry and reduced market concentration)</p>		<p>Yes</p>
<p>Dynamic</p>	<p>Increased levels of product innovation</p>	<p>Yes. Reduces risks to companies of setting initial prices too low</p>	
	<p>Increased levels of process innovation</p>		
	<p>Deterrence of anti-competitive conduct</p>		

1 Generic substitution: [Partial impact assessment of the proposals to introduce 'Generic Substitution' in primary care](#) (December 2009). Note: DH estimates that an additional £1 in NHS spending generates £2.40 in benefits to patients. To calculate patient benefits, DH multiplies cost savings to the NHS from generic substitution by 2.4. This would equate to 49m pa.

Private dentistry market study

CASE STUDY REVIEW

The OFT's market study into private dentistry was initiated in January 2002 and concluded in 2003. The impacts of this market study are considered in this case study review.

Objectives and recommendations

Source

The OFT's market study into private dentistry was initiated in response to a super-complaint received from the Consumers' Association in 2001. The Consumers' Association alleged that competition in the sector was ineffective and identified a number of core problems they considered to be worthy of further investigation. These included concerns around pricing transparency, failure of new entrants to affect prices and lack of consumer complaints mechanisms.

Market

The OFT's preliminary study of the market concluded that there were strong grounds to investigate further. In making their recommendations they investigated the market's size and concluded it was worth just over £1 billion in 2000-01⁹⁸. This represents approximately one third of total spend on dentistry services (i.e. combined private and NHS spend).

A survey⁹⁹ recent to the study suggested that the market had been growing at an annual rate of 13%, almost 4 times as fast as NHS dentistry services. On this basis they suggest that approximately 7 million patients would be receiving regular private treatment in 2003. The study also identified that nearly 11,000¹⁰⁰ practices provide a mix of private and NHS dentistry services.

⁹⁸ MSI Data survey, February 2002. No figures for actual expenditure exist (OFT market study, p23)

⁹⁹ *ibid*

¹⁰⁰ BDA evidence to OFT (OFT market study, p24)

Market failure rationale

The market failures identified in the study related to both consumer and competition concerns:

- Demand side concerns — The OFT had concerns that consumers have access to incomplete information on prices preventing them from making informed service choices. There was also perceived to be a restriction on patient switching and an inadequate complaints and redress mechanisms for unsatisfied patients.
- Supply side concerns — These were associated with existing regulations which imposed restrictions on persons and organisations who could offer ancillary/complementary dentistry services directly to customers.

The scale of the potential consumer detriment resulting from these market failures was not identified as part of the study.

Key recommendations

The OFT's study made recommendations that were targeted at government, industry and itself. The key recommendations are identified below along with the intended target of these recommendations (in brackets):

1. A consumer awareness campaign (*OFT*).
2. Pricing transparency guidelines and practice level complaints handling procedures (*industry*).
3. An independent complaints handling mechanism (*Government and/or industry*).
4. Legislation amendments to remove supply side barriers associated with restrictions on the bodies and professions that can carry out the practice of dentistry in order to enable them to supply ancillary dentistry services directly to patients (*Government*).

Interventions and the logic model

All of the report's key recommendations were in some way acted upon. Although the OFT's concerns regarding supply side restrictions were not adequately addressed.

In 2003 the OFT produced *Your guide to private dentistry, Questions to ask* as part of a wider campaign intended to educate uninformed consumers.

In relation to the pricing transparency concerns the government committed to working with the General Dental Council (GDC) to enforce (and in some instances expand the Council's *Maintaining standards guidance*. This guidance includes clauses relating to customer information provisions.

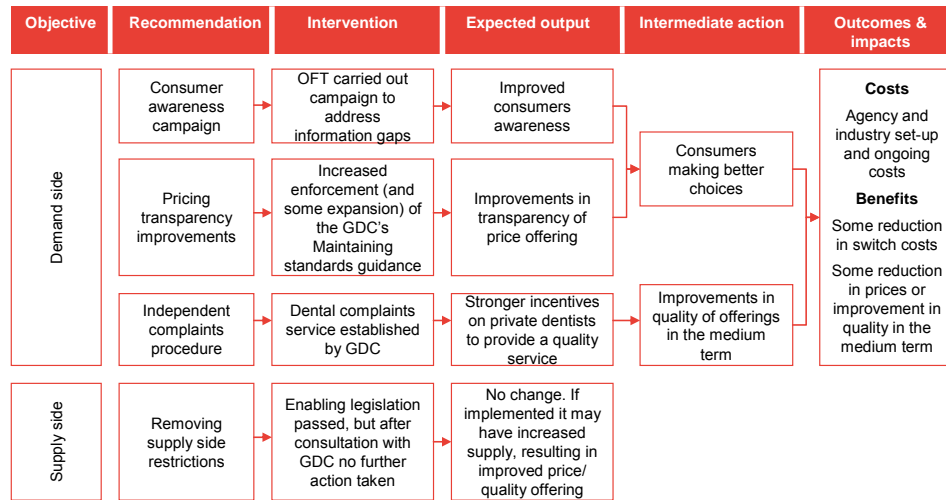
Private dentistry market study

The GDC was also given the powers to monitor and impose sanctions where it finds a dentist guilty of misconduct. Complementing this, the Government had, by 2006, developed the Dental Complaints Service to handle complaints relating to private dentistry services.

The Government made changes to s60 of the Health Act to remove some restrictions on who can be considered dental professionals. However, it did not introduce the additional legislation need to enable patients to get direct access to ancillary/complementary dentistry services. As a result the OFT’s concerns regarding supply side restrictions have not been acted upon.

Figure 8 below outlines the interventions that have resulted from the OFT’s recommendations and the logic chain by which these recommendations can be considered to link to study outcomes.

Figure 8. Private dentistry MS logic chain



Counterfactual

Possible counterfactuals have been considered in assessing what proportion of any outcomes can be attributed to the market study. These included:

- the absence of any intervention in the market; and
- the introduction of a complaints procedure in the absence of the market study.

If the counterfactual assumed is the absence of any intervention, all the costs and benefits described below should be considered attributable to the market study. However, the Government was amending the Dentists Act 1984 at the time the

market study was being conducted. This was understood to include the introduction of a complaints handling procedure for private dentistry consumers. The GDC's remit at the time covered cases of serious misconduct, rather than general complaints. This suggests that the benefits attributed to the market study from the introduction of the complaints mechanism should be reduced.

The government was also understood to be consulting on legislative changes that would remove restrictions on the number of corporate dental bodies. However, given the OFT supply side recommendations were not acted upon, this should not affect the subsequent assessment of any impacts.

Impacts and outcomes of the market study

In considering the impact of the market study we have looked at the:

- costs,
- static benefits; and
- the likelihood of further dynamic benefits.

Table 1 and 2 that follow provide further details the potential costs and benefits of the private dentistry market study respectively. Where evidence exists we have identified this in these tables.

Costs

We estimate the static one off costs of the market study to be around £4 million. The OFT's costs associated with conducting the MS were in the order of £0.5 million, therefore this estimate is primarily based on an estimate of the costs associated with one-off industry compliance¹⁰¹. Ongoing costs associated with operating the complaints service were estimated as being close to £1 million per annum¹⁰².

Benefits

The OFT did not quantify the benefits of the market study or its impact on consumer detriment. There appears to be very little evidence on the potential benefits identified.

It would appear that the largest benefits, would be dynamic and come from improvements in the price and quality of service over time driven by the

¹⁰¹ Estimated based on an assumed cost of £300 per practice for total market of 11,000 practices.

¹⁰² Estimate based on a cost of £500 per complaint (source: GDC Business plan milestone report <http://www.gdc-uk.org/NR/rdonlyres/7B4F4D96-ADD2-4D5E-8C49-43EEDC23D454/86513/080930BusinessPlanMilestonesQ3Final.doc>) and 1,870 complaints received in the 2007/08 from the Dental complaints service annual report.

complaints service, and to a less extent the pricing transparency guidelines.. Although the likelihood of information remedies leading to these benefits is unclear and subject to further discussions below and in the main body of the report (see section 5.1.3).

Dynamic benefits

Some dynamic benefits may have resulted from the complaints mechanism and informational remedies. These may lead to consumers exerting greater demand side competitive pressure on firms leading to productivity and service improvements over time. However, there is very little evidence available on whether information remedies lead to dynamic benefits and is subject to further discussion in the main body of the report (see section 5.1).

It is not clear that any of the remedies would have led to an increase in supply side competitive pressure that would have resulted in further dynamic benefits (although the later may have been likely had the OFT recommendations relating to supply side restrictions be acted upon).

While not conclusive, there is some literature that suggests that the dynamic benefits arising from pricing transparency remedies may not be as significant in the market for private dentistry¹⁰³. Similar to the broader health markets there are several aspects that point to price being a less important signal than in other markets, these include:

- The heterogeneous nature of the product and its status as a credence good — the same condition/disease can affect different patients in different ways leading to different dental treatments. This makes it difficult for patients to assess the offering in terms of price and quality.
- Third-party payments through insurance, which induce a moral hazard effect on patients who, once insured, do not have to worry about the cost of treatment.

These characteristics may lessen the likelihood that the Private Dentistry MS has led to significant dynamic benefits.

That said the dynamic benefit would not need to be large cover the costs of the study. For example a 0.25% fall in price as a result of this competitive pressure would be associated with dynamic benefit close to £5 million, which would cover the one-off cost of the market study¹⁰⁴.

¹⁰³ Congressional research Services, (2008) “Does Price Transparency Improve Market Efficiency? Implications of Empirical Evidence in Other Markets for the Health Sector”

¹⁰⁴ Estimate based on savings occurring in 2008-09 and a private dentistry market of approximately £2 billion in 2008-09. Denplan (the largest provider of private dental care) has estimated that the private dental market is worth some £3 billion, and represents up to half by volume of the total

Emerging observations

From a consumer welfare perspective the market study is likely to have had a net positive impact given the size of the market. In order to test the reasonableness of this conclusion we have assumed a percentage reduction in price. By assuming a reduction in prices of 1% and a market size of £1bn this would imply an improvement in consumer surplus of £10 million per annum. This would cover both the upfront and ongoing costs.

From a total welfare perspective it is less clear whether the market study would have resulted in a net positive impact, as a large proportion of the consumer surplus would be associated with a transfer from dentists to consumers.

However, the market study may lead to dynamic benefits from improvements in productivity in the long term, but this is uncertain. Any dynamic benefits would have to be associated with an increase in demand side pressure from the informational remedies resulting in customers making more optimal choices. Literature on the likelihood of this given the remedies involved and the particular characteristics of the market make this uncertain.

dental market (House of Commons Health Committee, Report on Dental Services, July 2008, p. 21, Ev. 66). It has also been suggested that the private dental market in the UK is at least equal to that of the NHS provisions (The UK Dentistry Market Development. Market and Business Development, 2007). The budget for dentistry in 2008-09 was £2.25 billion (Hansard 16 Dec 2008, Column 660W).

Costs

Table 10. Potential costs and transfers derived from the private dentistry MS

	Consumer awareness campaign	Pricing transparency improvements	Independent complaints procedure
Agency (OFT/CC) costs associated with conducting the study/investigation	<ul style="list-style-type: none"> □ OFT study costs of approximately £500,000 (incl. staff costs, consultancy and short term follow up)¹ □ BIS/DH costs 		
Industry costs associated with participating in the study/investigation.	Minimal — assume approximately £25,000 ²		
Remedy set up costs (enforcement/compliance) for OFT/CC/other agency.	Minimal — included in OFT study cost estimate	Minimal — only required to update existing documents	Minimal — mostly associated with running costs
Remedy running costs (enforcement/compliance) for OFT/CC/other agency.	-	-	Estimate of £1m pa (associated with the ongoing costs of the complaints service) ³
Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy).	NA	£3,300,000 ⁴	-
Potentially higher/lower consumption of environmentally damaging/beneficial goods	-	-	-
Lower economic profit (transfer from producers to consumers)	-	Lost profits from any price reductions resulting from improved transparency	Any refunds given where otherwise this may not have occurred as a result of the redress

Private dentistry market study

				mechanism.
Indirect or secondary decline in productive efficiency (i.e. affecting other markets)	-	-	-	

¹ Based on OFT estimates

² Frontier estimate based on survey response rate of 64 and 13 key interviews held (from OFT market study), average days spent per survey/interview of 1.5 and time value of money of £220/hr

³ Associated with the GDC complaints handling facility. Assuming running costs of £500 per complaint (from GDC 2008/09 business plan milestone report <http://www.gdc-uk.org>) and a total annual number of complaints of 1870 (from 2007/08 annual report)

⁴ Based on £300 per practice (Frontier assumption). This would include the one off costs associated with developing in-house complaints procedures and pricing lists. This would not include any costs associated with reworking this when the NHS offer changes.

Benefits

Table 11. Potential benefits derived from the private dentistry MS

		Consumer awareness campaign	Pricing transparency improvements	Independent complaints procedure
Static	Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Recommendations may result in activities that reduce prices. These are likely to be in the medium term and will depend on compliance with guidelines		
	Improved consumer trust	-	Some contribution	Some contribution
	Improved access to goods and services ¹	-	-	-
	Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	Reduction in switch costs through increased awareness of the ability to switch dentists	-	-
	Improvements in quality of goods or services	Some indirect effects through actions of more informed consumers	-	Likely to be improvements as the complaints procedure is being utilised successfully by patients ² . Patients received refunds of £106,811 in 2008/09 and £176,590 in 2007/08 ³ .

	Improvements in optimality of choice	Some benefits from the actions of more informed consumers	Yes, likely to be significant	-
	Increased choice ³	-	-	-
	Direct improvements in productivity			
	<ul style="list-style-type: none"> □ Reduction in operational, financial or systemic risks □ Reduction in transaction costs borne by producers 	-	-	-
	Indirect efficiency improvements in other markets	The market study did identify other issues associated with dentistry insurance, which were subsequently investigated by the OFT		
Dynamic	Improvements in productivity resulting from increased competitive pressure (i.e. new entry)	-	Some improvement in the optimality of consumers choice.	-
	Increased levels of product innovation	-	-	-
	Increased levels of process innovation	-	-	-
	Reduction in anti-competitive conduct	-	-	-

¹ These benefits are associated with any direct improvements in access i.e. through the removal of barriers to entry. It is not clear that the MS would have removed barriers to entry and therefore improved access to goods and services or increased choice for patients.

² Over 90% of complaints were referred back to individual dental practices' complaints resolution procedures. Of these, 82% were resolved. Of the rest, 99.7 % were resolved by the complaints service (source: Evidence from the first 100day of operations of the Dental complaints Service (source: <http://www.dentalcomplaints.org.uk/pages/index.asp?area=2&l1=54&l2=62>)

³ These figures are likely to be underestimated as they do not include all private refund arrangements reached (source: Annual reports of dental complaints service)

Private dentistry market study

Sale and rent back market study

CASE STUDY REVIEW

Under sale and rent back (SRB) agreements, homeowners sell their property at a discount to the market rate in exchange for a continuing tenancy arrangement. These agreements are aimed at people in financial difficulty that can no longer afford their mortgage repayments but wish to remain in the property.

In 2008 the OFT completed a study into the SRB market, under the Enterprise Act 2002. The impacts of this market study are considered in this case study review.

Objectives and recommendations

Source

In the lead up to the market study consumer bodies, including Shelter and the Citizens Advice Bureau, had received an increasing number of complaints related to SRB transactions and called on Government to regulate the market¹⁰⁵. In response the Government set up a cross-departmental working group to address housing issues related to the financial crisis. The Government subsequently requested that the OFT undertake a market study into SRB transactions to assess the need for action¹⁰⁶. The OFT set a short timeframe for the market study and published its findings within five months. This urgency reflected OFT concerns that the unfolding financial crisis would exacerbate any problems in the SRB market in the immediate term.

Market size

There is limited information available on the size and structure of the SRB market, as it is relatively new. The OFT estimated that over 50,000 SRB transactions had taken place by the time of the study, with most occurring in the preceding two years. The market is highly fragmented, with stakeholders citing that between 1,000-8,000 firms and non-professional landlords provide SRB agreements¹⁰⁷. However, according to industry sources there are 50 ‘significant players’¹⁰⁸.

¹⁰⁵ For example, [Shelter policy briefing on mortgages and repossessions](#) (January 2008) called on the government to extend regulation to sale and rent back transactions.

¹⁰⁶ Announcement in the Budget 2008

¹⁰⁷ OFT (2008), *Sale and rent back. An OFT market study*, October 2008, p16

¹⁰⁸ FSA Consultation Paper 09/6, *Regulating sale and rent back: an interim regime* (February 2009)

Market failure rationale

The concerns identified through the study related primarily to consumer issues, and in particular the following market failures:

- Irrationality of consumers — Consumers considering SRB agreements are generally in financial distress and may be facing imminent foreclosure proceedings. Decisions made in this ‘crisis mode’ may be irrational and out of line with their long-term interests.
- Asymmetric information — The SRB provider has better information about market values and rents and therefore the effective discount being offered in return for a quick sale and subsequent tenancy agreement. Furthermore, the consumer is often unaware of the conditions of the subsequent tenancy agreement. In particular they may not be guaranteed tenancy beyond 6-12 months, or they may face eviction if the landlord goes into foreclosure.

The OFT concluded that competition was not working effectively for consumers. While the market is highly fragmented, consumers do not shop around or discuss SRB transactions with family, friends or advisors. Also SRB providers were not considered to serve as competitive constraints on each other.

The OFT was not able to quantify consumer detriment due to the lack of information about the market, but noted that “(i)f the size of the market was around 5,000 transactions per year, and 5 per cent¹⁰⁹ of sale and rent back transactions resulted in detriment of the order of £20,000, the total detriment would be £5 million per year.”¹¹⁰

Key recommendations

The study made recommendations primarily targeted at government. The key recommendations are identified below along with their intended target (in brackets):

- Introduce statutory regulation of the SRB market by the FSA¹¹¹. This requires the creation of secondary legislation under FSMA 2000 (*Government*). This regulation was to cover the following:

¹⁰⁹ The OFT has noted that the estimate of 5% was arbitrary, but possibly at the lower bound of credible estimates.

¹¹⁰ OFT (2008) *Sale and rent back: an OFT market study* (paragraph I.1.11)

¹¹¹ The OFT supported the codes of practices being developed by industry bodies as a means to improve outcomes in the immediate term, but concluded that these would not provide sufficient consumer protection as the industry bodies’ only account for 20% of the market.

Sale and rent back market study

- Transparency — Firms to make the sale price, discount, rent and tenancy terms clear;
 - Advice — Firms to make consumers aware of sources of independent advice, and to allow time for this advice to be taken; and,
 - Risk — Reduce the risks to consumers by either offering more secure forms of tenancy, or providing regulatory safeguards such as guaranteed access to compensation.
- Increase consumer awareness of the risks of SRB particularly in the short term, before regulation is enacted (*government*)
 - Clarity regarding the eligibility for housing benefit for sale and rent back consumers (*government – DWP*)

Interventions and the logic model

The Government accepted all of the OFT's recommendations and acted quickly. Treasury and the FSA conducted concurrent consultations on regulations for the SRB market. Treasury passed legislation to extend FMSA 2000 to cover SRB transactions. The FSA concluded that the complexity of SRB agreements makes them riskier than standard mortgage contracts, which are already subject to regulation.

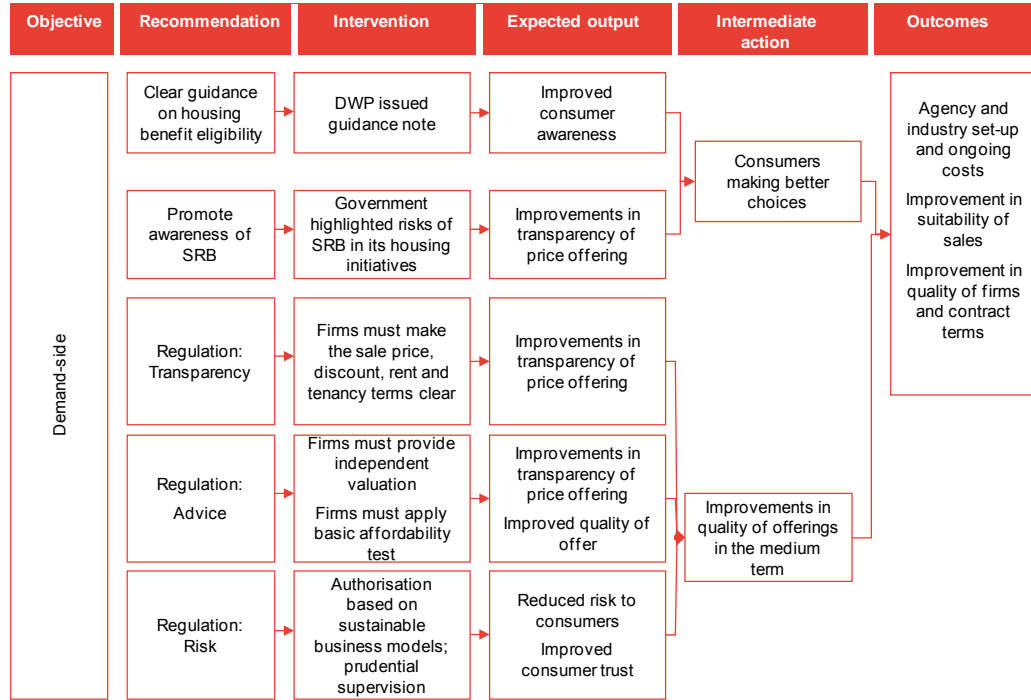
The adopted regulatory approach involved an interim regime that was brought in on 1 July 2009, followed by a full regime which is to be implemented on 30 June 2010.

The FSA's interim regime involved the requirement for firms to be authorised which requires them to demonstrate the sustainability of their business model. As a result, nearly 80 firms have been authorised as SRB providers. These firms are then required to comply with rules that include requirements relating to ongoing reporting, disclosure of the pre-sale prices and terms, and providing consumers with an independent valuation of the property. The full regime bans cold-calling and the use of emotive terms in adverts. The regime also requires a minimum five-year tenancy term and a 14-day cooling-off period¹¹².

Figure 1 below outlines the interventions that have resulted from the OFT's recommendations and the logic chain by which these recommendations can be considered to link to study outcomes.

¹¹² http://www.fsa.gov.uk/pubs/cp/cp10_04.pdf

Figure 9. Basic logic chain for sale and rent back recommendations



Source: Frontier Economics

Counterfactual

We have assumed as a counterfactual that no intervention would have taken place in the market without the MS. Although the following initiatives may have in some way contributed to any resulting market outcomes:

- the continuance of existing consumer protection legislation without further intervention;
- earlier initiatives developed by government aimed at preventing people from getting to a point of financial distress without further intervention; and
- increased self-regulation.

These are further discussed below.

Existing consumer protection legislation

At the time of the market study general consumer protection legislation existed (Consumer Protection from Unfair Trading Regulations). As did various sector

Sale and rent back market study

specific regulations that related to some of the activities of SRB providers. These included:

- Housing Regulations;
- Estate Agents Act 1979; and
- Consumer Credit Act 1979.

However, problems in the SRB market emerged despite these existing regulations on housing finance, debt advice and consumer protection. Further, the many smaller firms in the SRB market did not fall under existing FSA regulations, and some are understood to have been unaware of their obligations under consumer protection rules about providing debt advice¹¹³. As such, existing consumer protection legislation is not considered to reduce the impacts which can be attributed to the market study.

Initiative on financial distress

Concurrent to the OFT's market study, the Government introduced a series of initiatives aimed at assisting people with financial difficulties. The Government introduced these initiatives in response to the accelerated deterioration in housing and financial markets throughout 2008. These included:

- Income Support for Mortgage Interest (SMI); and
- Social Mortgage Rescue Schemes

The existence of these initiatives may have reduced demand for SRB agreements from that identified in the OFT's study, depending on eligibility for the schemes.

Self regulation

In the absence of the OFT market study the government could have relied on self-regulation. The OFT considered this in its market study as the three large trade associations (representing 20% of SRB transactions) were developing codes of conduct at the time. These codes of conduct may have led to the adoption of best practice among SRB providers. It is not clear how likely this would have been.

¹¹³ [OFT \(2008\) Sale and rent back: an OFT market study](#), (paragraph 8.12)

Impacts of the market study

In considering the impact of the market study we have looked at the following for each of the key MS recommendations.

- Costs — Agency and stakeholder costs associated with the study; remedy set-up, running and compliance costs; any indirect or secondary decline in productive efficiency; and any lost economic profit associated with a transfer between providers and consumers.
- Benefits— Reduction in prices (and/or increased consumption) due to removal of market power; improvements in consumer trust; improved access to goods and services; reduction in transaction costs borne by consumers; improvements in quality of goods or services; improvements in optimality of choice; increased choice; direct improvements in productivity and indirect efficiency improvements in other markets
- Likelihood of further dynamic benefits— Improvements in productivity resulting from increased competitive pressure; increased levels of product innovation increased levels of process innovation; and deterrence of anti-competitive conduct.

Table 1 and 2 that follow provide further details on the potential costs and benefits of the sale and rent back market study respectively. Where evidence exists we have identified this in these tables.

Costs

We estimate static one-off costs of the market study to be at least £4-5 million, with ongoing costs of over £1.3 million. This is based primarily on FSA estimates of the costs associated with one-off and ongoing industry regulatory compliance and excludes any profit transfers from firms to consumers. Treasury estimated a substantially higher cost for the market study. This mainly reflected differing views on the number of firms covered by the regulations¹¹⁴.

Benefits

The OFT did not quantify the potential benefits of the market study due to the lack of existing data and the short timeframe for the study. But it did estimate the ex ante scale of the detriment to be at least £5 million per annum. The FSA did not estimate the benefit to consumers or the impact on total welfare¹¹⁵. It is

¹¹⁴ Treasury estimated that there would be 1,000 firms covered by the regulations as apposed to the 80-100 anticipated by the FSA.

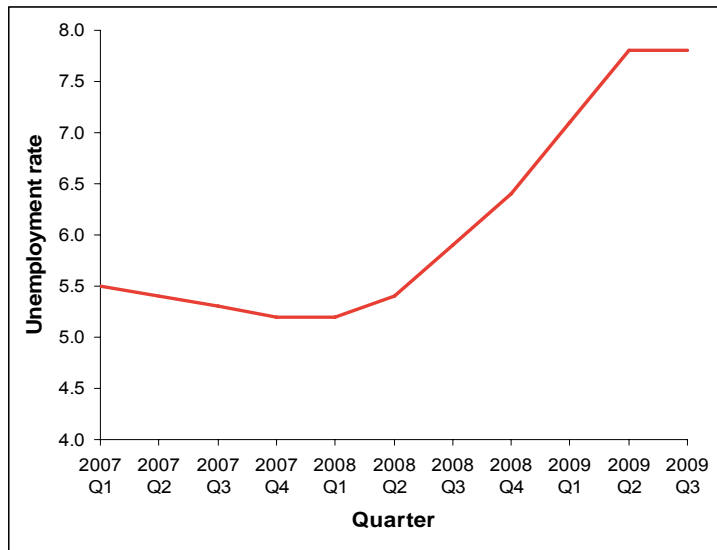
¹¹⁵ Instead it noted that SRB transactions are riskier for consumers than standard mortgage contracts, which are regulated, and share characteristics with equity release products, which are also regulated.

Sale and rent back market study

possible that the OFT’s estimate of benefit is likely to be conservative, as it is based on 5,000 transactions per year. However, the bulk of the roughly 50,000 SRB transactions up to 2008 took place in the two years preceding the market study.

In addition, growth in transaction levels may have occurred as a result of the financial crisis and this would affect conclusions on the size of the consumer detriment. Unemployment is likely to be strongly correlated with the demand for SRB agreements. Figure 2 below shows how unemployment has grown over the current recession. It is possible that in the period following the market study, SRB transactions may have grown. However, the limited availability of buy-to-let mortgages would have reduced the supply of SRB offers and may have worked to control transaction growth. That said, it is likely that the financial crisis would increase the benefits of the market study without much impact on the costs which are largely associated with the number of firms rather than the number of transactions.

Figure 10. Unemployment rate in the UK



Source: Office of national statistics data, MGSX series updated on 11/12/2009

This implies that the number of transactions in high-demand periods could be well above 5,000 per year. If we assumed there are 10,000 SRB transactions per year, the detriment figure rises to £10 million pa; at 20,000 transactions, the detriment figure is £20 million pa.¹¹⁶

¹¹⁶ These calculations follow from OFT assumptions that 5% of SRB transactions result in average detriment of £20,000.

The Treasury found that overall detriment, from equity forgone, resulting from the 50,000 SRB transactions entered between 2006-2008 ranged from £-69.3 million to £837.4 million¹¹⁷. This could imply that any detriment avoided in the two year period following the market study could be within this same range. The low end of the range reflected that some consumers may have got a good outcome from a SRB agreement, such that the market provided a net benefit to consumers.

It is not clear what proportion of any estimated consumer detriment has been redressed as a result of the market study. Anecdotal evidence suggests there is some non-compliance with the interim regime. A web sweep of 49 SRB providers in early September revealed that over half were operating without authorisation and that many authorised firms did not fully understand the interim rules¹¹⁸. In October, Shelter conducted a web sweep of 18 major SRB providers. Four of the 18 had not registered with the FSA and were operating illegally.¹¹⁹ In addition, an undercover journalist was offered a sale and rent back agreement by an unregistered firm in November.¹²⁰ In its response to the consultation on the full regime for SRB regulation in January 2010, the FSA expressed concern about unauthorised providers operating in the market, citing the large discrepancy between the 67 SRB providers with interim authorisation and the OFT's estimate of 1,000 operators. The FSA is actively monitoring the market for providers operating outside the regime and "will take enforcement action to ensure that only firms properly authorised to undertake SRB business do so"¹²¹.

Dynamic benefits

It is unclear how significant any dynamic benefits resulting from the market study may be. Innovations are unlikely to have been encouraged. Addressing the information problems may mean that consumers exert greater competitive pressure on firms resulting in productivity improvements in the long run. However, the size of the market may decline following the financial crisis, limiting the likelihood of any productivity improvements.

There is unlikely to be any dynamic effect from change in supply side pressure. The OFT, Treasury and FSA all agree that some smaller firms will exit the market due to regulation, but do not expect this to have a negative impact on competition. Treasury performed a competition assessment for its consultation

¹¹⁷ [Regulating the sale and rent back market: summary of responses to consultation](#), page 31

¹¹⁸ [Sale and Rent Back: An Early Assessment of the Interim Regulatory Regime](#), Advzr, September 2009

¹¹⁹ [Unlawful companies still advertising](#), 20 October 2009

¹²⁰ [Firms ignorance of sale and rent back rules](#), 19 November 2009

¹²¹ http://www.fsa.gov.uk/pubs/cp/cp10_04.pdf, January 2010

and found that regulation may actually have a positive effect on competition. They noted that “regulation may make entry from other potential providers (previously deterred by negative reputational effects of involvement in sale and rent back) more likely. There will also be potential benefits to competition of new consumers entering the sale and rent back market, who were previously dissuaded from doing so due to the degree of risk associated with the sale and rent back agreement.”¹²² Industry reports indicate that equity release providers may expand into SRB transactions in the near-term, given the similarity between the products and regulatory regimes¹²³.

Emerging observations

From a consumer welfare perspective the market study appears to have had a net positive impact. The per annum consumer detriment addressed by the interventions is likely to cover both the upfront and ongoing costs of the interventions. This may be true into the future, depending on the demand for SRB agreements. The speed with which recommendations were implemented would have increased the benefit arising from the study as they resulted in the intervention being in place during the peak of the financial crisis.

From a total welfare perspective the impact of the market study would be lower as a large proportion of the consumer detriment could be associated with a transfer from firms to consumers. That said, this transfer has equity considerations and is likely to be of concern to the OFT and the government. Therefore, the study clearly delivers benefits in line with the OFT current objectives.

It is not clear whether the study would have led to significant dynamic benefits.

- No clear rationale was developed for suggesting innovation would be encouraged.
- There is unlikely to be any increase in supply side competitive pressure.
- There may be some possible increase in demand side pressure from reduced information problems. However, the impact may be limited if the market declines following the financial crisis.
- There may be some reduction in anti-competitive conduct — Breaches of existing consumer legislation were identified through the study, and the OFT issued formal notices to 16 SRB providers over misleading claims in adverts.

¹²² [Regulating the sale and rent back market: summary of responses to consultation](#), page 38

¹²³ [Equity release providers turn to sale and rent back](#), 15 February 2010, FT Advisor

Costs

Table 12. Potential costs and transfer from the Sale and Rent Back market study

		Recommendation /intervention 1 FSA regulation	Recommendation /intervention 2 Increased awareness	Recommendation/ intervention 3 DWP guidance
Static	Agency (OFT/CC) costs associated with conducting the study	< £0.5 million (indicative estimate based on OFT data)		
	Stakeholder costs associated with participating in the study/investigation.	These would include the costs associated with Shelter’s mystery shopping exercise and case study interviews, The Citizens’ Advice and National Debtline 77 case studies, and NASARB surveyed 200 SRB firms.		
	Remedy set up costs (enforcement/compliance) for OFT/FSA	£1 million ¹	Minimal	Minimal
	Remedy running costs (enforcement/compliance) for OFT/FSA.	<£10,000 for the interim regime ²	Minimal	Minimal
	One-off industry compliance costs	£3 million ¹	Minimal	Minimal
	Ongoing industry compliance costs and any increases in operational, financial or systemic risks or transaction costs borne by the producer.	£1.3 million pa ³	Minimal	Minimal

Sale and rent back market study

Lower economic profit (associated with a transfer between producers and consumers)	Regulation would result in a net transfer to consumers	-	-
Indirect or secondary decline in productive efficiency (i.e. affecting other markets)		-	-

Minimal has been used to describe costs that are unknown but not considered to be significant.

1. Estimate includes the set-up costs associated with both the interim and final regulatory regime (based on FSA cost benefit analysis midpoint estimates)
2. Estimate based on figures provided in the FSA cost benefit analysis report and are associated with the costs of operating the interim regime only.
3. Estimates based on FSA cost benefit analysis midpoint estimates.

Benefits

Table 13. Potential benefits derived from the Sale and Rent Back market study

	Recommendation /intervention 1 FSA regulation	Recommendation /intervention 2 Increased awareness	Recommendation /intervention 3 DWP guidance
Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Regulation may have reduced discount on market value and provide greater protection against unexpected rent increases	Some indirect effects through actions of more informed consumers	Some indirect effects through actions of more informed consumers
Improved consumer trust	Yes through increased transparency and complaints and redress mechanism	-	-
Improved access to goods and services	-	-	-
Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	-	Some contribution	-
Improvements in quality of goods or services	Yes through increased transparency and complaints and redress	Some indirect effects through actions of more informed consumers	Some indirect effects through actions of more informed consumers
Improvements in optimality of choice (i.e. between customer wants & purchases)	Yes through increased transparency	Some contribution through actions of more informed consumers	Some contribution through actions of more informed consumers

Static

Sale and rent back market study

	Increased choice	-	-	-
	Direct improvements in productivity	Minimal -Prudential rules may promote improvements	-	-
	<ul style="list-style-type: none"> ▫ Reduction in operational, financial or systemic risks ▫ Reduction in transaction costs borne by producers 			
	Indirect efficiency improvements in other markets	-	-	-
Dynamic	Improvements in productivity resulting from increased competitive pressure (i.e. new entry and reduced market concentration)	More informed consumers may make more optimal choices. Although regulation may increase entry barriers.	More informed consumers may make more optimal choices.	-
	Increased levels of product innovation	-	-	-
	Increased levels of process innovation	-	-	-
	Reduction in anti-competitive conduct	<p>The firms that exit the market in response to regulation are likely to account for a higher number of unsuitable transactions.</p> <p>Also study identified breaches in existing consumer legislation that were then able to be prosecuted</p>	-	-

Sale and rent back market study

Attachment 2: Review of market investigations by the Competition Commission

If the OFT, or other economic regulator such as the Office of Rail Regulation, suspects a market of having features which prevent, restrict or distort competition, it can refer the market to the CC for further investigation under section 131 of the Enterprise Act (EA). We refer below to the OFT only, although we take this to mean also those other economic regulators who have equivalent powers. A reference may result from:

- an OFT market study;
- an OFT response to a super-complaint under section 11 of the EA; or
- an OFT review of undertakings or orders put in place by the CC following an earlier merger or market investigation reference, under section 92 or 162 EA (respectively).

Once the OFT refers a market, the CC must conduct a market investigation in accordance with sections 134-138 of the EA. The CC is required to determine whether there is an adverse effect on competition (AEC) and if so, whether it, or others, should take action. This action should aim to remedy, mitigate or prevent the AEC concerned, or any detrimental effect of the AEC on customers.

So far, there have only been six market investigations where remedies are fully implemented, including a reference of rolling stock leasing by the Office of Rail Regulation. Another three market investigations have been undertaken, but remedies have not yet been fully implemented. Table 14 lists these nine investigations.

Table 14. Market investigations

Remedies have been fully implemented	Remedies not yet fully implemented
Store cards	BAA airports
Liquefied petroleum gas (LPG)	Payment protection insurance
Home credit	Groceries
Classified directory advertising services	
Northern Ireland Banking	
Rolling stock leasing	

Source: Competition Commission

We have reviewed five of the investigations where remedies have been implemented. We have not reviewed rolling stock leasing as the full implementation of remedies has been quite recent. By looking at all of these, we aim to provide more general conclusions on the effectiveness of the market investigation regime.

For each of these reviews we will apply a counterfactual that no action would have been taken in this market without a market investigation by the CC. This is the simplest counterfactual to apply, but may not always be the most likely scenario. For example, in the absence of an MIR some action to reduce consumer detriment could have been taken by the OFT or by Government.

As we are covering a larger sample than for market studies, these reviews of the market investigations will be at a higher level and not include primary data on market outcomes. Clearly, such data is required to draw robust conclusions, and so those we can draw in this review can only be tentative. For each investigation we will consider:

- objectives and recommendations;
- interventions and a logic model; and
- impacts.

Review of store cards market investigation

Objectives and recommendations

The details of the store cards MI are set out in Table 15 below.

Table 15. Details of the key characteristics of the store cards MS and MI

Source	Initiated by the OFT in response to Treasury Select Committee's concerns about consumer protection and competition in this market. Referred to Competition Commission in March 2004.
Sector focus of MI	Private — provision of cards used for transactions and credit with specific retailers.
Market size (2005)	<ul style="list-style-type: none"> □ 11.4 million active cards □ Outstanding balances of £2.3bn □ Annual revenues of £670m
Features of the market which adversely affect competition	<ul style="list-style-type: none"> □ Providers and retailers structure cards so that customers take them out to obtain the retail benefits, rather than the credit □ Most retailers do not exert competitive pressure on store card annual percentage rates (APRs) □ Customers do not exert competitive pressure on store card APRs because their sensitivity to them is low □ Most retailers do not exert competitive pressure on the level of provider's late payment fees □ Most customers do not exert competitive pressure on the level of late payment fees because their sensitivity to them is low □ Many providers combine different insurances (that is purchase, price and payment protection) into packages □ Most retailers do not exert competitive pressure on providers to lower their insurance premiums to cardholders, or to offer components of insurance separately □ Most customers do not exert competitive pressure on premiums for insurance because their sensitivity to price is low □ Providers do not include sufficient information on their store cards

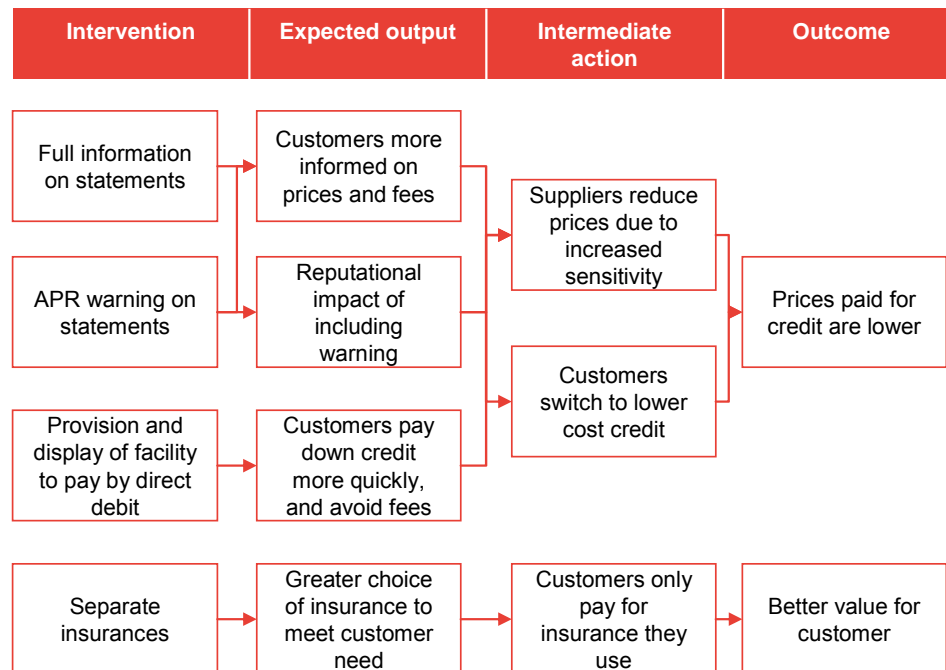
Scale of detriment	At least £55million per year from 1999 to 2006.
Decision on remedies	<ul style="list-style-type: none"> □ Full information on statements, with mandatory rules for what and how it is displayed. □ APR warning on statements if the APR is greater than 25 per cent. To be reviewed after 3 years. □ Provision and prominent display of facility to pay by direct debit. □ Separate offer of payment, purchase and price protection insurance.

Source: OFT/Competition Commission

Interventions and the logic model

All of the interventions target providers of store cards and were implemented by order. Figure 11 shows the logic chain for these remedies.

Figure 11. Logic chain of store card remedies



Source: Frontier Economics

Impacts of the market investigation

For this market investigation we qualitatively assessed its costs and benefits. The costs and benefits of these impacts are set out in the tables below. We then discuss some of these estimates in more detail below.

Table 16. Estimated costs of the store cards market investigation

Agency (OFT/CC) costs associated with conducting the study/investigation	£2m at CC + smaller amount at OFT
Industry costs associated with participating in the study/investigation.	£6m (assumes half of agency costs for each of six major providers)
Remedy set up costs (enforcement/compliance) for OFT/CC/other agency.	Small
Remedy running costs (enforcement/compliance) for OFT/CC/other agency.	Small
Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy and any increases in operational, financial or systemic risks or transaction costs borne by the producer).	Small
Lower economic profit due to transfer to consumers	Potentially relatively large proportion of the consumer welfare benefit

Source: CC and Frontier Economics

Table 17. Estimated benefits of the store cards market investigation

Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Potentially large. See discussion on lower prices below.
Improvements in optimality of choice	Potentially large. Consumers switch to cheaper forms of credit.
Increased choice	Medium. Customers can choose to opt out of insurances which they do not use.
Improvements in productivity resulting from increased competitive pressure (i.e. new entry)	Potentially large. See discussion of dynamic benefits below.
Increased levels of product innovation	Medium. Providers innovate in response to switch to other forms of credit.

Source: Frontier economics.

These tables of costs and benefits highlight the importance of:

- customers paying a lower price for credit, either through lower priced store cards or switching to alternative forms of credit;
- increased choice for insurance customers; and
- dynamic benefits.

We discuss each of these in turn below.

Lower price for credit

The main expected impact of the market investigation is to lower prices. This should occur due to greater customer responsiveness to prices as shown in Figure 11. Prices will be lower for customers either because the prices on store cards fall, or because customers switch to lower cost forms of credit. If store card prices fell to their cost reflective levels or all customers switched to other forms of credit, this would remove all of the customer detriment, estimated as at least £55million per year. This is substantially larger than the other costs and benefits.

However, to allow for this large an impact it must be the case that the remedies had the desired impact on prices and customer behaviour. We consider below the factors that would make this more or less likely for each remedy.

Review of store cards market investigation

Additional information provided on statements

How it should work: The remedies provide for more information to be included on statements. This should help customers to compare their store cards to other sources of credit and be more responsive to prices. This should increase the competitive pressure on providers and lower prices.

Risk factors: This remedy relies on customers being aware of the information on statements and then using this to choose better priced sources of credit. But to the extent that some customers are not aware of this information, then this will limit the desired impact of the remedy.

APR warning on statements

How it should work: The warning provides additional information that the customer is paying an interest rate “higher than other sources of credit” when it is above 25%. This should make customers more responsive to prices above this level. Firms may also respond to the reputational impact of having to carry such a warning with their product.

Risk factors: This remedy relies on customers being aware of the warning on their statement and reacting to it. Or of firms choosing to avoid the reputational impact. The CC designed the remedy to maximise the likelihood customers take note of the messages. To the extent that customers are not aware, do not react or firms fail to be affected by any reputational effect this will lessen the impact of the remedy. The 25% may also act as an anchor on prices, preventing further reductions.

Provision of facility to pay by direct debit

How it should work: Customers find it easier to pay down their credit and enable them to avoid late payment fees. This will benefit customers directly, giving more choice, and helping to reduce fees. It may also reduce prices as customers become more responsive to higher prices.

Risk factors: The impact of this remedy will depend on the take-up of the direct debit option. It may also decrease responsiveness, and counteract other remedies, if customers choose to make minimum payments and so no longer need to review their statements. This may put upward pressure on prices.

Separating insurances

The primary outcome of the fourth remedy on insurances is to give customers increased choice and so better value. This could have a medium sized impact, although the CC did not calculate the size of this detriment.

How it should work: Customers can choose whether to have payment, purchase or price insurance. Payment and purchase insurance is usually limited in duration, but customers pay in proportion to their credit balance. This means

customers that continue to use a line of credit have to pay for purchase and price insurance for which they receive no benefit. With this remedy, such customers will not have to pay for purchase and price insurance, which they have ceased receiving, in order to have payment insurance. Such customers will directly benefit from this choice. The remedy also increases comparability with other providers of PPI insurance which may increase competitive pressure on PPI prices.

Risk factors: This remedy relies on customers making the correct choice for their circumstances and therefore understanding the insurances on offer.

Dynamic benefits

The dynamic benefits from these remedies must come from the increased responsiveness of customers. If this leads to stronger competition then it may force firms to compete to offer lower prices by reducing costs, encourage entry by lower cost firms, or force higher cost firms to leave the market. This could provide a dynamic benefit which may be large, but it would be difficult to assess the size and likelihood of such an effect. To illustrate, a cost reduction of only 1% would deliver benefits of over £6million per year, which is large relative to the costs of the investigation and remedies.¹²⁴

The increased awareness of alternative forms of credit and customer switching may increase competitive pressure for providers to innovate to retain customers.

Conclusions on impact of market investigation

If the remedies removed all the consumer detriment then the ongoing benefits to the consumer would be much larger than the one-off costs of the intervention. However, the remedies largely rely on customers acting on the additional information provided to reduce the consumer detriment. If customers are not aware or do not sufficiently respond to the new information then the benefits of the investigation may be smaller. But in this market, even a 10% reduction in detriment would lead to consumer benefits of over £5million per year, and a clearly significant positive impact of the investigation, from a consumer welfare standard.

¹²⁴ Based on 1% of total costs which are assumed to be total revenues of £670m less detriment of £55m.

Review of LPG

Objectives and recommendations

The details of the LPG MI are set out in Table 18 below.

Table 18. Details of the key characteristics of the domestic bulk LPG MI

Source	Referred to the CC in July 2004 by the OFT in response to complaints about pricing and difficulty of switching.
Sector focus of MI	Private — provision of domestic bulk LPG to households in the UK.
Market size	<ul style="list-style-type: none"> □ 150,000 customers in the UK □ Average bills of £800 □ Total revenue of £120m
Features of the market which adversely affect competition	<ul style="list-style-type: none"> □ The practice of uplifting and replacing tanks when a customer switches supplier. □ The lack of information available to customers on the costs and benefits of switching and on the level of inconvenience involved in the switching process. □ The imposition of contractual restrictions on switching, which affect the level of switching costs and inconvenience of the switching process. □ The limited ability of suppliers to identify and target their marketing efforts on each other's customers.
Scale of detriment	Between £4 and £8.5million per year.
Decision on remedies	<ul style="list-style-type: none"> □ Changes to process for tank transfer, including a customer's right to request tank transfer, an incoming supplier's right to buy the existing tank from the outgoing supplier, and incoming suppliers being given the opportunity to negotiate a price for a tank with the out-going supplier, but an obligation on the outgoing supplier to sell for a 'backstop price' determined by a methodology. □ Changes to customer contracts, including notice periods of no more than 42 days and exclusivity periods of no more than two years. □ Standardisation of, and improved information on, the switching

process.

- Improved information on alternative suppliers and prices.

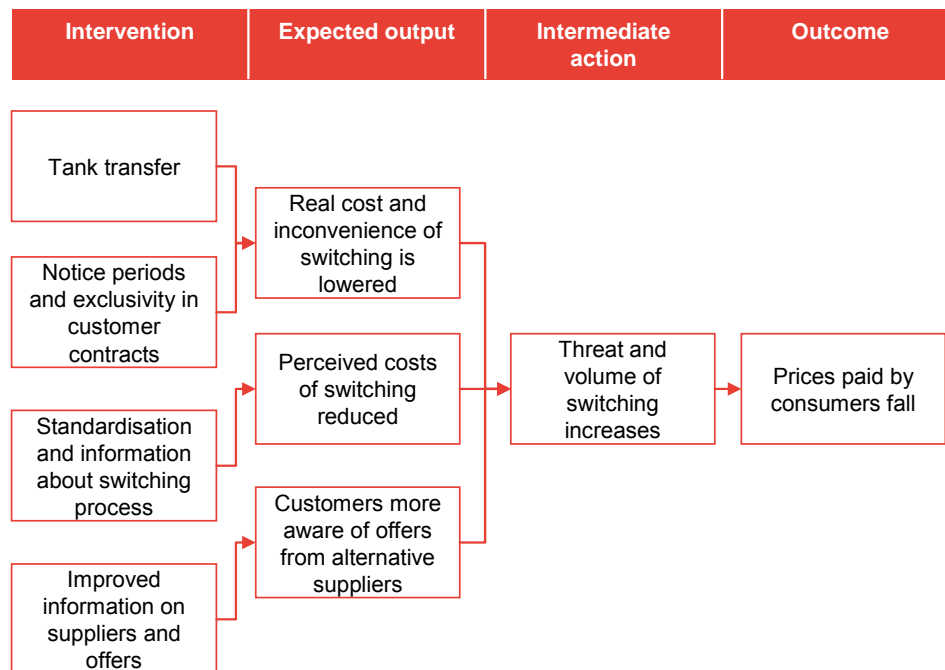
Source: OFT/Competition Commission

Interventions and the logic model

All of the interventions target providers of LPG and were implemented by order. Two orders were made. The CC made the first order for non-metered estates where a single customer uses a single tank in October 2008. The second was made in May 2009 for metered estates where a group of customers share a supply from a single tank and each pay for their own usage.

Figure 12 shows the logic chain for these remedies.

Figure 12. Logic chain of LPG remedies



Source: Frontier Economics

Impacts of the market investigation

For this market investigation we qualitatively assess its costs and benefits. The costs and benefits of these impacts are set out in the tables below. We then discuss some of these estimates in more detail below.

Table 19. Estimated costs of domestic bulk LPG market investigation

Agency (OFT/CC) costs associated with conducting the study/investigation	£1.3m at CC + smaller amount at OFT
Industry costs associated with participating in the study/investigation.	£2.6m (assuming half of agency costs incurred by each supplier)
Remedy set up costs (enforcement/compliance) for OFT/CC/other agency.	Small
Remedy running costs (enforcement/compliance) for OFT/CC/other agency.	Small
Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy and any increases in operational, financial or systemic risks or transaction costs borne by the producer).	£240k one-off + £60k per year. Paragraph 7.150 of Final Report.
Lower economic profit	Potentially large proportion of consumer welfare benefit

Source: CC and Frontier Economics

Table 20. Estimated benefits of domestic bulk LPG market investigation

Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Potentially large. See discussion on lower prices below.
Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	£500k per year from removing the need to install and uplift tanks for existing switchers. ¹²⁵

¹²⁵ Assumes 0.5% of customers switch and that cost of uplift and install is £700.

	Medium. For new switchers there will be reduced costs of switching.
Improvements in productivity resulting from increased competitive pressure (i.e. new entry)	Potentially large. See discussion of dynamic benefits below.

Source: Frontier economics.

These tables of costs and benefits highlight the importance of lower prices and dynamic benefits to the review of LPG. We discuss these below.

Lower prices

The main impact of the market investigation is to lower prices through easier switching. Customers will get lower prices either through switching to a lower priced supplier or retention pricing by a current supplier in response to a threat of switching.

If prices fell to their cost reflective levels for all customers, this would remove all of the customer detriment, estimated as between £4 and 8.5million per year. This is substantially larger than the other costs and benefits.

To allow for this large an impact it must be the case that the remedies have the desired impact on prices. We consider below the factors that would make this more or less likely for each remedy. We also discuss the risk of price discrimination in response to these remedies.

Tank transfer and changes to notice periods and exclusivity

How it should work: These remedies will remove the cost and inconvenience of switching. Customers will be more ready to switch and force retention pricing from their existing supplier or they will achieve lower prices with an alternative supplier, including new entrants.

Risk factors: This remedy relies on customers being aware of the change to the switching process. This risk is mitigated by the standardisation and information remedy.

Standardisation and information on switching process

How it should work: The tank transfer and contract remedies will reduce the real costs and inconvenience of switching. This remedy will reduce the perceived costs of switching and make customers more aware of the ability to switch.

Risk factors: The effectiveness of this will depend on customer awareness of the information they are sent about the ability to switch .

Review of LPG

Improved information on suppliers and offers

How it should work: Lower real and perceived costs of switching will be supported by increased information about the ability to switch and alternative offers. This remedy will make such information more easily available to customers

Risk factors: This remedy relies on customers being aware and acting on the new information.

Risk of price discrimination

The existing supplier will be made aware that a customer is switching. This will allow suppliers to price discriminate between those customers that try and switch and more inert customers. If lower prices are not offered to inert customers this may significantly reduce the impact of the remedies.

Dynamic benefits

There will be dynamic benefits from these remedies if they reduce the industry costs of providing heat and cooking fuel to homes. With more switchers there will be competitive pressure to offer the lowest prices and best service. This pressure will increase incentives for innovation of more efficient technologies or the removal of x-inefficiency in the industry. Even a reduction in costs of 1% of turnover would provide an economic benefit of over £1million per year.

Conclusions on impact of market investigation

If the remedies removed all the consumer detriment then the ongoing benefits to the consumer would be much larger than the one-off costs of the intervention. However, lower benefits might result if any of the following risk factors materialise.

1. The tank transfer and restrictions on notice and exclusion periods are real reductions in the cost and inconvenience of switching. However, the effectiveness of these remedies will depend on how aware customers are made of the ability to switch, which is the aim of the other remedies.
2. Lower prices may not be available to customers who do not seek to switch. Instead, suppliers could price discriminate between price sensitive switchers and non-switchers. This would mean detriment is only reduced for some consumers, and there is not a more general reduction in prices.

Review of home credit

Objectives and recommendations

The details of the home credit MI are set out in Table 21 below.

Table 21. Details of the key characteristics of the home credit MI

Source	Supercomplaint by National Consumer Council to the OFT in June 2004. Referred to the CC in December 2004.
Sector focus of MI	Private — provision of home credit loans in the UK.
Market size (2005)	<ul style="list-style-type: none"> □ 2.3million customers in the UK □ Lending of £1.3billion □ Repayments of £1.8billion
Features of the market which adversely affect competition	<ul style="list-style-type: none"> □ The insensitivity of customers to prices. □ Failure of lenders to compete on price in any significant way. □ The inability of customers to convey reliable information about their credit worthiness to other lenders. □ Incumbent lenders' knowledge of customers' creditworthiness. □ A lack of data sharing with credit reference agencies. □ Customers' requirement for an agent that they trust. □ The regulatory prohibition on door-to-door canvassing of loans.
Scale of detriment	Excess profits of around £75million per year, equivalent to £7 per £100 of loans issued.
Decision on remedies	<ul style="list-style-type: none"> □ Data sharing: Lenders are required to share data with credit reference agencies if they have more than 60 agents or turnover of over £2million. □ Publication of prices: All lenders to provide information on price and other terms of loans to an independent website operator. □ Better information to customers: Additions to statements include: total cost of credit for the loan; wording on early settlement rebates; and reference to the price information website details of how to request additional statements. Also, customers will have a right to request a statement each quarter.

- Early settlement rebates: All home lenders will be required to give an ESR at least as generous as one based on an actuarial formula.

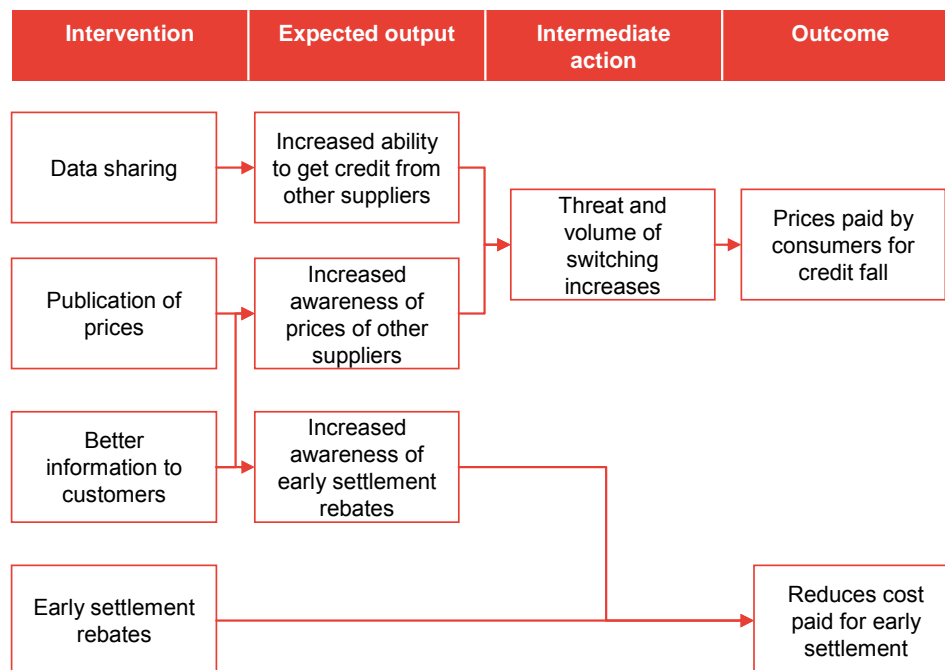
Source: Competition Commission

Interventions and the logic model

All of the interventions target providers of home credit and were implemented by order.

Figure 13 shows the logic chain for these remedies.

Figure 13. Logic chain of home credit remedies



Source: Frontier Economics

Impacts of the market investigation

For this market investigation we qualitatively assess its costs and benefits. The costs and benefits of these impacts are set out in the tables below. We then discuss some of these estimates in more detail below.

Review of home credit

Table 22. Estimated costs of the home credit market investigation

Agency (OFT/CC) costs associated with conducting the study/investigation	£1.9m at CC + smaller amount at OFT
Industry costs associated with participating in the study/investigation.	£5.7m (assuming half of agency costs incurred on average by each major supplier identified)
Remedy set up costs (enforcement/compliance) for OFT/CC/other agency.	Small
Remedy running costs (enforcement/compliance) for OFT/CC/other agency.	Small
Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy and any increases in operational, financial or systemic risks or transaction costs borne by the producer).	£350k for website running costs (para 9.56). £800k for one additional statement per year per customer. ¹²⁶ Additional £200k to £300k per year for administering early repayment charge (para 9.113)
Lower economic profit	Potentially large proportion of the consumer welfare benefit.

Source: CC and Frontier Economics

Table 23. Estimated benefits of the home credit market investigation

Reduction in prices due to removal of market power and additional consumption arising from this price reduction	£10million to £15million per year from fairer early repayment charge. Potentially large impact from lower credit prices. See discussion below.
Improved access to goods and services	Potentially large. Customers benefit from credit references and access to other sources of credit.

¹²⁶ Assumes 1 additional statement per year per customer at cost of 35p (para 9.88).

Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	Medium. Porting credit history is easier and search costs for alternative suppliers will be lower with website.
Improvements in productivity resulting from increased competitive pressure (i.e. new entry)	Potentially large. See discussion of dynamic benefits below.

Source: CC and Frontier Economics

These tables of costs and benefits highlighted the importance of lower prices and dynamic benefits to the review of home credit. We discuss these below.

Lower Prices

The clearest impact of the market investigation is to lower early settlement charges for customers to an actuarially fair level. There will also be a potentially large impact through lower prices. Customers will pay lower prices either due to customers switching to a lower priced supplier or by retention pricing by a current supplier in response to a threat of switching.

If prices fell to their cost reflective levels, this would remove all of the customer detriment, estimated as around £60 - 65million per year, not including the reduction in prices of early settlement charges.

There could also be additional benefits to customers beyond the level of consumer detriment. This would be possible if customers switched to alternative and cheaper suppliers of credit, such as standard credit facilities.

Benefits are therefore still likely to be large relative to costs. But, to allow for a large an impact it must be the case that the remedies have the desired impact on prices. We consider below the factors that would make this more or less likely for each remedy.

Data sharing

How it should work: Lenders above a certain size (60 agents or turnover of £2million) will share information about customers with credit reference agencies. This will remove barriers to customers using a new supplier, including standard credit facilities. The increased ability of customers to shop around will put pressure on current suppliers to reduce their prices.

Risk factors: Customers ability to benefit from improved credit references depends upon their awareness that they can access different forms of credit and to shop around for alternative suppliers. This is mitigated by the other information remedies. In addition the appetite of other suppliers, in particular mainstream lenders, to seek to win business from home credit lenders may have been diminished during the ‘credit crunch’.

Review of home credit

Publication of prices

How it should work: Customers have a simple tool for comparing prices of home credit lenders. This will help customers to access lower priced credit and competitive pressure will drive down prices of credit.

Risk factors: The effectiveness of this will remedy will depend on the number of customers who use the website to compare prices. So far the website has averaged 10,000 visitors per month since its launch out of a total customer base of 2 million. Also, lower prices may only be available to those customers who do shop around. Suppliers may use the act of switching, or threatening to switch, to discriminate on prices with higher rates paid by those that do not respond to the remedies.

Better information to customers

How it should work: This information remedy will support the other remedies by making customers aware of the price comparison website and improved early settlement rebates.

Risk factors: This remedy relies on customers being aware and acting on the new information.

Dynamic benefits

There will be dynamic benefits from these remedies if they reduce the costs of providing home credit or other forms of credit. With more switchers there will be competitive pressure to offer the lowest prices and best service. This pressure will increase incentives for innovation or the removal of x-inefficiency in the industry.

The market investigation did not find that there was reduced innovation in the market which suggests this is unlikely to be a source of dynamic benefits. However, the increased competitive pressure to reduce costs and offer better prices may remove inefficient suppliers or processes. Even a reduction in costs of 1% of repayments would provide an economic benefit of over £12million per year.

Conclusions on impact of market investigation

It is possible with this market investigation to quantify benefits that are significantly greater than the costs, on a consumer welfare basis. This is different from the other market investigations where benefits are harder to quantify. The ease of quantifying benefits should not suggest that benefits are more likely or larger than for other investigations.

Quantification is possible in this case because the remedy that reduced early settlement would save consumers £10 to £15million per year. This compares to

one-off costs of up to £8million and ongoing costs of around £1.3million per year.

The benefits may be even greater due to the other remedies in place. These other remedies potentially remove all consumer detriment with additional benefits of £60 to £65million per year. Even a 10% reduction of detriment would add to the benefits by around £6million per year.

The effectiveness of these other remedies may be limited if the following risk factors materialise:

3. If customers are unaware of the increased ability to shop around and compare prices via the website. The level of awareness will depend on the effectiveness in communicating via the revised statements of this information.
4. Suppliers are able to price discriminate between those customers who act on the new information and remedies, and those that continue to use existing relationships with agents to access and price credit.

Review of classified directory advertising services (CDAS)

Objectives and recommendations

The details of the CDAS MI are set out in Table 24 below.

Table 24. Details of the key characteristics of the CDAS market investigation

Source	Yell, the largest provider, was subject to a price control (RPI-6) for several years. The OFT wanted to review this price control and referred the whole market to the CC in April 2005.
Sector focus of MI	Private — provision of CDAS.
Market size (2005/06)	<ul style="list-style-type: none"> □ Turnover of around £700million
Features of the market which adversely affect competition	<ul style="list-style-type: none"> □ The market is highly concentrated. □ Entry barriers are high and include network effects and the need to establish a strong identity. □ The incumbency position of the largest player is reinforced by network effects. □ Yell has market power and is the price setter in the market. □ Yell's prices are not constrained by those of competitors and it does not compete on price in any significant way.
Scale of detriment	Excess profits of around £20million per year compared to an unregulated market
Decision on remedies	<ul style="list-style-type: none"> □ Price control: Prices are limited by RPI-6 until end of March 2008, and then by RPI. □ Second-tier directories: Yell should be limited from publishing smaller local directories. □ Themed guides: Yell should be limited from publishing themed guides for certain classifications. □ These remedies to be reviewed after three years.

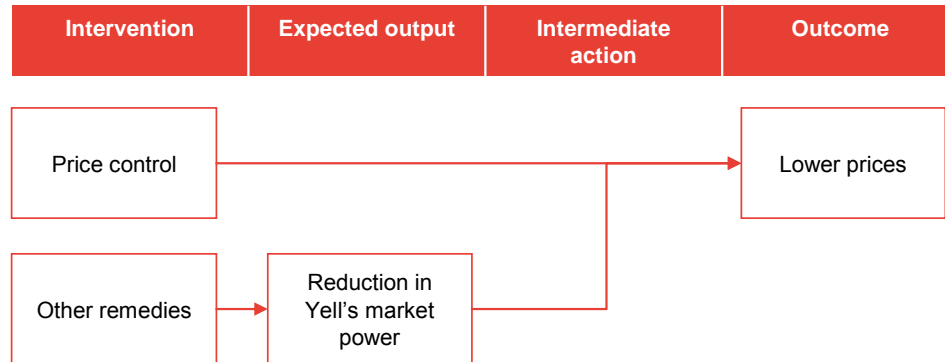
Source: Competition Commission

Interventions and the logic model

All of the interventions target Yell and were implemented by order.

Figure 14 shows the logic chain for these remedies.

Figure 14. Logic chain of CDAS remedies



Source: Frontier Economics

Impacts of the market investigation

Choice of counterfactual

The counterfactual for considering the costs and benefits of this investigation should be wider than used elsewhere. This market has been investigated several times since 1996 by the OFT, CC and their predecessors and was already subject to a price control prior to this investigation. It may therefore be more appropriate to consider the costs and benefits of interventions since 1996, rather than to consider the benefits of this follow-on intervention alone.

However, for simplicity, we have looked only at the impact of this investigation. This means the counterfactual could either be that the price control was removed in the absence of this investigation, or that the pre-existing remedies continued to be imposed. In the latter case, the static consumer benefits of the market investigation are likely to be small or negative. This is because the remedies weakened the price control already in place.

Therefore, we have considered costs and benefits against a counterfactual of no remedies in place from the time of the final report. The costs and benefits of these impacts are set out in the tables below. We then discuss some of these estimates in more detail.

Review of classified directory advertising services (CDAS)

Table 25. Estimated costs of the CDAS market investigation

Agency (OFT/CC) costs associated with conducting the study/investigation	£1.5m at CC + smaller amount at OFT
Industry costs associated with participating in the study/investigation.	£2.2m (assuming half of agency costs incurred by each major supplier identified)
Remedy set up costs (enforcement/compliance) for OFT/CC/other agency.	Small
Remedy running costs (enforcement/compliance) for OFT/CC/other agency.	Small
Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy and any increases in operational, financial or systemic risks or transaction costs borne by the producer).	Unknown
Lower economic profit	Potentially large proportion of the consumer benefit

Source: CC and Frontier Economics

Table 26. Estimated benefits of the CDAS market investigation

Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Potentially large. Depends on whether Yell is constrained by the cap.
Improvements in productivity resulting from increased competitive pressure (i.e. new entry and reduced market concentration)	Small. Some barriers to entry removed by other remedies

Source: Frontier economics.

Conclusions on impact of market investigation

The static consumer benefits of this market investigation are potentially large if Yell is pricing up to the cap as the remedy will be having an effect. To illustrate,

a 1% reduction in prices due to the cap would generate consumer benefits of around £7million per year. However, if Yell is pricing below the cap then there would be no reduction in price benefit from the investigation. Any benefit is not only attributable to this single market investigation, but the continued intervention in this market by the OFT, CC and its predecessors since 1996.

Review of Northern Ireland Banking

Objectives and recommendations

The details of the NI banking MI are set out in Table 27 below.

Table 27. Details of the key characteristics of the Northern Ireland banking MI

Source	Supercomplaint by <i>Which?</i> and the General Consumer Council of Northern Ireland in November 2004. Referred to the CC in May 2005.
Sector focus of MI	Private — provision of personal current accounts (PCAs) in Northern Ireland.
Market size (2005)	<ul style="list-style-type: none"> □ Income from PCAs of £167million (from 8 largest providers covering 95% of market)
Features of the market which adversely affect competition	<ul style="list-style-type: none"> □ Banks have unduly complex charging structures. □ Banks do not fully or sufficiently explain their charging structures or practices. □ Customers generally do not actively search for alternative PCAs or switch bank.
Scale of detriment	Excess profits of around £18million per year.
Decision on remedies	<ul style="list-style-type: none"> □ Easy to understand terminology and descriptions of PCA services (A) □ Customers must receive explanations of the level of charges and interest rates and how and when they are applied (B). □ Banks must provide key information on statements (C). □ Banks must provide an annual summary and breakdown of charges (D). □ Banks must provide advanced notice of charges and debit interest incurred (E). □ Banks must provide a regular reminder of right to switch PCAs (F) □ Changes to the switching process giving new customers an interest and charge free overdraft facility for three months (G).

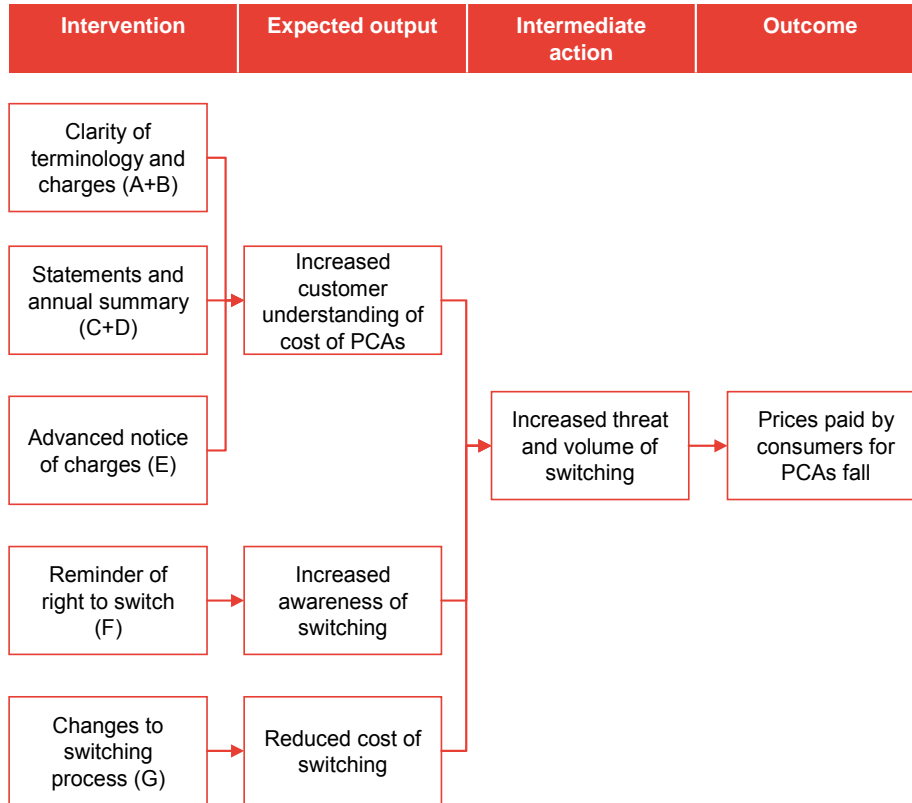
Source: Competition Commission

Interventions and the logic model

All of the interventions target banks that have more than 10,000 customers in NI and were implemented by order.

Figure 15 shows the logic chain for these remedies.

Figure 15. Logic chain of Northern Ireland banking remedies



Source: Frontier Economics

Impacts of the market investigation

For this market investigation we qualitatively assess its costs and benefits. The costs and benefits of these impacts are set out in the tables below. We then discuss some of these estimates in more detail below.

Review of Northern Ireland Banking

Table 28. Estimated costs of the Northern Ireland banking market investigation

Agency (OFT/CC) costs associated with conducting the study/investigation	£1.7m at CC + smaller amount at OFT
Industry costs associated with participating in the study/investigation.	£6.4m (assuming half of agency costs incurred by each clearing bank, and quarter by non-clearing)
Remedy set up costs (enforcement/compliance) for OFT/CC/other agency.	Small
Remedy running costs (enforcement/compliance) for OFT/CC/other agency.	Small
Industry compliance costs (incl. any one-off or ongoing costs associated with the remedy and any increases in operational, financial or systemic risks or transaction costs borne by the producer).	Medium. Costs of providing more information + free overdraft facility.
Lower economic profit	Potentially large proportion of consumer welfare benefit.

Source: CC and Frontier Economics

Table 29. Estimated benefits of the Northern Ireland banking market investigation

Reduction in prices due to removal of market power and additional consumption arising from this price reduction	Potentially large. See discussion below.
Reduction in transaction costs borne by consumers (i.e. time, search and switch costs)	Medium. Free overdraft facility during switching process for those customers that would have incurred charges due to errors.
Improvements in productivity resulting from increased competitive pressure (i.e. new entry)	Potentially large. See discussion of dynamic benefits below.

Improvements in quality of goods or services

Wider awareness of financial issues in NI during inquiry may have led to improvements in quality of goods and services.

Wider applicability of findings to UK banking has helped OFT in PCA inquiry and Banking Code Standards Board.

Source: Frontier economics.

These tables of costs and benefits highlight the importance of lower prices and dynamic benefits to the review of NI banking. We discuss these below.

Lower prices

The main impact of the market investigation should be to lower the cost of personal banking for consumers. Customers will pay lower prices for rates or charges either due to customers switching to a lower priced supplier or by retention pricing by a current supplier in response to the threat of switching.

If prices fell to their cost reflective levels, this would remove all of the customer detriment, estimated as around £18million per year. However, to allow for this large an impact it must be the case that the remedies have the desired impact on prices. We consider below the factors that would make this more or less likely for each remedy.

Increased understanding of PCAs and switching (Remedies A-F)

How it should work: Remedies A-E should increase the level of understanding that customers have of PCAs. These remedies will provide information that should explain the services provided by a PCA, set out the level of charges incurred and notify customers when they incur certain charges. This increased awareness should make customers more sensitive to prices when they choose their current account. Remedy F reminds customers of their right to switch current account and should increase the threat of switching by customers acting on this increased awareness. The increased price sensitivity will force banks to compete for customers by reducing charges.

Risk factors: These remedies rely on customers reading the new information and then acting on it as they choose a PCA provider or to switch. If customers do not read the new information or do not act on it then the effectiveness of the remedy will be limited.

Also, if banks are able to identify those customers that are threatening to switch they might be able to price discriminate and offer better prices only to these customers. The detriment for more inert customers would not be reduced.

Review of Northern Ireland Banking

Changes to switching process (Remedy G)

How it should work: This remedy reduces the costs of mistakes during the switching process. This should increase the number of customers willing to switch and thereby put pressure on banks to reduce prices, both to retain existing customers and win switching customers.

Risk factors: This remedy only removes some of the barriers to switching. Others such as the time it takes to switch, inconvenience and the feature of the market that customers generally do not actively search. Therefore, this remedy may not have a large enough impact on the threat of switching by customers to reduce the prices paid by customers sufficiently to remove the detriment.

Dynamic benefits

There may be dynamic benefits from these remedies if they reduce the costs of providing PCAs in NI. If these remedies lead to more active switching by customers, banks will need to lower prices such that inefficient providers and practices will be removed from the industry. To illustrate, even a small cost reduction of 1 per cent of revenues would be equivalent to £1.7million per year.¹²⁷ However, it is not possible to estimate the likelihood or magnitude of such cost reductions.

Conclusions on impact of market investigation

The benefits of this market investigation if all consumer detriment was removed would be much larger than the costs of the study and implementing the remedies. However, the effectiveness of the remedies may be limited if certain risk factors materialise:

5. Customers do not read or do not respond to the new information.
6. The perceived barriers to switching are reduced insufficiently to make a significant impact on consumer detriment.
7. Providers are able to price discriminate such that inert customers do not receive lower prices.

¹²⁷ Based on 1% of total revenues of £167m per year in 2005.

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