

# **Evaluating the impact of the Supply of Extended Warranties on Domestic Electrical Goods Order 2005**

**Prepared for the Office of Fair Trading by LECG**

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OFT1024

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# 1 EXECUTIVE SUMMARY

## Introduction

- 1.1 An extended warranty is a type of insurance that provides a customer with cover against the possibility that a domestic electrical good ('DEG') might break down or is accidentally damaged. The pricing of an extended warranty is linked to the price of the associated DEG and impacts on the latter may have an impact on the extended warranty. The most common means through which a consumer buys an extended warranty is at the same time as they buy the DEG, from the same retailer.
- 1.2 In 2001 the Office of Fair Trading (OFT) launched an inquiry into the extended warranty market. It concluded that the market for extended warranties did not appear to be working effectively and that consumers were not adequately informed or protected. In 2002 the OFT referred the market to the Competition Commission for a more in-depth study.<sup>1</sup> The Competition Commission reported in December 2003 and recommended a number of remedies which were implemented by the Supply of Extended Warranties on Domestic Electrical Goods Order 2005 ('the Order'), which came into force on 6 April 2005.
- 1.3 In December 2007, we were commissioned by the OFT to evaluate the impact of the Order. The focus of our evaluation is on extended warranties only. The report does not look at the primary market for DEGs, of which extended warranties is a secondary product, or the interaction between markets.
- 1.4 We have assessed how the extended warranties market has changed since the implementation of the Order drawing on four sources of information: our own research; interviews with stakeholders; a consumer survey, and a mystery shopper exercise.

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<sup>1</sup> Under the monopoly provisions of the Fair Trading Act 1973.

## **What the Order requires**

1.5 The Competition Commission concluded that a complex monopoly existed in the supply of extended warranties on DEGs, and that this complex monopoly operated against the public interest. The Competition Commission found:

- that DEG providers enjoy a point-of-sale advantage over non-point-of-sale-suppliers in the provision of extended warranties
- a lack of effective competition from non-point-of-sale suppliers
- high prices and high profits.

1.6 The Order aimed to address these problems by making consumers better informed and empowering them to shop around between point-of-sale and non-point-of-sale suppliers. The provisions of the Order include:

- a requirement for retailers to display prominently freely-available leaflets containing specified information to consumers
- a requirement for retailers to display price and duration information about extended warranties adjacent to the price of the DEG
- a requirement for retailers, upon request by a consumer who is buying a DEG, to provide a written quotation that guarantees that the extended warranty will be available on the same terms for 30 days if the consumer chooses not to buy it at that time
- rights for consumers to cancel an extended warranty which has an initial period of more than one year and receive a full refund for 45 days after it has been purchased, and to be able to terminate it after this for a pro rata refund.

## **Developments in the supply of DEGs**

1.7 Since the Competition Commission report in 2003 there have been changes in the supply of DEGs which may have affected the market for

extended warranties. Prices of DEGs have fallen and sales volumes have increased. At the same time, supermarkets and internet retailers have increased their share of supply at the expense of traditional high-street DEG retailers.

- 1.8 Traditional high-street DEG retailers told us that increased competition from supermarkets and internet retailers had led them to reduce prices of both DEGs and extended warranties. They claimed to have increased the quality of their extended warranty offerings in order to compete against lower cost competitors.
- 1.9 We were told by stakeholders that the reliability of DEGs has improved (although evidence on this is unclear), which may have reduced the cost of providing extended warranties, but the cost of repairs has also increased, which will have had the opposite effect.
- 1.10 In assessing the impact of the Order we need to take account of these various developments. In practice, it is not always possible to distinguish between the impact of the Order and these other effects.

## **Implementation of the Order**

- 1.11 The implementation of the Order led to retailers providing more information to consumers:
  - Leaflets provided by retailers now contain more relevant information about the rights consumers have when purchasing an extended warranty.
  - The majority of the retailers visited during the mystery shopper exercise display information about the price, duration and optional nature of extended warranties next to at least some of the DEGs. This information was not previously displayed.
- 1.12 However, there is scope for improvement:

- There has not been an increase in leaflets 'prominently displayed' in shops and five out of the 13 leaflets we reviewed had at least one or more pieces of required information missing.
- We found that in around 45 per cent of the DEG areas we visited retailers had not listed information about the price, duration and optional nature of extended warranties next to any DEG in the area, and in about 20 per cent of areas this information was listed next to only some DEGs. In about 10 per cent of cases where either some or no information was provided next to individual DEGs, a standard extended warranty applying to a range of products was displayed (and in a minority of cases an extended warranty may not have been offered).
- There is also evidence that some sales assistants are providing incorrect information concerning the consumer rights given by the Order (as many as one-third in the mystery shopper exercise).

1.13 Evidence from the mystery shopper exercise also suggests that the sales assistant provided a written quotation on only around one third of occasions. Most of the retailers we spoke to have interpreted the quotation requirement as meaning that a written quotation is required only once a customer has committed to buying a DEG. This interpretation does not seem to fulfil the Competition Commission's expectation, which was that shoppers would be able to use the quotation to shop around between different retailers *before* committing to purchase from a particular retailer.

## **Impact on consumer behaviour**

- 1.14 If more information is available in the market we might expect consumers to be better informed and this may lead to a change in consumer shopping behaviour.
- 1.15 There is evidence that suggests consumers are now more knowledgeable about extended warranties:

- The evidence shows that around 71 per cent of people were aware that cancellation rights exist but most were not sure of the exact details. However, two-thirds of respondents were not aware of termination rights.
- Fewer people (26 per cent compared to 39 per cent in 2002) are under the impression that they have to make an instant decision on an extended warranty.

1.16 There is also evidence that consumer shopping patterns are changing:

- Some consumers are making use of new cancellation and termination rights. The consumer survey revealed that, out of the 2,012 respondents, 98 (4.9 per cent) had cancelled a contract and 108 (5.3 per cent) had terminated a contract in the past three years.
- More consumers are shopping around, although the proportion is still small. The proportion of extended warranty customers who considered alternative offers to the point of sale has increased from 4 per cent to 15 per cent.
- Fewer consumers are purchasing extended warranties at the point-of-sale, but still the majority. The proportion of customers who bought or received their extended warranties from point-of-sale suppliers fell from 82 per cent to 68 per cent. However, we estimate that around two-thirds of this change was due to customers obtaining extended warranties from manufacturers free of charge.

## **Impact on the market**

1.17 If consumers had changed their purchasing patterns then we would expect to see that it would impact on competition for extended warranties. We might expect to observe a fall in prices for extended warranties or an improvement in quality or service.

1.18 We sought to analyse the impact of the Order on prices. However we found it difficult to assess. The reasons were:

- There were many different extended warranty prices that applied to many different DEGs making the analysis complex.
- There were many exogenous factors that have impacted on costs and prices during the period.

- 1.19 Bearing in mind these problems, our analysis of prices and comments from stakeholders suggests that prices have either remained stable or have fallen, which is likely to be a fall in real terms. Although we did not observe a clear reduction in prices, it may be because the impact of the Order has not yet fully materialised.
- 1.20 Our analysis of the impact of the Order on quality of service suggests that it has either remained stable or improved.
- 1.21 During the period since the Competition Commission's investigation we also observed the entry of new suppliers to the extended warranty market: supermarkets. This entry, however, is unlikely to have come about due to the Order. We were told by stakeholders, however, that the increased cancellation period provided non-point-of-sale suppliers with a greater opportunity to compete in the market, which might account for some of the increase in the proportion of extended warranties sold away from the point-of-sale.

### **Impact on costs**

- 1.22 Although the Order is likely to have brought benefits to consumers, it has also imposed costs on suppliers.
- 1.23 Some high-street retailers told us that the Order had imposed significant one-off costs. However, a rough estimate of one-off costs suggests that these costs for the whole market were around £4.9 million, which is small relative to retailer extended warranty turnover in 2005 of £671 million.
- 1.24 The evidence does not suggest that the Order has imposed significant on-going costs, although some are difficult to quantify.

## **Impact on consumer detriment**

- 1.25 We used a cost-benefit approach to estimate the change in consumer detriment due to the Order.
- 1.26 We estimated the total change in consumer detriment by comparing the proportion of consumers purchasing at the point-of-sale in 2002 and 2007. Assuming that point-of-sale prices have not fallen and non-point-of-sale prices are at competitive levels, we calculated the total change in the cost of extended warranties to consumers. We then allocated part of this change to the impact of the OFT and Competition Commission investigations and the Order, and then converted the resulting benefits and costs into a Net Present Value.
- 1.27 We estimated the net present value of the benefits that the Order has created so far (i.e. three years of benefit). We anticipate that there will be further benefits in the future but do not attempt to quantify them. This represents a conservative approach to estimating benefits, since we would in practice expect the benefits to continue for longer than three years.
- 1.28 The results of our calculations were as follows:
- We estimate the reduction in consumer detriment due to the Order so far to be £51 million (in 2008 prices).
  - Before taking account of the costs that the Order has imposed on retailers, this is equivalent to benefits of £18.6 million per year. This compares to an estimated annual detriment of £366 million and the OFT's and Competition Commission's combined investigation costs of £4.6 million (in 2008 prices).

## **Conclusions and lessons learnt**

- 1.29 We conclude that the Order has produced benefits for at least some consumers.

- Consumers are better informed leading to a small increase in shopping around and purchases away from the point-of-sale. However it is unclear whether this has led to any reduction in point-of-sale extended warranty prices or improvements in quality of service.
- While the Order has benefited some consumers, it appears that it only offsets a small proportion of the consumer detriment identified by the Competition Commission.

1.30 While consumer awareness has improved, there is scope for further improvement.

- Our evidence suggests that some retailers may not be fully complying with the Order. The evidence revealed: five out of the 13 leaflets we reviewed had one or more pieces of required information missing; there does not seem to be an increase in the availability of leaflets since the Order; in around 45 per cent of the DEG areas we surveyed retailers had not listed any information about the price, duration and optional nature of extended warranties next to each DEG in the area (although in a minority of cases there was a standard extended warranty applying to a range of products or no extended warranty applied); and as many as one-third of sales assistants are giving incorrect information.
- Some provisions appear to be more effective than others. Consumers found the leaflets and price information helpful and used cancellation and termination rights; whereas we have found that customers did not always receive a written quotation and there is little evidence that customers who were given quotations used them to shop around.

1.31 More generally, we have some practical suggestions to help ensure the effectiveness of information-based remedies and assist future evaluations of their performance.

- There is scope to increase the information available to consumers before the purchase of the extended warranty. We suggest that the OFT should consider providing guidance to consumers on how to buy complex products such as extended warranties, possibly through the Consumer Direct website.
- We believe the OFT should continue to monitor the extended warranty market to ensure retailers comply with the Order. The OFT should consider how best to monitor the extended warranty market proactively and effectively in the future.
- We suggest the OFT considers further the effectiveness of the thirty-day price quotation. Interviews with retailers reveal that they believe written quotations impose an unnecessary burden.

1.32 Finally, we suggest the following practical steps to ensure that information-based remedies are effective in achieving their goals:

- Setting a benchmark for success against which the performance of the remedies can be measured.
- Road testing of the remedies to verify that they are likely to achieve the anticipated goals.

## 2 INTRODUCTION

- 2.1 In December 2007, we were commissioned by the OFT to evaluate the impact of the Order.
- 2.2 The Order is a result of the OFT and Competition Commission investigations of extended warranties on DEGs. The provisions of the Order aim to ensure that consumers purchasing extended warranties possess the information necessary to make an informed purchase decision and have the opportunity to shop for competing offerings.
- 2.3 The aim of this evaluation is to identify and, where possible, to quantify the impact of the Order on the market for extended warranties.
- 2.4 The structure of the report is as follows. Section 3 provides a summary of the OFT and Competition Commission findings, recommendations and the Order. Section 4 describes how we have carried out this evaluation. In Section 5 we describe the findings on the impact of the Order on the availability of information to consumers and on the changes in consumer awareness and shopping behaviour. In Section 6 we describe how market outcomes have been affected. We analyse the impact of the Order on extended warranty prices and non-price features. In section 7 we analyse retailers' costs. In Section 8, we estimate the consumer benefits resulting from the Order. Lastly, in Section 9 we set out our conclusions and lessons learnt.

### 3 BACKGROUND

3.1 In this section we summarise the findings of the OFT and Competition Commission investigations which led to the Order and provide an overview of extended warranty and DEG markets.<sup>2</sup>

#### Extended warranties

3.2 DEGs are normally covered by a manufacturer's guarantee, or warranty, against the breakdown of the product. This manufacturer's guarantee normally covers the first year after the purchase of the DEG. Extended warranties are contracts which provide consumers with similar cover for a period after the manufacturer's guarantee has expired. They may also provide cover for risks not covered by the manufacturer's guarantee.<sup>3</sup>

3.3 Extended warranties vary between providers in a number of ways. These include:

- Price – An extended warranty could involve a single upfront payment or be a 'pay-as-you-go' contract.
- Coverage – An extended warranty could potentially cover labour, parts, help-lines, no-fault call-outs, and accidental damage. The extended warranties currently available offer some or all of these.
- Features – Extended warranties have different features including whether a policy is continuous or not (that is, whether it finishes if a

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<sup>2</sup> The Competition Commission defined an extended warranty market that was separate from DEGs. See Competition Commission. 2003. *Extended warranties on domestic electrical goods: a report on the supply of the extended warranties on domestic electrical goods within the UK* ('Competition Commission report'), para. 12.132.

<sup>3</sup> Extended warranties cover repair and replacement of DEGs if they break down, may also provide cover against other risks, such as accidental damage and, in a few cases, loss or theft and may also provide other support services.

repair is made) and the circumstances under which a replacement DEG is provided.

- Financial backing – An extended warranty is either insurance-backed (underwritten by an insurance company) or service-backed (backed only by the supplier of the extended warranty).
- Supplier – Most extended warranties are supplied by retailers at the same time as a customer buys the DEG (at the 'point-of-sale'). However extended warranties can also be supplied by manufacturers, banks and credit card providers (for example, as a special offer for using a card to buy a DEG), utilities (who take advantage of their customer database to offer extended warranties) and insurers.

3.4 Suppliers usually price extended warranties in relation to a price band of the DEG. As such, changes in the price of a particular DEG are likely to imply changes in the price of the associated extended warranty.

### **The OFT investigation**

3.5 In October 2001, the OFT launched an investigation into the market for extended warranties on DEGs. It published its report in July 2002.<sup>4</sup>

3.6 The 2002 report identified a lack of effective competition and consumer choice. The OFT found that:<sup>5</sup>

- Retailers' behaviour limited consumers' ability to make accurate assessments of the value of buying extended warranties. In particular, retailers' sales tactics appeared to exploit the limited

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<sup>4</sup> OFT (2002) *Extended warranties on domestic electric goods*. OFT387 ('The OFT report'). The OFT had investigated this market twice before but decided to revisit it because it considered that competition in the market was not working effectively and that consumers were not adequately informed or otherwise protected.

<sup>5</sup> The OFT report, para 1.2.

nature and extent of consumer information. In addition, it seemed that extended warranty pricing was not cost reflective.

- There was a lack of effective competition in the extended warranty market. In particular, retailers seemed to enjoy a point-of-sale advantage, which presented a significant barrier to entry or expansion for alternative suppliers.
- Consumers were largely unaware of their options regarding where they could buy extended warranties.
- Consumers could be exposed to considerable sales pressure and extended warranties contracts may contain potentially unfair terms and conditions.

3.7 In light of these findings the OFT referred the supply of extended warranties on DEGs to the Competition Commission in July 2002.

### **The Competition Commission investigation**

3.8 In December 2003 the Competition Commission concluded that a complex monopoly existed in the supply of extended warranties on DEGs, and that this complex monopoly operated against the public interest.<sup>6</sup> In particular, the Competition Commission findings focused on competition and informational market failures.<sup>7</sup>

3.9 **Competition in the extended warranties market:** The Competition Commission found there was relatively little competition on the pricing

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<sup>6</sup> See Competition Commission report, para. 1.16-1.17. We take the Competition Commission's conclusions as the starting point for our analysis. It was not our role to revisit these conclusions.

<sup>7</sup> See Competition Commission report, para. 1.142.

of extended warranties.<sup>8</sup> In particular, the Competition Commission found the following competitive characteristics:<sup>9</sup>

- Prices set by point-of-sale retailers appeared to be set at levels that consumers would bear rather than in the light of competition from readily available alternatives.
- Prices did not appear to reflect variations in underlying costs or risks.
- Larger retailers' returns on capital on extended warranties persistently and substantially exceeded their cost of capital, indicating that extended warranty prices were generally higher than necessary to cover costs and generate an adequate return.

**3.10 Information provided and available to consumers:** The Competition Commission found that providers of extended warranties at the point-of-sale have a competitive advantage over those who do not have access to consumers at the point-of-sale.<sup>10</sup> In particular:<sup>11</sup>

- Few consumers sought information on extended warranties prior to their purchase.
- Consumers had little opportunity to consider alternatives to the extended warranty on offer at the point-of-sale.
- Almost all extended warranties were purchased at the point-of-sale and extended warranties offered at the point-of-sale were nearly always all sourced from one provider, usually the retailer (or a third party which was the sole supplier to the retailer).

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<sup>8</sup> See Competition Commission report, para. 1.17.

<sup>9</sup> See Competition Commission report, para. 1.12-1.15.

<sup>10</sup> See Competition Commission report, para. 1.14

<sup>11</sup> See Competition Commission report, para. 1.15.

- Generally, no information was available at the point-of-sale on prices, or terms and conditions, of extended warranties available from alternative providers.

## The Order

3.11 In light of the findings described above, the Competition Commission recommended a set of remedies. It considered two packages of remedies: 'behavioural' remedies and 'structural' remedies.<sup>12</sup> The behavioural remedies are the basis of the Order. The main provisions of the Order and the impact that the Competition Commission anticipated they would have are set out in Annexe A. The Order was implemented in 2005.

3.12 The Order includes the following provisions:

On line, store and catalogue suppliers of DEGs which also sell extended warranties must do the following:

- In stores, on web sites and in catalogues, show the price and duration of at least one applicable extended warranty clearly and legibly next to the price of DEGs and make clear that the purchase of an extended warranty is optional.
- Bring the following information to consumers' attention on web sites (through links on the home page and introductory pages offering DEGs), in catalogues (by statements at the beginning of the catalogue and each section offering DEGs) and in stores (through prominently displayed free leaflets):
  - consumers' statutory rights relating to the purchase of a DEG and where they can get information on this;

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<sup>12</sup> The main proposal of the structural remedies was preventing point-of-sale providers selling extended warranties which provide cover for more than one year on the day of sale of the relevant DEG or for 30 days thereafter. Ibid., para. 1.21.

- that extended warranties can be obtained elsewhere;
- that household insurance may be relevant to the purchase of a DEG;
- that an extended warranty does not have to be purchased at the same time as a DEG;
- any cancellation and termination rights;
- the financial protection consumers have if the provider of the extended warranty goes out of business;
- information on financial protection of the extended warranty; and
- whether or not the extended warranty will be ended if a claim is made.

If the warranty costs more than £20 (including VAT), in store consumers can get a written quotation. The quotation must prominently state:

- the price and duration of the extended warranty
- that the extended warranty can be purchased at that price for a period of 30 days (or more if that is the case)
- that extended warranties may be available elsewhere
- that the extended warranty does not have to be bought at the same time as the DEG
- consumers' cancellation and termination rights (see below), and
- whether or not the extended warranty will come to an end if a claim is made.

Suppliers' advertisements must show prices for at least one applicable extended warranty clearly and legibly next to displayed prices of DEGs (unless the supplier has sold less than £10,000 (including VAT) worth of extended warranties in the previous business year).

If the extended warranty lasts for more than one year, consumers can:

- cancel it within 45 days of buying it and get a full refund where no claims have been made, or
- get a pro rata refund if they want to cancel the extended warranty after 45 days, even if a claim has been made.<sup>13</sup>

If the extended warranty costs more than £20 (including VAT), the supplier must notify these rights in writing to the consumer no more than 24 days after the consumer bought the DEG.<sup>14</sup>

3.13 The Competition Commission anticipated that these remedies would create the conditions and provide the information necessary for consumers to make informed choices, and competition to develop in the supply of extended warranties.<sup>15</sup>

## **Enforcement of the Order**

3.14 The OFT has a duty to enforce compliance with the Order:<sup>16</sup>

'The OFT has a duty to keep under review the action taken (if any) in compliance with the Extended Warranties Order ('the Order').<sup>17</sup> If it considers that the Order has, in any respect, not been complied with, it has to consider whether any action should be taken to secure compliance with the Order. Where such action

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<sup>13</sup> The Order, paragraph 8 (1)(b). For example, if a consumer bought a 3-year warranty for £120 and cancelled it after one year, they should get £80 back.

<sup>14</sup> The Order, para. 3(a)

<sup>15</sup> See Competition Commission report, para. 2.466.

<sup>16</sup>The following text concerning the legal framework for enforcement of the Order has been supplied by the OFT.

<sup>17</sup> Pursuant to Section 88(5) of the Fair Trading Act 1973, continued in force by schedule 24, paragraph 14(1) of the Enterprise Act 2002.

would be appropriate it can take enforcement action itself, or give advice to the Competition Commission, or any other person, by whom such action can be taken.<sup>18</sup>

3.15 This evaluation has provided the OFT with information to assist it in considering the effectiveness of and compliance with the Order. In addition, the OFT has so far carried out the following activities to monitor and enforce compliance with the Order:

- website monitoring
- catalogue monitoring. and
- responding to complaints.

3.16 The OFT has periodically monitored websites and catalogues to ensure that retailers have been complying with the Order. The OFT has also been monitoring complaints, though very few have been received so far. Where it has found possible breaches, it has followed up by contacting the relevant parties requesting that they make the necessary changes to comply with the Order. There have not been cases prior to the evaluation where the OFT has considered it necessary to take further action to secure compliance.

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<sup>18</sup> Under paragraph 15(2) of Schedule 24 of the Enterprise Act 2002, sections 94(1) to (6) of the Enterprise Act 2002 apply to the enforcement of compliance with the Order. Any person who is affected by a breach of the Order and suffers loss as a result is able to bring an action for breach of statutory duty against the breaching party. Under section 94(6) of the Enterprise Act 2002, the OFT is able to bring civil proceedings for an injunction or for interdict or for any other appropriate relief or remedy in order to secure compliance with the Order.

## The Evaluation of the impact of the Order

### Goals of the evaluation

- 3.17 The aim of this evaluation is to identify the impact of the OFT and Competition Commission investigations (together, the 'Investigations') on the market for extended warranties.
- 3.18 The main result of the Investigations was the Order. Therefore, the primary goal of the evaluation is to identify and, where possible, to quantify the impact of the Order on the market for extended warranties for domestic electrical goods (DEGs). The OFT identified the following questions:
- Has the market for extended warranties on DEGs grown since the implementation of the Order?
  - How have prices of extended warranties changed relative to those for DEGs? Do extended warranties on DEGs now offer better value for money across a range of products?
  - Are businesses complying with the Order?
  - Are consumers more aware of their options and more likely to shop around for the best value extended warranty product? Do they use the new information which is available as a result of the Order?
  - What is the incidence of consumers' exercising their new rights both in relation to the 30-day quotation and 45-day cancellation rights?
  - How valuable do consumers find the new information and rights in contrast to having no information? Are any alternative/additional remedies required? What is the minimum information people require to make informed decisions?
- 3.19 As a wider goal we are also interested in any impact the Investigations themselves had on the market. The media coverage of the Investigations may have alerted consumers that extended warranties may not be good

value and that there may be cheaper extended warranties available away from the point-of-sale. The media coverage may have encouraged suppliers to change or improve their product offering to ensure it is still attractive to doubtful customers.

- 3.20 Our research therefore looks at the impact that both the Order and the Investigations had on the extended warranties market. We note that an extended warranty has economic features of a 'secondary good'. That is, a customer will only purchase an extended warranty after he has purchased a 'primary' good, which in this case is a DEG. The Competition Commission identified that a market existed for extended warranties, which was separate from the market for DEGs.<sup>19</sup> The focus of this evaluation is on the market for extended warranties only and we do not look at interactions between primary and secondary markets.

### **Developments since the Competition Commission investigation**

- 3.21 Our research covers the period from October 2001 (when the OFT initiated its study) until now. During this time there have been developments in the extended warranties and related DEG markets. We set out in this section some of those trends.

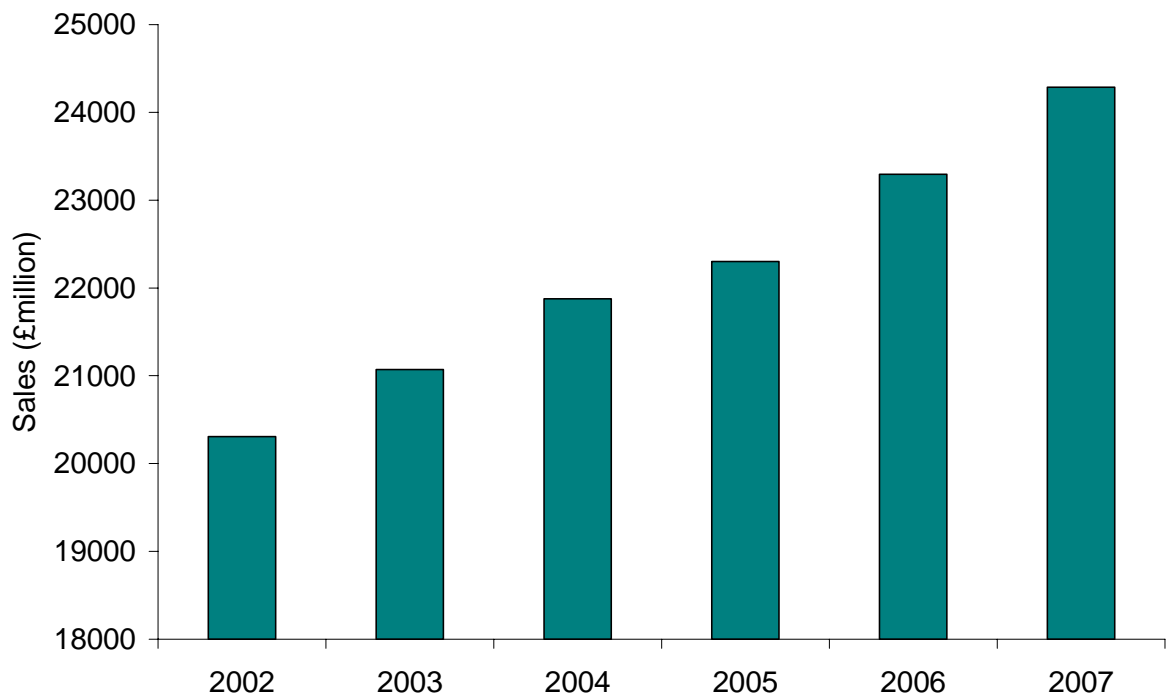
#### **DEG spending**

- 3.22 There has been consistent growth in the supply of DEGs in recent years, as we show in the chart below.

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<sup>19</sup> See Competition Commission report, para. 12.132-12.133.

**Chart 3.1: Electrical spending 2002-2007**



Source: Verdict Research. See <http://www.verdict.co.uk/Marketing/dmvt0431m.pdf>, 25 April 2008.

3.23 According to independent research reports, there has been a strong increase in spending on electrical goods.<sup>20</sup> Sales of DEGs increased by 20 per cent between 2002 and 2007. As we show below, we found that DEG prices have fallen. This implies that the *volume* of DEG sales will have increased more quickly than the *value* of sales shown in Chart 3.1. All else equal, if customers are purchasing more DEGs, there is a greater opportunity for retailers to supply extended warranties. However, other factors might have had opposing effects on the take-up of extended warranties.

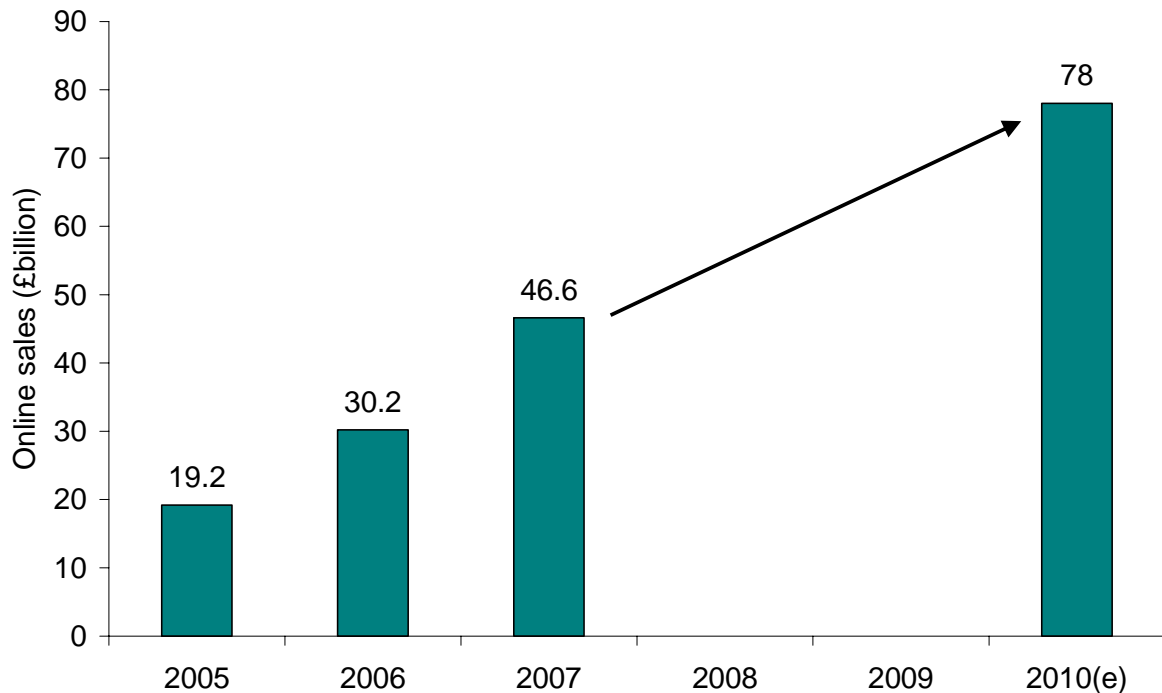
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<sup>20</sup> See Verdict Research. See <http://www.verdict.co.uk/Marketing/dmvt0431m.pdf>, 25 April 2008

## Growth of retail spending on the internet

3.24 One factor that might reduce the take-up of extended warranties purchased from traditional retailers is the increase in purchases of DEGs on the internet. The chart below illustrates the growth of all retail spending on the internet.

**Chart 3.2: Total retail spending on internet 2005-2010(e)**



Notes: (i) 2010(e) is an estimated figure.

Source: See IMRG Capgemini e-Retail Sales Index, *15% of all retail spend was online*, 18 January 2008; *Online sales to double by 2010*, 30 April 2007, at <http://www.vnunet.com/computing/news/2188891/online-sales-double-2010>.

3.25 The move to internet shopping represents a major shift in consumer shopping patterns. Internet spending on all retail goods increased by 57 per cent from 2005 to 2006, which was followed by a 54 per cent

increase from 2006 to 2007.<sup>21</sup> Online spending is expected to rise to £78 billion in 2010.<sup>22</sup> These estimates suggest that online spending accounted for 15 per cent of total retail sales in 2007 compared to 10 per cent the year before.

- 3.26 One of the strongest growth areas in internet shopping is electrical goods. According to reports, sales in July 2007 of electrical goods were over 100 per cent higher than in July 2006.<sup>23</sup> The growth in electrical goods purchased over the internet has implications for the supply of extended warranties. When a customer purchases a DEG online it may be easier for customers to compare competing offers, including those for extended warranties. Therefore increased internet use may increase competition for extended warranties.

### DEG price deflation

- 3.27 DEG prices have fallen. The chart below shows a price index for DEGs.

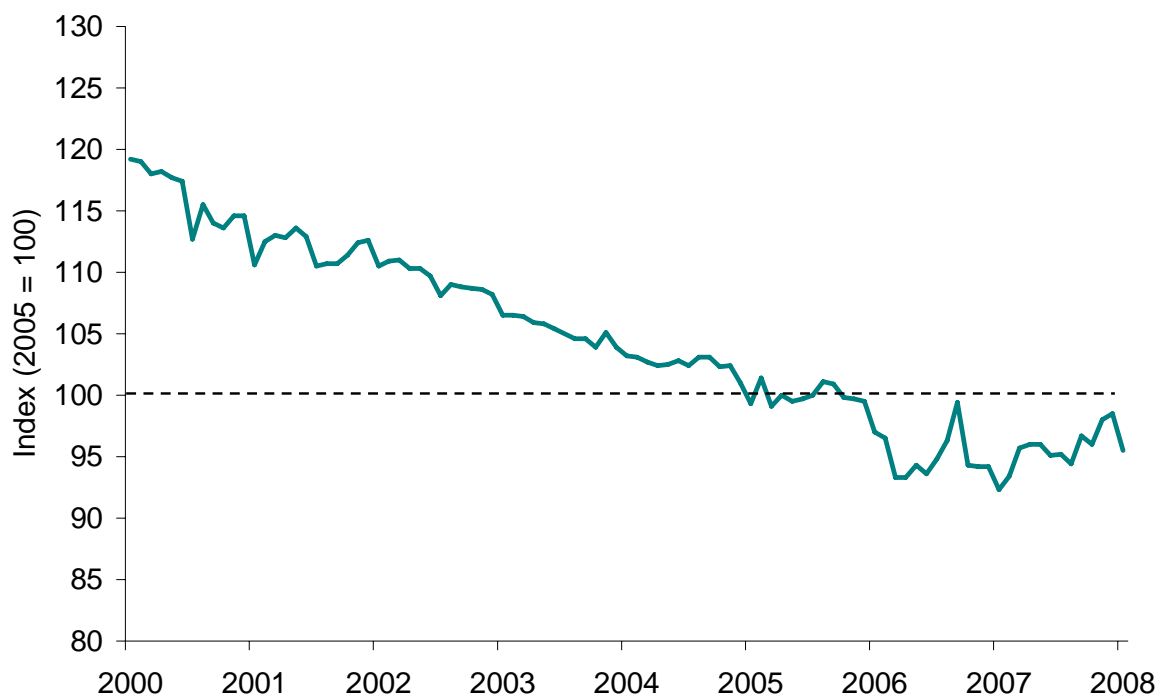
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<sup>21</sup> See IMRG Capgemini e-Retail Sales Index, *15% of all retail spend was online*, 18 January 2008.

<sup>22</sup> *Online sales to double by 2010*, 30 April 2007, at <http://www.vnunet.com/computing/news/2188891/online-sales-double-2010>

<sup>23</sup> See *Brits spend over £4bn online in July*, 21 August 2007 at <http://www.vnunet.com/vnunet/news/2197120/uk-spends-4bn-online-july>

**Chart 3.3: DEGs monthly inflation rates**



Notes: DEGs = D7E3 (Major HH appliances and small electrical HH appliances, 2005 = 100).  
Source: Office for National Statistics

3.28 The chart shows that prices of major household appliances and small electrical household appliances have been consistently decreasing, since before the Investigations began. This reduction in price may be due to a combination of factors including, the increase in competition from supermarkets and internet suppliers described below, advances in DEG technology, and the shift of DEG production to low-cost countries.

3.29 Price deflation of DEGs may have implications for the extended warranty market. A fall in DEG prices relative to disposable income may reduce the risk of having to purchase a replacement or pay for repair. This change may reduce customers' willingness to pay for an extended warranty.<sup>24</sup>

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<sup>24</sup> In practice, retailers' price extended warranties in DEG price bands. So if a DEG falls in price it will possibly move to a lower price band and the associated warranty will have a lower price.

## Entry of supermarkets and internet suppliers into the DEG market

- 3.30 As we discuss further in paragraphs 6.18-6.23 below, retailers have told us that a major influence on the DEG and related extended warranty market is the entry of and expansion by supermarkets and internet retailers. Stakeholders have told us that supermarkets and internet suppliers are now the price setters in the market, and that the increase in price pressure has forced retailers to improve and adapt their offer.
- 3.31 A supermarket that we spoke to told us that it had increased its focus on electronics. It told us that this opportunity had become available as more people have shifted from shopping in high street outlets to 'destination' shopping e.g. driving to large out-of-town shopping centres. Tesco, for example, has substantially increased its sales of consumer electronic goods. For the 2007 financial year, Tesco increased its consumer electronics sales by 35 per cent from the previous year.<sup>25</sup>
- 3.32 The growth of online shopping has had an impact on the traditional high street retailers. For example, these retailers identified internet suppliers such as Amazon as posing a competitive threat. Amazon has increased its sales of electronics in its 'international' market segments (all markets outside North America) by over 50 per cent every year since 2005.<sup>26</sup> It now has over US\$2billion of electronic sales outside North America.

## Increase in repair costs

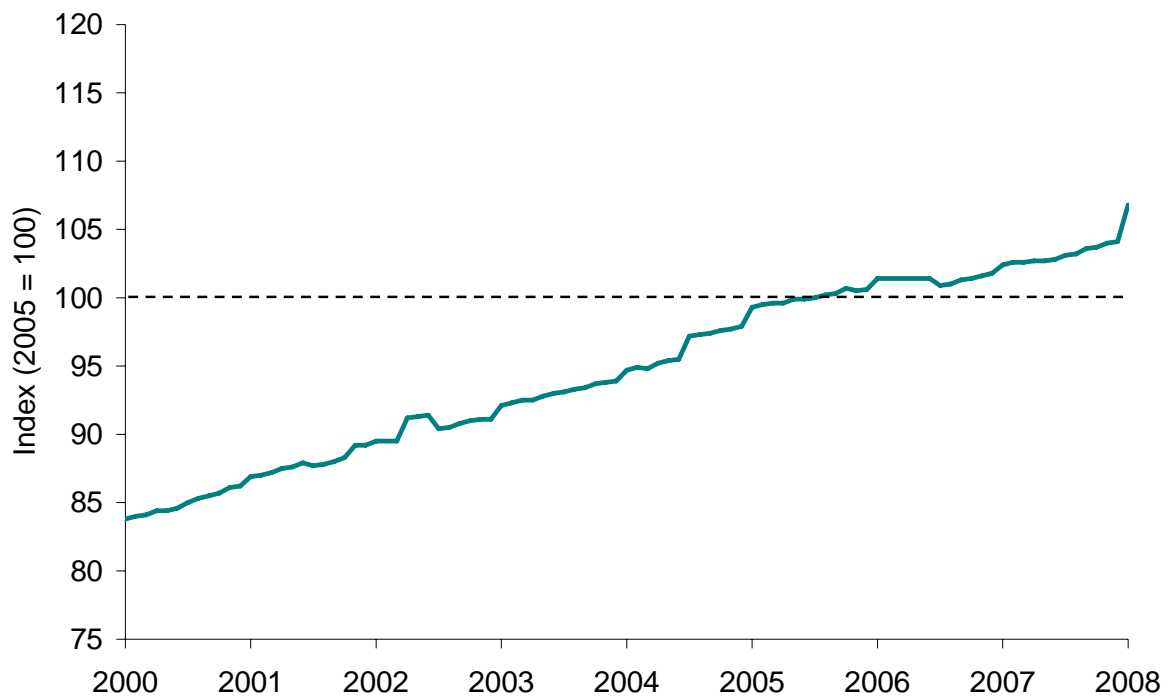
- 3.33 As we show in the chart below, DEG repair costs have increased over time.

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<sup>25</sup> See *Annual Report and Financial Summary 2007*, Tesco, p. 13.

<sup>26</sup> See *Annual Report 2007*, Amazon, p. 34.

**Chart 3.4: Index of repair costs**



Notes: D7E4 (Repair of HH appliances, 2005 = 100)

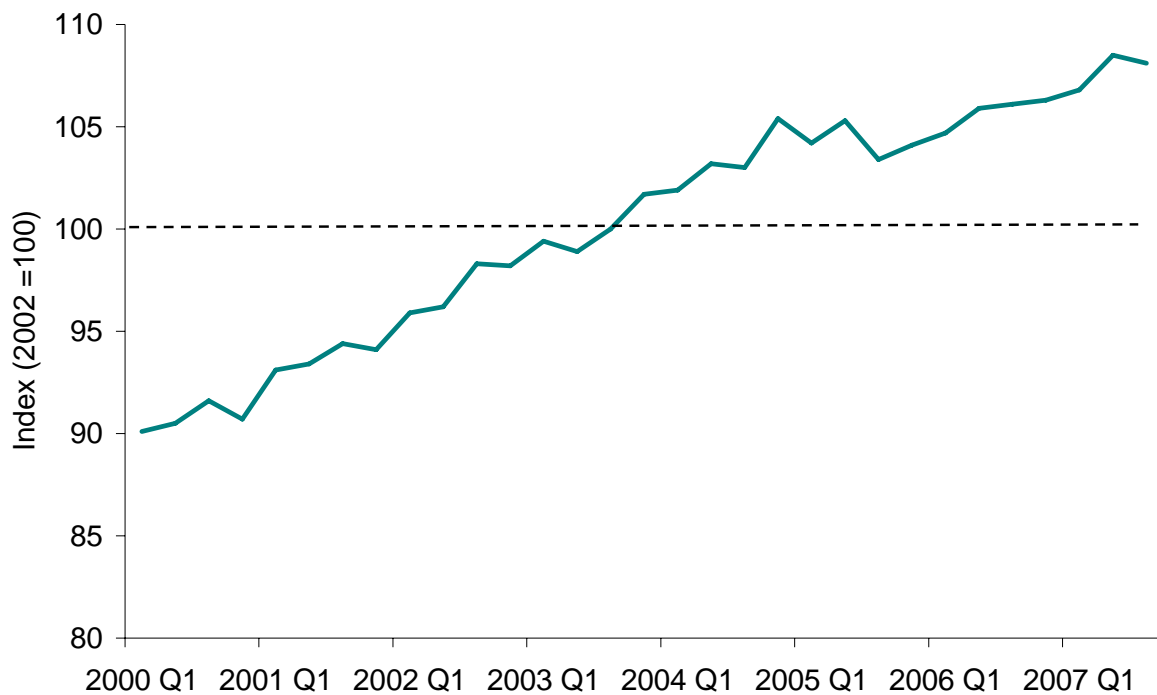
Source: Office for National Statistics

3.34 According to the data from Office of National Statistics, repair costs for household appliances have increased slowly over the period. We note that repair by an independent service provider is a potential substitute for an extended warranty. If the cost of repairs increases, then it may increase demand for extended warranties. However, repair services are themselves a cost component for a supplier of an extended warranty. Therefore, the same factors that have driven an increase in the cost of repairs might also place upward pressure on extended warranty prices.

#### Increase in wealth

3.35 As we show in the chart below, disposable income has risen.

**Chart 3.5: Gross national disposable income at market prices**



Notes: Series variable YBFP.

Source: Office for National Statistics.

- 3.36 An increase in disposable income may lead to an increase in demand for DEGs, which has in part been observed in the chart above and, all else equal, increase demand for extended warranties.
- 3.37 However an increase in disposable income may also have an offsetting effect on extended warranty take up. An increase in disposable income (while DEG prices are falling) decreases the share of disposable income spent on a typical DEG. Consumers are therefore more likely to be able to afford to replace their DEG if it breaks down, which may lead to a decrease in the take up of extended warranties.

### **Extended warranty market trends**

- 3.38 Evidence we have gathered suggests that there may have been a slight reduction in penetration rates of extended warranties.

3.39 According to the results of the Marketing Sciences consumer survey, which are described at paragraph 4.13 below, the proportion of DEGs that consumers purchase with extended warranties has fallen slightly between 2001 and 2008. We show this in the table below.

**Table 3.6: Extended warranty penetration rates**

	2001/2002	2008
Colour television	28%	23%
Video or DVD player or recorder	17%	13%
PC/Laptop	23%	22%
Games console	13%	16%
CD player, Hi-fi, or personal stereo	N/A	11%
Vacuum cleaner	14%	10%
Camera/ Camcorder	N/A	13%
Washing machine/ Tumble dryer	23%	26%
Fridge, freezer or combined fridge/ freezer	16%	19%
Microwave	9%	14%
Cooker	N/A	24%
Dishwasher	25%	16%
Total	19%	17%

Notes: (i) Sample sizes: 2001 = 1886, 2008 = 1521.

Source: OFT consumer survey Q11 and Q12, Marketing Sciences consumer survey Q2.

3.40 There has been a slight fall in the overall penetration rate of two percentage points, but the change is not statistically significant.<sup>27</sup> The

<sup>27</sup> This difference is not statistically significant at the 95 per cent confidence level. It includes the provision of 'free' extended warranties by some manufacturers as described in paragraphs 5.51 to 5.53 below

penetration rates for televisions, video/DVD players, computers, vacuum cleaners, and dishwashers have decreased. The extended warranty penetration rate for games consoles, fridge/freezers and microwaves increased.

### **Conclusions on market trends**

3.41 In summary it appears that between 2002 and the present:

- sales of DEGs have increased while prices of DEGs have on average decreased
- traditional retailers of DEGs have faced increased competition from supermarkets and internet retailers, and
- penetration rates for extended warranties have not changed significantly.

## 4 THE APPROACH

4.1 In this section we set out the approach to evaluating the impact of the Order on the market for extended warranties. We explain the 'before-and-after' methodology, and list economic indicators that we expect would reflect the impact of the Order and Investigations.

### The before and after approach

4.2 Our approach is to identify how various economic indicators have changed since the Investigations began and the Order was implemented. Under this approach, we compare the performance of selected economic indicators before and after the implementation of the Order. The before-and-after analysis aims to:

- measure the levels of the economic indicators of interest before and after the impact of an event
- draw inferences about the impact of that event by comparing the change in those levels<sup>28</sup>

4.3 When performing a before-and-after analysis, we must attribute any change in an economic indicator to the correct cause. We might infer that a change in the economic indicators was caused by the event we are examining. However, there are other factors that might have impacted the market and thus the economic indicators at the same time. For example, when prices (an economic indicator) change at the same time as a competitor enters the market (an event of interest) one cannot assume that entry was the only factor causing the change in prices. Other factors, such as a change in costs, might have affected prices. Although it might be difficult to identify the precise impact of these factors on the indicator, we must recognise them when making

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<sup>28</sup> Our primary source for collecting data for the 'before' period is from the OFT and Competition Commission reports. We have collected our own data for the 'after' period, using a consumer survey, a mystery shopper exercise and data that stakeholders have provided.

inferences about how the Investigations and the Order have affected the market.

## **Economic indicators**

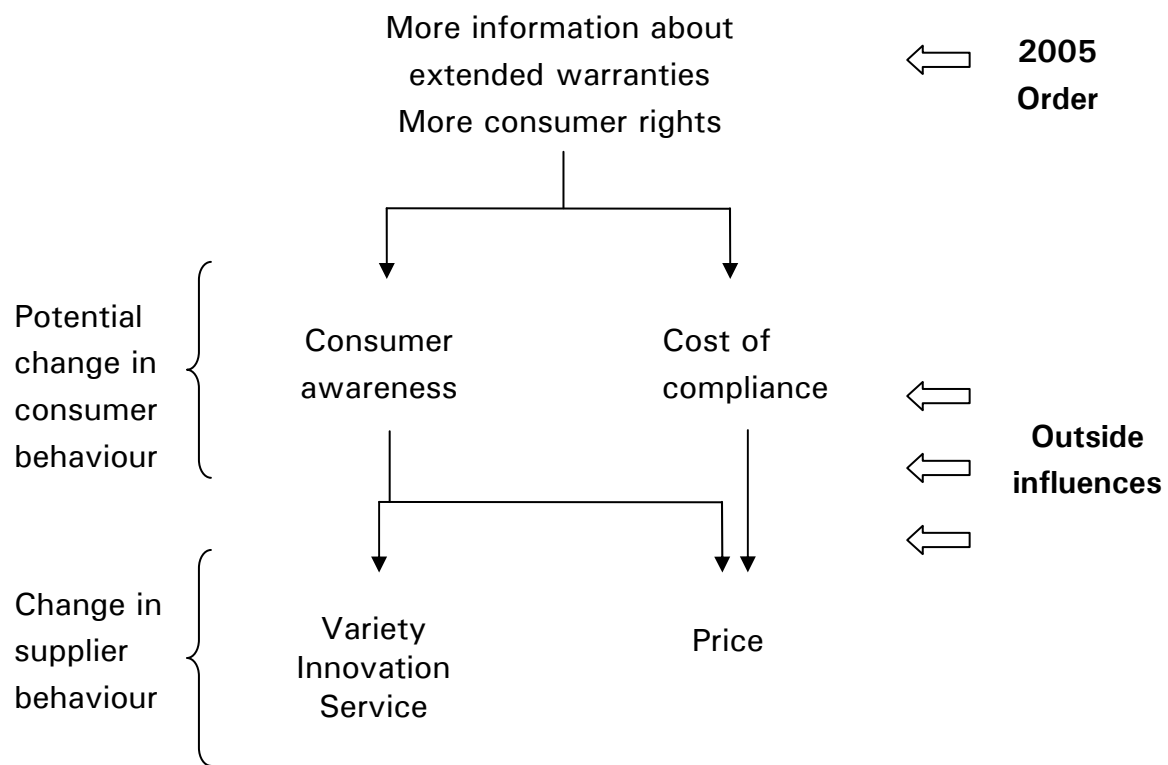
4.4 We have selected economic indicators that will identify the impact, if any, that the Investigations and the Order have had on the market. These indicators were chosen to provide evidence of either the impact of the Investigations (such as heightened consumer awareness), the immediate impact of the Order (for instance, the additional information required by the Order or the subsequent costs of providing this information) or the subsequent impact (for instance, the change in consumer shopping patterns and improved product offerings).

4.5 The economic indicators we looked at are:

- availability of information provided by suppliers of extended warranties
- consumer awareness of information and rights as well as changes in consumer behaviour
- extended warranty prices
- innovation, product variety, and quality of service
- costs and risks of the regulatory burden created by the Order

4.6 These indicators are not independent of each other. We set out in the figure below how these indicators are related.

**Figure 4.1: Inter-relation between indicators**



- 4.7 The initial impact of the Order is to increase the information available to consumers and improve their rights associated with buying an extended warranty (especially cancellation and termination rights). Complying with the Order will come at a cost to business, which may impact on extended warranty prices.
- 4.8 The increase in information and consumer rights is expected to provide consumers with the opportunity to shop around. This change in consumer behaviour might reduce the point-of-sale advantage the retailers enjoy, and improve the level of competition in the market. The latter might bring a decrease in the price of the extended warranties supplied by point-of-sale suppliers, an increase in the quality of service and in product variety and innovation. In other words, the potential change in consumer behaviour might lead to a change in supplier behaviour.

4.9 There are outside influences that have also impacted on the indicators. These other factors, such as the increase in competition for the supply of DEGs or the increase in use of the internet, may increase or decrease the indicators independently of the Investigations and the Order. We have therefore tried to identify whether changes we observe are caused by the Order or by these other factors.

## **Research methods**

4.10 In carrying out this evaluation we have drawn on four sources of information:

- our own research
- interviews with stakeholders
- a consumer survey, and
- a mystery shopper exercise.

4.11 Our research included researching the OFT and Competition Commission reports, market research reports, making an assessment of the products that stakeholders offered, and gathering information on extended warranty prices.

4.12 We held interviews with stakeholders who had an interest in or might be affected by the Order. We conducted interviews with 14 stakeholders comprising three trade and consumer associations, two insurers, one DEG manufacturer and eight retailers.

4.13 A consumer survey was carried out on our behalf by Marketing Sciences, a market research organisation. The consumer survey questionnaire was designed by the OFT and ourselves in conjunction with Marketing Sciences. Marketing Sciences held two waves of an omnibus telephone survey and conducted telephone interviews with 2,012 members of the public. A summary of the survey results are in Annexe B.

4.14 Marketing Sciences also conducted a mystery shopper exercise at 100 physical stores and on 14 websites. A summary of the results are in Annexe C.

## **5 THE IMPACT OF THE ORDER ON THE MARKET: INFORMATION, RIGHTS AND CONSUMER AWARENESS**

5.1 In this section we address three issues:

- First, we assess whether the information required by the Order has been made available.
- Second, we assess whether this information has made consumers better informed and, in particular, aware of their new rights.
- Third, we assess whether this information, and the existence of new consumer rights, has changed consumer behaviour.

### **Availability of more and better extended warranty information**

5.2 The first step in our evaluation is to assess whether the Order has led to extended warranty suppliers providing more and better information to consumers. We assess in this section whether retailers have fulfilled the requirements of the Order and whether as a result there is more information available to consumers.

#### **Wider availability of leaflets by retailers**

5.3 Under the Order, retailers who offer extended warranties must ensure that leaflets providing further relevant information are:<sup>29</sup>

...prominently displayed in a manner that ensures, so far as is reasonably possible, that they are likely to come to the attention of consumers, and that such leaflets are freely available to consumers.

5.4 We used the information from the mystery shopper surveys performed in 2002 and 2008 to compare the proportion of retailers that had leaflets

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<sup>29</sup> The Order, para. 3(1)b.

'clearly' on display before and after the Order.<sup>30</sup> We set out the results of this analysis in the table below.

**Table 5.1: Were leaflets on extended warranties available?**

Outlet type	2002 (%)	2008 (%)
Large chain retail outlets	61.9	65.9
Small-medium chain retail outlets	36.3	41.3
Independents	26.6	0.0
Supermarkets	N/A	33.3
Department stores	51.9	50.0
Overall	48.2	47.0

Notes: (i) Sample size: 2002 = 1,000 stores, 2008 = 100 stores. (ii) Actual outlets used for 'Outlet type' do not precisely match between years. (iii) The change in the overall figure is not significant at the 95% confidence level.

Source: OFT mystery shopper survey, 2002; Marketing Sciences mystery shopper exercise, 2008.

5.5 We place some caveats on these results. First, the mystery shopper exercise in 2008 used a small sample (100 outlets in total), so the results for each outlet type and overall will have a margin of error. Second, the outlets used in each 'Outlet type' category do not match precisely between 2002 and 2008.<sup>31</sup> Third, the assessment by the mystery shopper as to whether the leaflet is 'clearly' on display contains a degree of subjectivity.

<sup>30</sup> The mystery shopper survey by Taylor Nelson Sofres (TNS) in 2002 was designed to check the degree to which firms followed the British Retail Consortium's (BRC) code. There was no specific requirement to display leaflets before the Order but some leaflets were available from retailers.

<sup>31</sup> There are several reasons for these differences. First, the 2002 mystery shopper survey covered 1,000 outlets so was more extensive than the 2008 mystery shopper exercise. The 2008 mystery shopper exercise covered 100 stores, therefore we could only select outlets to broadly (rather than precisely) match market share. Finally, some retailers have closed or contracted since 2002, therefore we did not include them in the survey.

- 5.6 Bearing in mind these caveats, the evidence does not show an increase in leaflets 'clearly' available in shops. Large and small-medium retail chains showed increases in leaflet availability, independent stores appear to show a decrease in the availability of leaflets: none of the 10 independent stores surveyed in 2008 had leaflets 'clearly' on display.
- 5.7 The results of the consumer survey did, however, provide evidence that more consumers are seeing leaflets. We find that 46 percent saw a leaflet when buying a DEG compared to 28 percent that responded to a similar question that the Competition Commission asked in 2002.<sup>32</sup>
- 5.8 To reconcile this apparent inconsistency it is possible that there is now a greater consumer awareness of extended warranties. Alternatively, it is possible that the sales assistant provided a leaflet when the customer purchased a DEG.<sup>33</sup>

### **New information contained in the leaflet**

- 5.9 The Order requires that retailers who offer extended warranties must provide leaflets with 'further relevant information'.<sup>34,35</sup> It goes on to say

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<sup>32</sup> The question in the 2002 survey was: 'Apart from materials provided by the salesperson, was there any other written information about 'extended cover' displayed in the store?'. The question in the Marketing Science was: 'When you made the purchase of the <DEG>, did you see any leaflets about extended warranties in the store?' The sizes of the samples are 2002 = 652, 2008 = 1046. The change statistically significant at 99% confidence level.

<sup>33</sup> Our mystery shoppers were told to engage a sales assistant about a given DEG. The mystery shopper exercise found that, for those products on which extended warranties were offered, on 65 per cent of the occasions a sales assistant was able to produce a leaflet. On 25 per cent of the occasions when the sale assistant produced a leaflet, it was without prompting. See Marketing Sciences mystery shopper exercise Q6.3.

<sup>34</sup> The Order, para. 3(1)b.

<sup>35</sup> All the retailers that we spoke to (that offered extended warranties at the time of the investigations) provided information leaflets prior to the Order. However these retailers did not face any obligations on the information contained in their leaflets. Some retailers may have followed the BRC Best Practice Code for Extended Warranties on Electrical Goods (December

what this 'further relevant information' is.<sup>36</sup> We analysed the leaflets of 13 retailers to see whether they contained all the information required by the Order. Our results are set out in the table below.

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2001), which offered recommendations on the content of leaflets. However the OFT concluded that retailer compliance with the BRC Code was poor, which in part justified its decision to investigate the extended warranties market. See OFT report 2002, paragraph 2.3.

<sup>36</sup> We analysed the difference between the information required under the BRC Code and the Order. The main differences are that leaflets must now inform consumers: that extended warranties are available from other suppliers; that warranties do not have to be purchased at the same time as the DEG; that household insurance may be applicable; and that consumers have specific cancellation and termination rights.

**Table 5.2: Analysis of information contained in leaflets**

<b>Outlet type</b>	<b>Yes</b>	<b>No</b>
Relevant statutory rights of a consumer relating to the purchase of a domestic electrical good and where further information may be obtained in relation to such rights	12	1
That extended warranties may be available from other persons	11	2
That household insurance may be relevant to the purchase of a domestic electrical good	12	1
That an extended warranty does not have to be purchased at the same time as a domestic electrical good	11	2
Any cancellation and termination rights pursuant to article 8	13	0
The nature of the financial protection provided to a consumer who purchases an extended warranty offered by the supplier in the event of the provider going out of business	11	2
Whether or not an extended warranty offered by the supplier will be terminated in the event of a claim being made	12	1

Notes: (i) 13 leaflets analysed.

Source: Authors' own analysis based on leaflets collected during the mystery shopper exercise.

5.10 Our analysis found that the majority of leaflets contained all information that was required. However we found that some leaflets did not contain all the information that the Order required. In some cases the information was hard to find or in small print. In total, five out of the 13 leaflets we reviewed had one or more pieces of required information missing.

## **Information on the price and duration of the extended warranty and that the extended warranty is optional**

5.11 Under the Order whenever a supplier of an extended warranty displays the price of a DEG it must:<sup>37</sup>

...display the price and duration of one applicable extended warranty adjacent to the price of the relevant domestic electrical good ... in a manner that is clear and legible and makes clear that the purchase of an extended warranty is optional.

5.12 The retailer is not required to display the information on each item if:

- the retailer does not offer extended warranties on the product(s), or
- the retailer offers a standard extended warranty on a range of goods and the price, duration, and optional nature of that extended warranty is displayed in 'close proximity' to the range of goods it applies to.

5.13 The majority of retailers we spoke to did not display the price of the extended warranty next to the price of the DEG prior to the Order. Also there was no legal obligation to do so.<sup>38</sup> We therefore expected to see an increase in the availability of this information after the Order.

5.14 The mystery shopper exercise provided information about how many stores displayed the information as required by the Order. The mystery shoppers visited three DEG areas in each store.<sup>39</sup> For each area the mystery shopper recorded the proportion of items that clearly displayed

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<sup>37</sup> The Order, para. 3(1)a.

<sup>38</sup> See Competition Commission report, para. 9.49(b).

<sup>39</sup> For example, a section of the store selling televisions would be one DEG area. In total the mystery shoppers surveyed 302 DEG areas.

the information mentioned in 5.11 above. We show the results in the table below.

**Table 5.3: Proportion of in-store areas where the retailer displayed information next to the DEG**

	All	Some	None
Price	35%	21%	44%
Duration	31%	23%	46%
Optional	37%	17%	46%

Notes: (i) Sample size: 302 store areas. (ii) 'None' and 'Some' does not include number of areas (approximately 10%) in which price, duration or option was not listed next to some or all DEGs but there was a standard extended warranty that applied to all products and information on it was displayed near the range of products.

Source: Marketing Sciences mystery shopper exercise Q1-4.

5.15 From the table we see that retailers displayed information on price, duration and the optional nature of an extended warranty on all DEGs in around one-third of areas the mystery shoppers visited. In another 20 per cent of areas the information was displayed on at least 'some' DEGs in an area. In just under half of the areas retailers did not display this information on any of the DEGs.<sup>40</sup>

5.16 In addition to those DEGs which had information directly next to them, the mystery shopper exercise found that for those areas in which either price, duration or the optional nature of extended warranties was not listed on some or any DEG, around 10 per cent had a standard extended warranty that applied to all DEGs in an area. Therefore the figures we present in the table above are a lower bound of DEGs that had information about extended warranties listed next to them.

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<sup>40</sup> We also observe that the figures are very similar for 'price', 'duration' and 'optional'. This suggests that when retailers do display information on extended warranties it will tend to display all the pieces of information (price, duration, optional) that the Order requires.

- 5.17 Prior to the Order, retailers did not list price information next to the DEG but instead only in leaflets. The results of the mystery shopper exercise therefore reflect a positive impact of the Order.<sup>41</sup> There is, however, room for improvement. Many DEGs are being displayed without the required information. In a minority of cases, it may be because no extended warranty is offered on the individual product while in others it may be due to a failure to comply with the Order.
- 5.18 Online DEG suppliers are also providing information about extended warranties. Our mystery shopper exercise examined 50 DEG areas on the websites of 14 retailers. Sixty six per cent of the total number of surveyed areas clearly showed all the required information next to all DEGs.<sup>42</sup> Around 14 per cent had the information clearly displayed only on some DEGs, while 20 per cent had no information displayed. The majority of retailers we spoke to did not list extended warranty prices next to the DEG prior to the Order. Therefore, this is likely to represent a substantial improvement compared to the situation before the Order.

### **Providing correct information to customers**

- 5.19 Another important channel of information is the sales assistant. The consumer survey found that around half of extended warranty buyers had not seen a leaflet.<sup>43</sup> So in many cases the shop assistant may be the only source of information that a customer will have prior to buying the extended warranty.

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<sup>41</sup> The mystery shopper exercise found that over 50 per cent of DEG areas now have information on price, duration and optional nature displayed on some or all of the products. For the reasons we have noted above, this represents a lower bound on the occasions where an extended warranty is available and where the retailer has displayed price, quality and optionality information.

<sup>42</sup> As a percentage this is a higher proportion than for in-store. This is not altogether surprising since it may be easier for outlets to comply with the Order for online offers than in-store.

<sup>43</sup> Marketing Sciences consumer survey Q6.

5.20 We used the mystery shopper exercise to test whether shop assistants provide accurate information on extended warranties.<sup>44</sup> We list the questions the mystery shoppers asked shop assistants in the table below along with the responses.

**Table 5.4: Shop assistant responses**

Question	Yes	No	Don't know
'If I buy the extended warranty, can I change my mind later and get my money back?' (45 days cancellation right). <sup>45</sup>	68%	24%	8%
'Can I buy an extended warranty elsewhere, instead of buying this one?' (Availability of alternative suppliers). <sup>46</sup>	54%	34%	11%
'If I want to think about it first, can I get the Extended Warranty later at the same price?' (30 days written quotation). <sup>47</sup>	76%	18%	6%

Notes: (i) Correct answer to all questions is 'yes'. (ii) Sample size = 79. (iii) Rows may not add to 100% due to rounding.

Source: Marketing Sciences mystery shopper exercise Q6.5.

5.21 The answer to all of these questions should have been 'yes'. In most cases the sales assistant gave the correct answer, but in a significant minority of cases the sales assistant provided incorrect information. For

<sup>44</sup> The mystery shoppers' instructions were to engage the shop assistant about buying an extended warranty on a specified good, and then ask some questions about the provisions of the Order.

<sup>45</sup> The Order, para. 8(1)a.

<sup>46</sup> The Order, para. 1(3)b and para 3(4)c.

<sup>47</sup> The Order, para 3(1)c.

example, one-third of shop assistants told our mystery shopper that they could not buy the extended warranty elsewhere.

### **Written quotation and reminder**

- 5.22 The Order requires that suppliers provide a written quotation upon request by the customer if the request is 'at the same time' or 'immediately subsequent' to the purchase of a DEG, or whenever the customer buys an extended warranty costing more than £20.<sup>48</sup>
- 5.23 The consumer survey found that 48 per cent of extended warranty buyers recall receiving a written quotation.<sup>49</sup> Around half of that subgroup (i.e. 22 per cent of extended warranty buyers) believed that the quotation was clear that they could use it later to purchase the extended warranty at the same price.<sup>50</sup>
- 5.24 According to the mystery shopper exercise, in stores where an extended warranty was available, the sales assistant provided a written quotation on only 32 per cent of occasions.
- 5.25 Most of the retailers we spoke to have interpreted the quotation requirement as meaning that a written quotation is required only once a customer has committed to buying a DEG. Retailers appear to have taken this view because they felt that it would be unnecessary and excessively burdensome to give a written quotation at any time.<sup>51</sup>

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<sup>48</sup> The order, para. 3(1)c.

<sup>49</sup> Market Sciences consumer survey Q14.

<sup>50</sup> We note that this question relies on accurate recall so may not reflect the proportion of consumers who actually received a written quotation.

<sup>51</sup> Retailers that we spoke to expressed doubts over the usefulness of the written quotation. Some retailers told us that, in their view, written quotations were unnecessary since their extended warranty prices are normally 'fixed' for a period by the price lists or catalogues that they publish. Most retailers provided an application period after the purchase of the DEG when a customer could purchase an extended warranty. Some retailers did not believe consumers

5.26 The Order also requires retailers to send a reminder to customers who have purchased an extended warranty of their right to cancel within 45 days and receive a full refund.<sup>52</sup> The consumer survey found that 47 per cent of consumers that bought an extended warranty recalled receiving a reminder in the post.

### **Comment on compliance**

5.27 The purpose of the mystery shopper exercise and research discussed in the preceding paragraphs was to provide an indication of whether the Order had increased the level of information provided to consumers at the point-of-sale. However, some of the results suggest that some retailers may not be complying with the Order.

5.28 The evidence from the mystery shopper exercise suggests that large chain retailers appear to provide more information both in terms of the availability of leaflets in store and with respect to the information contained in the leaflets themselves. The retailers that provided less information were medium, small and independent retailers. However, this rule did not apply in all cases and as highlighted in Table 5.1 there are instances where larger retailers are not displaying leaflets. In our lessons learnt we suggest that the OFT continue to monitor compliance of all types of retailers.

### **Consumer knowledge and awareness**

5.29 The evidence in the previous section seems to indicate that there is more and better information available to consumers, although there is room for improvement. As a result of this new availability of information we might

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'shopped' for extended warranties but instead made a 'yes' or 'no' purchase decision at the time they purchased the DEG.

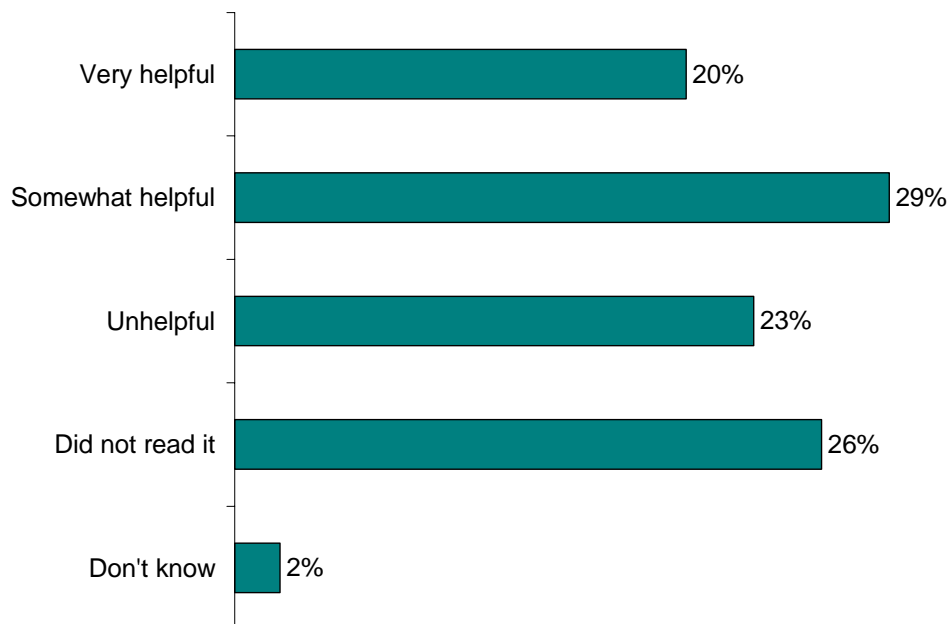
<sup>52</sup> This is an important source of information since if consumers did not receive information at the point-of-sale it may be their last chance to do so before the cancellation period finishes. The reminder reinforces the chance for the consumer to correct a poor purchase decision.

expect that consumers are now better-informed about extended warranties. In this section we analyse whether consumers have found the new information useful and whether they are aware of their rights.

### Quality and relevance of the information in the leaflets

5.30 The Order requires suppliers to provide a leaflet for consumers containing relevant information about extended warranties.<sup>53</sup> We asked consumers how helpful they found the leaflets. The chart below shows the results.

**Chart 5.5: 'How helpful did you find the leaflet in deciding whether you needed an extended warranty?'**



Notes: (i) Sample size = 488.

Source: Marketing Sciences consumer survey Q7.

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<sup>53</sup> As we note earlier, there appears to have been an increase in the proportion of shoppers who saw a leaflet.

- 5.31 The Chart above shows that half of all respondents who saw the leaflet found it helpful in deciding whether they needed an extended warranty. Since more consumers saw a leaflet (see paragraph 5.7), and half of them found it helpful, it appears that there has been some benefit from this provision.<sup>54</sup>
- 5.32 We also find that one third of all the customers who bought a DEG recalled seeing the information about the price and duration of the extended warranty.<sup>55</sup> Of those that saw the information, 65 per cent found it helpful in deciding whether to buy an extended warranty.

### **Customer awareness of when you can take out an extended warranty**

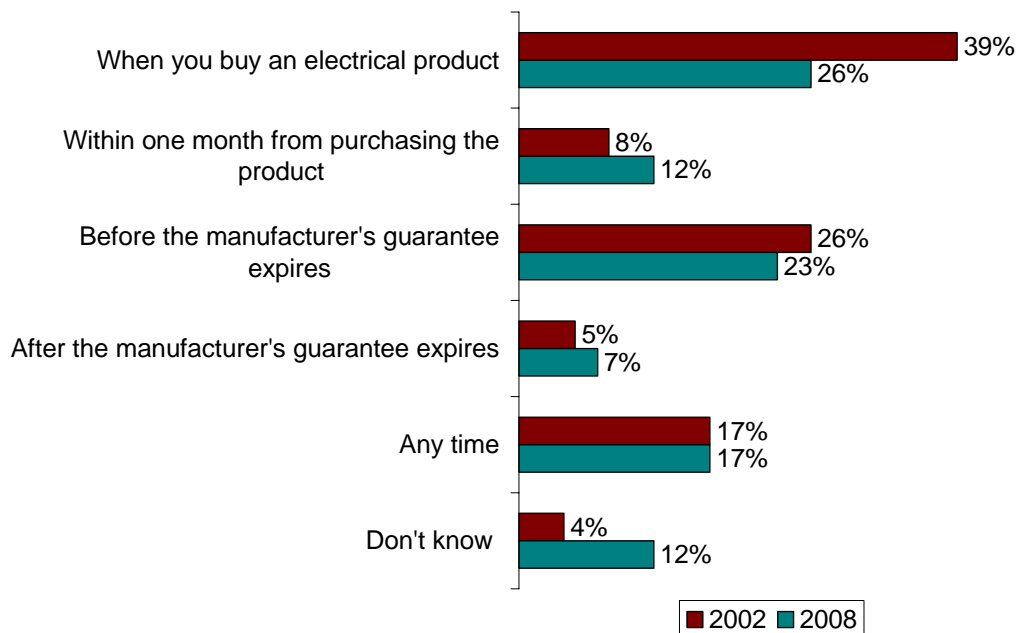
- 5.33 In the consumer survey we asked respondents when they think it is possible to purchase an extended warranty. If customers thought that they can buy an extended warranty only at the time that they buy the DEG, this would increase the advantage that the retailer has over its non-point-of-sale rivals.

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<sup>54</sup> A report issued by the National Consumer Council and the Better Regulation Executive in 2007 looked at whether information that the Government has required businesses to provide actually had the desired impact on consumers. It identified two potential areas of concern specifically about the Order. First, it noted that the requirement to inform customers that extended warranties were available from alternative suppliers created a conflict of interest for retailers. Second, the information is presented in a 'legalistic' way which makes consumers think the information is not for their benefit, but rather to protect the retailer from legal liability. (See NCC and Better Regulation Executive. 2007. *Warning: Too much information can harm.*)

<sup>55</sup> Market Science consumer survey Q8.

**Figure 5.6: 'When do you think you can take out an "extended warranty" for electrical products?'**



Notes: (i) Sample sizes: 2002 = 1080, 2008 = 1423.

Source: Competition Commission consumer survey Q12a, Marketing Sciences consumer survey Q5.

5.34 The best answer to this question is 'anytime'.<sup>56</sup> There is no change in the proportion of respondents who gave this answer. However there has been a significant reduction in the number of respondents who believe that one can buy an extended warranty only at the point-of-sale. This suggests that consumers are more aware that they do not have to make an immediate decision on the extended warranty, even if they do not know exactly how long they have to decide.

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<sup>56</sup> Both Warranty Direct and D&G, for example, offer an extended warranty for products up to eight years old.

## **Consumer awareness of their cancellation and termination rights**

- 5.35 Prior to the Order there was no standard policy for cancellation and termination.<sup>57</sup> The Order provides a minimum 45-day cancellation period that suppliers of extended warranties must offer and provides new termination rights.<sup>58</sup> The longer cancellation period allows consumers a greater chance to reverse poor decisions made at the point-of-sale and improve their ability to shop around.
- 5.36 Using the consumer survey we tested consumers' knowledge of their cancellation and termination rights. The consumer survey asked respondents whether they knew the period within which they could cancel an extended warranty, and how much they would be reimbursed if they terminated an extended warranty. We show the results in the two tables below.

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<sup>57</sup> For example, Comet and Dixons, who were the leading suppliers of extended warranties, both had a two week cancellation period, while Argos had a 30 day cancellation period.

<sup>58</sup> See Competition Commission report, para. 2.388. The Competition Commission considered that a longer cancellation period would allow consumers more time to consider alternative options.

**Table 5.7: 'How long after you purchased the extended warranty could you have cancelled it and received a full refund, if at all?'**

<b>Response</b>	<b>%</b>
None (can't get refund)	9
Up to a week	10
Up to a month	35
Up to 45 days	3
Up to 2 months	3
Over 2 months	7
Don't know period, but can get refund	13
Don't know if can get a refund	20

Notes: (i) Best answer in most cases is 'Up to 45 days'. (ii) Base = All those answering who purchased an extended warranty. (iii) Sample size = 381.

Source: Marketing Sciences consumer survey Q16.

5.37 Only three per cent of respondents knew they have a right to a minimum cancellation period of 45 days. Around 71 per cent of consumers knew that there was a cancellation period, even if on the whole they did not know the exact length of the period required by the Order. Only nine per cent of respondents thought that it was not possible to cancel a purchased extended warranty and get a refund. Overall this is a positive result.

**Table 5.8: 'If you were to terminate your extended warranty AFTER 45 days has passed but before the contract ends, what proportion of the total amount would you receive as a refund?'**

Response	%
No refund	17
All/Full refund	15
Some of it - in proportion to the time left to run (pro rata)	14
Some of it unspecified, or specified but not in proportion to the time left to run (pro rata)	8
Don't know	46

Notes: (i) Correct answer is 'Some of it – in proportion to the time left to run (pro rata)' (ii) Base = All those answering who purchased an extended warranty. (iii) Sample size = 381.

Source: Marketing Sciences consumer survey Q19.

5.38 The results for awareness of termination rights in the table above are weaker than those for cancellation rights. Almost two-thirds either thought that no refund was possible or didn't know if a refund was available or not.<sup>59</sup> Fourteen per cent of the respondents correctly answered the question. A further 23 per cent were aware that a refund was available although they were not able to identify how much they would receive.

5.39 To summarise the two tables, it appears that most consumers are aware that cancellation rights exist, but are not aware of the exact details. This is a positive result. However, only around one-third of consumers are aware of termination rights suggesting there is room for improvement in this area.

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<sup>59</sup> The lower awareness of termination rights compared to cancellation rights is perhaps not unexpected. Cancellation rights existed before the Order although they were not standardised, however the termination rights are new.

## Consumer shopping behaviour

5.40 In the previous section we analysed whether consumer knowledge had improved as a result of the additional information and rights. If consumers were more knowledgeable we would expect that they would be taking advantage of their rights and changing their shopping behaviour.

### Consumers making use of their new legal rights

5.41 We have looked at whether consumers have taken advantage of cancellation and termination rights.

5.42 We asked extended warranty suppliers whether they had seen an increase in cancellation or termination rates. The findings were mixed. Most retailers had not observed any change, although they noted that cancellation and termination rates were very small so changes might be hard to notice. One retailer reported a decrease of around 16 per cent in the proportion of extended warranties cancelled within 45 days of purchase since the Order was introduced.<sup>60</sup> In contrast, one insurer reported an increase in the proportion of customers that cancelled their policies within 45 days.<sup>61</sup> Given these mixed results, it is not possible to

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<sup>60</sup> The retailer believed that this was due to customers being better informed due to the provisions of the Order.

<sup>61</sup> We note that these figures do not distinguish between consumers who cancelled or terminated their extended warranties only, and those customers who cancelled or terminated their extended warranty due to returning a DEG. Therefore these figures alone do not enable us to identify the extent to which respondents made use of extended warranty cancellation and termination rights having changed their mind on the purchase of an extended warranty. We also do not have 'before' data therefore it is not possible to gauge whether these rates are different from prior to the Order. Termination rights, however, were introduced after the Order and cancellation rights were not widely available, nor consistent, among the different retailers before the Order.

conclude what the overall impact the Order has had on cancellation and termination rights from our stakeholder interviews.

- 5.43 Second, we analysed the relevant findings from the consumer survey. We asked respondents whether they had either cancelled or terminated an extended warranty contract in the last three years. The survey question revealed that, out of the 758 respondents who had purchased an extended warranty in the past 12 months, 98 had cancelled a contract and 108 had terminated a contract in the past three years. These are small but non-trivial proportions. However, we do not have data from before the Order to compare the figures to, so it is unclear what impact the Order has had on cancellation and termination rates.<sup>62</sup>

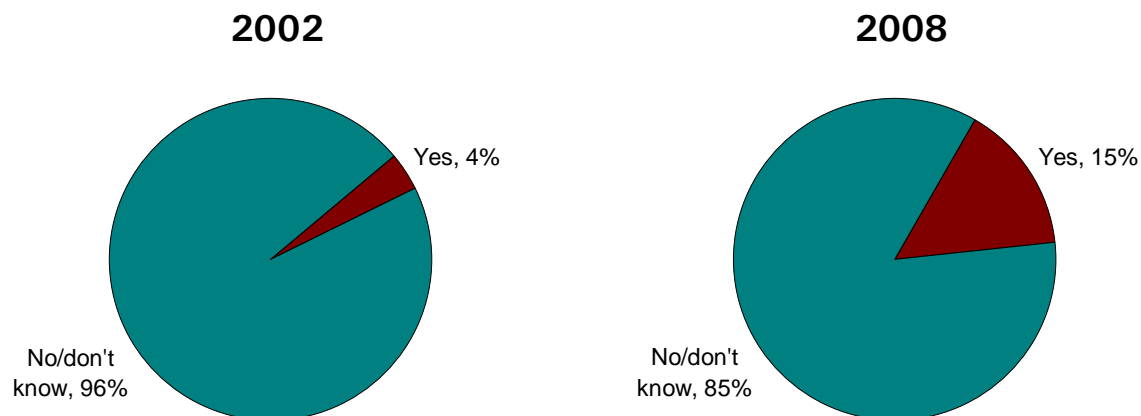
### **Customers who compared offers**

- 5.44 In the consumer survey we asked respondents who purchased extended warranties whether they compared the retailer's offer to those of other extended warranty suppliers. We compared this number to a comparable figure from the Commission's 2002 consumer survey. In the chart below we show the results.

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<sup>62</sup> These cancellation figures will also include where a customer has returned a DEG for which they had purchased an extended warranty.

**Chart 5.9: 'Did you consider alternative extended warranty offers?'**



Notes: (i) Competition Commission consumer survey 2002: "Did you consider getting your extended cover from any other suppliers of extended cover?". Consumer survey 2008: "Did you compare the extended warranty from the retailer of the appliance with those of other suppliers of extended warranties?". (ii) Sample size: 2002 = 353, 2008 = 381. (iii) Change is significant at the 99% confidence level.

Source: Competition Commission consumer survey Q25a, Marketing Sciences consumer survey Q12.

5.45 The chart shows that there has been an increase in shopping around. In 2008, 15 per cent of consumers compared the retailer's extended warranty offer with that of another supplier. Although this figure is small it is still a significant increase from 2002.<sup>63</sup> This is a positive result.

5.46 Stakeholders had mixed views on whether the Order had impacted on consumers' purchasing behaviour. Although the retailers generally agree that the information required by the Order benefited consumers, some retailers were doubtful that consumers actually compared offers. One

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<sup>63</sup> The 2002 survey asked whether respondent 'considered' other extended warranty offers whereas the 2008 survey question asked whether they actually 'compared' alternative extended warranty offers. We consider the 2002 figure is an upper bound for the number of customers that actually 'compared' alternative offers.

insurer, however, told us that the Order had made consumers compare prices between the retailer from whom they purchase the DEG and web or non-point-of-sale offers.

- 5.47 Despite the stakeholders comments the results of the consumer survey seem to confirm that the Order was a key reason for customers shopping around.<sup>64</sup> Of those customers that shopped around the survey found that: 51 per cent were prompted to do so because retailers displayed information on the price and duration; 40 per cent because of the salesperson mentioning other suppliers; and 26 per cent because the leaflet mentioned other suppliers.<sup>65</sup> The overall conclusion is that more consumers are shopping around because of the information provided by the Order.

### **Consumer purchasing behaviour**

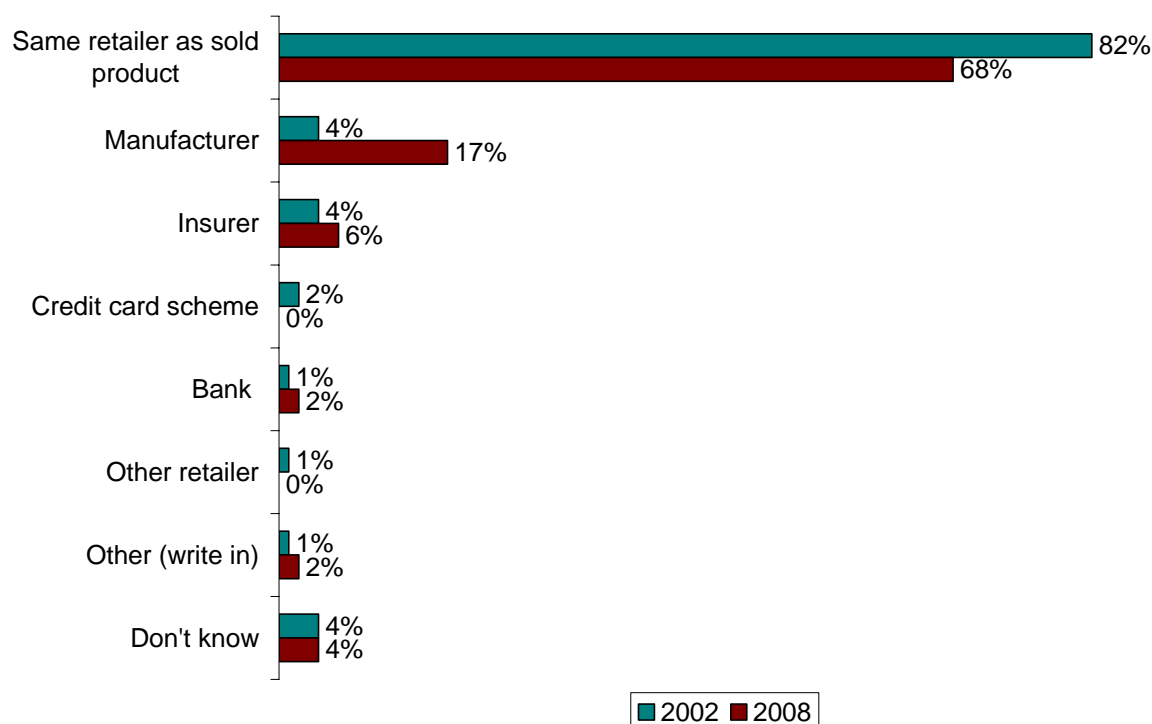
- 5.48 If consumers are now shopping around more, and have a higher awareness of non-point-of-sale alternatives for extended warranties, we might expect to see an increase in purchases of extended warranties from suppliers who are not the retailer of the DEG, and consumers delaying the purchase of the extended warranty until some time after the purchase of the DEG.
- 5.49 In the consumer survey we asked respondents where they bought their extended warranty. We set out the results in the chart below, with a comparison against the same question asked in 2002.

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<sup>64</sup> To reconcile this inconsistency, it may simply be that it is difficult for stakeholders to observe shopping around or the numbers are still too small to notice changes.

<sup>65</sup> See Marketing Sciences consumer survey Q13.

**Chart 5.10: 'Where did you purchase the extended warranty?'**



Notes: (i) 2002 Question "Where did you obtain the 'extended cover' from?". 2008 Question "Where did you obtain your extended warranty from? Was it...?" (ii) Sample size: 2002 = 488, 2008 = 381. (iii) Change in proportion of consumers purchasing from retailers is significant at 99% confidence level.

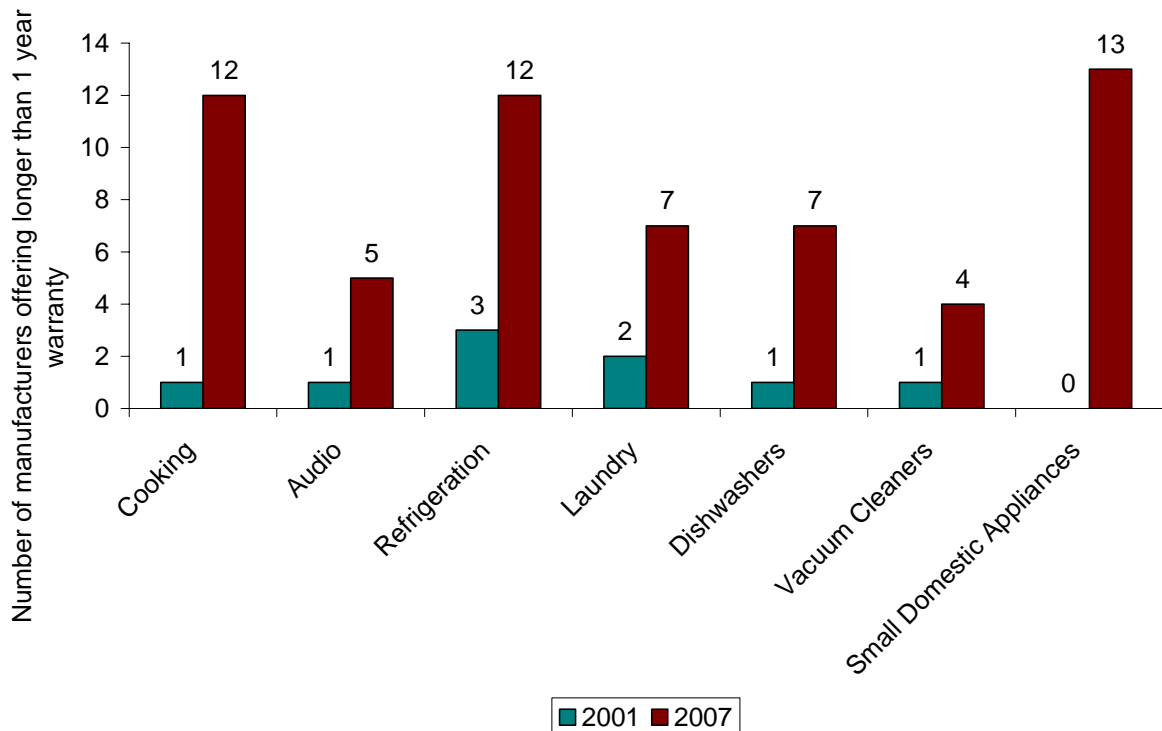
Source: Competition Commission consumer survey Q23, Marketing Sciences consumer survey Q11.

5.50 According to the chart above, the proportion of extended warranties sold by the same retailer as sold the product (the point-of-sale supplier) has fallen by 14 percentage points. In comparison, there has been an increase in the proportion of consumers purchasing from manufacturers, insurers, banks, and 'others'.

5.51 There are several possible explanations for the increase in extended warranties supplied by manufacturers. First, there has been a trend over the past few years by manufacturers – particularly those offering more expensive DEGs – to offer free extended warranties as a promotional tool. One retailer provided data to illustrate the increase in warranties that manufacturers offer. In the chart below we show the number of

manufacturers carried by this retailer which offered warranties of longer than one year in 2001 compared to 2007.

**Chart 5.11: Number of manufacturers offering warranties longer than one year**



Source: Data provided by a retailer

5.52 The chart shows a strong increase in the number of manufacturers offering extended warranties on their products.

5.53 The manufacturers that we have spoken to told us that the increase in warranty periods is not due to the Order, but rather a reaction to competitive pressures in the DEG market. Manufacturers believe a free extended warranty provides a way to differentiate their product by providing customers with a guarantee of quality.<sup>66</sup> A consequence of this

<sup>66</sup> These extended warranties are advertised on the DEG or in promotional material as a means to compete against rival DEG suppliers. Therefore customers will be aware of the free extended warranty before being offered a paid-for extended warranty.

strategy is that customers have less need to purchase an extended warranty from the retailer. Therefore this will naturally increase the extended warranty penetration rates of the manufacturer at the expense of the retailer.

- 5.54 The second reason manufacturers' penetrations rates have risen may be related to the Order. Aside from standard guarantees and promotional extended warranties, manufacturers offer extended warranties through leaflets placed in the DEG's box. When a customer purchases a DEG there is a product registration card in the box. Upon receipt of the registration card, the manufacturer (or insurer that it partners with) can use the customer's contact details to send an offer of an extended warranty to the consumer.
- 5.55 Under the Order there is now a minimum cancellation period of 45 days, which is enough time for manufacturers to contact consumers with a rival extended warranty offer. This is likely to have improved manufacturers' and insurers' ability to offer alternative products, and therefore may account for at least part of the manufacturers' increase in market share.

### **External factors impacting on consumer awareness and behaviour**

- 5.56 The Investigations are likely to have raised awareness, through media coverage and information campaigns.<sup>67</sup> The media coverage surrounding the Investigations and when the Order was implemented, is likely to have alerted consumers to concerns over the value of these products and made them aware that alternatives to the point-of-sale suppliers are available. In addition, the OFT implemented a campaign to improve consumer knowledge regarding extended warranties. The OFT released its own information leaflets (*Extended warranties – Do you need one*)

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<sup>67</sup> The Competition Commission consumer survey in November 2002 found that 23 per cent of respondents had seen publicity about extended warranties. Of those, 59 per cent found the publicity as negative towards extended warranties, 31 per cent neutral and 9 per cent positive. See Competition Commission consumer survey, Q64 and Q65.

during 2002, which identified factors that consumers should consider before purchasing an extended warranty.<sup>68</sup> Consumer organisations may also have distributed information about extended warranties during the period.

- 5.57 The increase in the use of the internet may have also impacted consumer awareness and shopping behaviour. We identify in Section 3 that the use of internet shopping has steadily increased in recent years, particularly for DEGs. A customer that uses the internet is likely to have access to a wider range of information at the point-of-sale to make their extended warranty purchase decision. They can more easily compare prices, check reviews, and perhaps even find data on DEG reliability. Furthermore, the customer is not exposed to the risk of pressure selling which may occur in the store. Therefore they may be less likely to make poor purchasing decisions.
- 5.58 The data shows that the extended warranty penetration rate for DEGs purchased on the internet (11 per cent) is much lower than the penetration rate in-store (18 per cent).<sup>69</sup> In this regard, evidence from the consumer survey suggests that around half of customers that purchased an extended warranty away from the retailer did so over the internet.<sup>70</sup>

## **Conclusion on the impact of the Order on the market: information, rights and consumer awareness**

- 5.59 In this section we analysed whether the Order had impacted on the availability of information, whether that had led to greater consumer

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<sup>68</sup> *Extended warranties - Do you need one*, OFT399, October 2002. The OFT accompanied this with a press release (see "OFT advises shoppers to think before taking out extended warranties", October 2002, at [www.offt.gov.uk/news/press/2002/pn\\_68-02](http://www.offt.gov.uk/news/press/2002/pn_68-02) ).

<sup>69</sup> See Marketing Sciences consumer survey Q3.

<sup>70</sup> See Marketing Sciences consumer survey Q10.

awareness, and whether that in turn had led to a change in consumer shopping patterns. We make the following observations:

- There has been an increase in the information available, although there is scope for improvement. There is better information included in leaflets although it is unclear if more leaflets are available. Many DEGs now have information about the price, duration and optional nature of extended warranties displayed next to them. There is evidence that some sales assistants are providing incorrect information concerning the consumer rights given by the Order (as many as one-third in the mystery shopper exercise).
- The Order has introduced new rights and in general consumers seem to be aware of them. A high proportion of customers recall seeing the price information and the leaflet and are aware of cancellation rights (even if they are not aware of the precise details). However, there is lower awareness of termination rights.
- There has been a change in behaviour by some consumers. There has been an increase in the proportion of consumers shopping around for alternative extended warranty offers, and an increase in customers switching to non-point-of-sale suppliers. Some consumers are making use of their cancellation and termination rights.

5.60 These findings suggest that there has been an increase in the information available to consumers. Consumers generally seem to be aware of the new provisions of the Order. There have also been positive developments in the way consumers shop for extended warranties. Together, this may have reduced the point-of-sale advantage that retailers' enjoyed to some extent.

5.61 These changes are likely to be in part due to the Order, the media coverage of the Investigations and increased use of the internet. The Order's requirements to provide leaflets and price and duration information next to the DEG appear to have been helpful for consumers,

as have the improved cancellation and termination rights.<sup>71</sup> There are mixed views about the usefulness of the written quotations.

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<sup>71</sup> The evidence from the consumer survey suggests that over three-quarters of respondents that were prompted to compare the extended warranty offered by the retailer against the extended warranty from other suppliers did so for a reason likely to be associated with the Order. See Marketing Sciences consumer survey Q13.

## 6 THE IMPACT OF THE ORDER ON MARKET OUTCOMES: PRICES AND NON PRICE COMPETITION

- 6.1 In the previous section we analysed whether the Order has increased the supply of information available to consumers and led to any changes in their awareness and behaviour. The key results were that there was an increase in the information available, and that more consumers were now shopping around and purchasing their extended warranties away from the point-of-sale.
- 6.2 Although we found that the proportion of consumers who changed behaviour was small, this may have been sufficient to alter the behaviour of suppliers. The threat that a small number of consumers may shop around and switch suppliers can be sufficient to provide a competitive constraint.<sup>72</sup> In this section we analyse whether this is the case. We consider the impact of the Order on:
- prices
  - innovation and quality of service
  - entry.

### Impact on prices

- 6.3 Typically, retailers set extended warranty prices according to DEG price bands. For example, a retailer might offer an extended warranty at £100 for any television priced between £200 and £300, and an extended warranty at £150 for any television priced between £300 and £450, and so on. The price of the extended warranty is higher for higher-priced DEGs.

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<sup>72</sup> The loss of a few customers can be significant depending on the size of the margin of those sales. When the profit margin for each customer is high, the loss of a small proportion of customers can quickly affect a firm's profits. See Padilla, A.J. and R. O'Donoghue. 2006. *The law and economics of Article 82*. Hart Publishing, p.79.

- 6.4 In a competitive market, prices should reflect cost. However, the Competition Commission found evidence that extended warranty prices were set at what the market would bear.<sup>73</sup> Therefore if the Investigations and the Order had had the effect of increasing competition, we would expect to see the price of extended warranties fall relative to the price of the DEG to be more in line with costs. In the example of extended warranties for televisions we gave above, the extended warranty would fall below £100 or, equivalently, the price band that the extended warranty applied to would increase above £200-300.
- 6.5 We examine how prices changed over the period from 2000 to 2008 and attempted to identify the impact that the Investigations and the Order have had on prices. However we must be aware that other factors might have also impacted prices, therefore changes in prices cannot necessarily be fully attributed to the Investigations and the Order.
- 6.6 We describe in Annexe D in more detail the exogenous factors that might have affected prices during this period. A significant development in the market is the fall in prices of DEGs. This change in DEG prices is likely to have placed downward pressure on extended warranty prices, for two reasons. First, extended warranty prices are usually linked to the price band of the DEG. If the DEG price falls to a lower band this will reduce the price of the DEG. Second, as DEGs become less expensive consumers are more likely to be able to afford to replace the DEG if it breaks down. Consumers may therefore be more willing to accept this risk, which will reduce the demand for extended warranties which will put downward pressure on their prices. When analysing changes in extended warranty prices we need to consider whether any observed changes were caused by the Order or were caused by other factors, such as the fall in DEG prices.
- 6.7 During the same period there has been an increase in the costs of supplying extended warranties (including the cost of employing engineers and transporting them to households), which would have put

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<sup>73</sup> See Competition Commission report, para. 13.33.

upward pressure on prices. However, one retailer reported that the reliability of some DEGs has improved. This would lower the expected cost of meeting customers' claims.

6.8 Analysing all the extended warranty prices and controlling for these exogenous factors would be a complex exercise and is beyond the scope of this evaluation. We have however sought to conduct an analysis of price changes which is representative of the market and as robust as possible. To achieve this we have taken the following approach.

6.9 First, we have analysed prices in two different ways. We have:

- compared extended warranty prices in 2003 with prices in 2008 for selected DEGs provided by selected retailers, and
- looked at how the prices of extended warranties changed in each year between 2003 and 2008 for two retailers who provided price data for selected DEGs.

6.10 Second, we have sought the views of stakeholders on whether the Order has had an impact on prices and competition. These comments provide a qualitative view of the impact of the Order on prices. We compare these comments with the results of our price analysis.

## **Price comparison**

### **Price comparison between 2003 and 2008**

6.11 We compared the prices of extended warranties for certain DEGs in 2003 with prices in 2008. The comparison looked at the price of an extended warranty for a DEG of a given price. It therefore excludes the direct effect of falling DEG prices. The aim of this comparison is to look at the net change in prices between, roughly, when the Investigations started and today when we might expect the impact of the Order to have started to feed through to retailers' prices.

- 6.12 We collected publicly available price data for 2003 and 2008 for televisions, washing machines and fridge freezers.<sup>74</sup> The full set of price data that we collected is shown in Annexe E.<sup>75</sup> We collected data for seven major retailers of DEGs. According to the consumer surveys, in 2003 these seven retailers accounted for around 50 per cent of goods over £50 bought in-store, while in 2008 they accounted for around 45 per cent of all DEGs bought.<sup>76</sup>
- 6.13 We summarise the results of the net change in prices analysis in the table below. For the purposes of this summary we have used the Competition Commission's categorisation of 'large' and 'medium' retailers.<sup>77</sup> In the table 'Large retailers' include Currys, Comet and Argos who, according to our consumer survey, together accounted for around 36 per cent of the DEG market.<sup>78</sup> 'Medium retailers' include MFI, Bennetts, Miller Bros, and John Lewis who, according to our consumer survey, together accounted for around three per cent of the DEG market.

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<sup>74</sup> 2003 prices are from the Competition Commission report, Appendix 11.2. 2008 prices are from our own research.

<sup>75</sup> For the 2003 prices we have used figures from the Competition Commission report, Appendix 11.2. For the 2008 figures we have mainly used current price lists taken from stores and websites. The DEGs and retailers chosen for the analysis were selected based on a) their relative importance in the market (in terms of market share) and b) availability of data. A fuller explanation of the methodology is in Annexe E.

<sup>76</sup> See Competition Commission consumer survey Q4, Marketing Sciences consumer survey Q4.

<sup>77</sup> See Competition Commission report, p.37.

<sup>78</sup> See Marketing Sciences consumer survey Q4. Currys is part of DSG group that also includes Dixons, PC World, The Link. The 36% figure quoted above includes only the market share of Currys (and not DSG's other stores) since the prices we analysed were for Currys stores only.

**Table 6.1: Summary of net extended warranty price changes between 2003 and 2008**

	Televisions	Washing machines	Fridge freezers
Large retailers	Mostly decreases	Mixed	Mostly decreases
Medium retailers	Mostly increases	Mixed	Mostly increases

Notes: (i) 'Large retailers' include Currys, Comet, Argos, while 'medium retailers' include MFI, Miller Bros, Bennetts, John Lewis.

6.14 The table shows that between 2003 and 2008 the large retailers have mostly decreased their prices of extended warranties for televisions and fridge freezers. For washing machines there have been both increases and decreases. In addition, the prices of extended warranties for some DEGs (televisions and fridge freezers) provided by medium retailers have increased between 2003 and 2008. We provide our detailed analysis in Annexe E.

#### Year-on-year price comparison 2003-2008

6.15 The comparison of prices between 2003 and 2008 provides a useful indication of how prices have moved in aggregate between those years. However to help us identify trends that have occurred between those years we requested period-on-period price data from suppliers of extended warranties. Two retailers provided this price data.

6.16 In the charts included in Annexe E we set out the nominal non-weighted period-on-period price changes for two high-street retailers. This comparison provides evidence on the movement of prices during the Investigations, and after the implementation of the Order, that is not evident from the data we presented in the previous subsection.

6.17 The findings on period-on-period changes of the prices of extended warranties are mixed over time and across the two retailers. In summary

- The prices of extended warranties offered by Retailer A have a common feature. Specifically, although there were price decreases for some extended warranties, they all preceded the Order. The price decreases instead occurred during the Competition Commission's investigation.
- The prices of extended warranties offered by Retailer B initially changed significantly: some prices decreased and others increased. The prices then remained unchanged until after the implementation of the Order. Overall prices have decreased or are the same compared to August 2001.

### Views of stakeholders on prices

6.18 In the previous sub-sections we have presented our findings on what the price data tells us about the impact of the Investigations and the Order. We recognise there are some limitations to looking at prices because it is difficult to disentangle the impact of the Order and the impact of exogenous factors. We have therefore sought qualitative information from the stakeholders about changes in prices. The views of the stakeholders are set out below.

6.19 Stakeholders suggested that a number of potential factors impacted on prices of extended warranties in the period after the Order. These factors include (i) the requirement of the Order to display prices; (ii) competition from the internet and supermarkets; and (iii) price trends for the underlying DEG.

6.20 Stakeholders' views on the impact of the Investigations and the Order on prices are mixed. Some stakeholders told us that the Order has led to a decrease in prices by increasing transparency and by enabling consumers to more easily compare rival offers. Others told us that they do not believe that the Order had had a significant impact either on competition or on the point-of-sale advantage enjoyed by retailers.

- 6.21 Almost all retailers interviewed suggested that the increasing competition from internet and supermarkets in the provision of DEGs had led to a decrease in the prices of DEGs.<sup>79</sup> As mentioned earlier, prices of extended warranties are linked to the prices of the underlying DEGs. Stakeholders believed that decreasing prices of particular DEGs had impacted on the prices of extended warranties. This would not, however, significantly affect the prices of warranties relative to DEGs.
- 6.22 Last, retailers told us that they have not increased the prices of extended warranties, despite repair costs rising. This would suggest a fall in extended warranties prices in real terms.
- 6.23 In summary, the stakeholders' comments seem to agree that extended warranty prices relative to the price of the DEG have either decreased or at least not increased (which is likely to be a fall in real terms). The suppliers expressed mixed views as to whether the Order had had a major impact on the market. The stakeholders believed that the decreases in price were most likely associated with an increase in competition in the supply of DEGs<sup>80</sup> but that some changes might be attributable to the provisions of the Order.

### **Conclusion on prices**

- 6.24 In summary, we found the following:
- The net changes in the prices of extended warranties for selected individual DEGs and suppliers between 2003 and 2008 are mixed. However, importantly, most of the extended warranty prices of the largest suppliers have decreased.

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<sup>79</sup> Specifically, the outcome of the entry of these suppliers is to affect the prices of particular DEGs exposed to the increased competition. As result of this increased competition DEGs positioned in particular price bands before the increased competition are now in lower price bands.

<sup>80</sup> We describe in Annexe D the links between competition for the supply of DEGs and extended warranty prices.

- The extended warranty prices that we tracked for two particular retailers are mostly lower today than in 2002 and 2001, although some prices increased (mainly for retailer A).
- The comments of the stakeholders were that extended warranty prices relative to the DEG price had either decreased or, at least, not increased.

6.25 The evidence on prices is mixed. When we compared extended warranty prices for a DEG of a given value, we found that overall prices appear to have either decreased or been stable, which is likely to be a fall in real terms. To the extent that they may have decreased, it is not clear to what extent that decrease might be due to the Order or due to other factors, such as increased competition from supermarkets and internet retailers in the supply of DEGs.

6.26 Although we do not have clear evidence of a decrease in extended warranty prices this may be because the full effects of the Order and Investigations are yet to materialise. Those consumers who have switched to non-point-of-sale suppliers are also likely to have benefited from lower prices, as we explain in Section 8 below.

### **Impact of the Investigations and the Order on non-price competition**

6.27 In the previous section we analysed whether the Investigations and the Order might have had any impact on extended warranty prices. However, price represents just one dimension of competition. Suppliers of extended warranties also compete on dimensions such as service and product innovation.

6.28 In this section we consider what impact the Investigations and the Order have had on non-price competition. We consider:

- whether there has been an increase in innovation or variety of extended warranties, and
- whether there has been an increase in the level of service or quality.

## Impact on innovation or variety

6.29 If the Order has improved competition we might expect to see an increase in the level of innovation or product variety. We note that extended warranties now have more 'features' available because some were made mandatory by the Order. Customers have 30 days to decide whether to accept an extended warranty.<sup>81</sup> They also have a standard 45-day cancellation period for warranties lasting over a year, and the right to terminate such warranties at any time and receive a pro-rata refund. As shown in Annexe F, prior to the Order many suppliers offered cancellation rights for significantly less than 45 days. Most suppliers did not have any official policy on terminating the contract once the cancellation rights had passed. These additional rights are an additional quality dimension to extended warranties, which is directly attributable to the Order.

### Product developments

6.30 The stakeholders that we have spoken to identified the following product developments in recent years:

- the introduction of pay-as-you-go policies
- an increased availability of multi-product policies, and
- an increased availability of free extended warranties.

6.31 We discuss each of these developments in turn, starting with the introduction of pay-as-you-go policies.

6.32 Traditionally, most suppliers have sold extended warranties which the customer paid for with a single up-front payment, typically made when the consumer purchased the DEG. Under pay-as-you-go policies, customers instead make a regular payment to pay for a policy, typically

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<sup>81</sup> For warranties that cost more than £20.

a monthly fee. The policy has no fixed term and the customer can stop paying for the extended warranty at any time. We understand that DSG was the first major extended warranty supplier to offer pay-as-you-go policies, in February 2005. Other suppliers also now provide pay-as-you-go products. For instance, Warranty Direct, D&G, and British Gas offer pay-as-you-go products.

- 6.33 DSG told us that in order to provide its customers with increased flexibility and better value for money, it introduced a pay-as-you-go product. DSG noted it has the effect of mitigating any concerns about locking customers into long-term commitments at the point-of-sale.<sup>82</sup> DSG believed that, together with other market developments, this has contributed to a new competitive dynamic which has overtaken the policy concerns that motivated the implementation of the Order.
- 6.34 Suppliers of extended warranties have advised us that 'multi-product' extended warranties have become more widely available. Most extended warranties cover repairs for a specific DEG.<sup>83</sup> A multi-product extended warranty allows a customer to cover several electrical goods of their own choosing. Although multi-product extended warranties were available prior to the Order, some stakeholders believed these products have become more prevalent.
- 6.35 The views we heard from stakeholders are mixed. One supplier of multi-appliance extended warranties told us that they had observed no increase in sales that could be attributed to the Order. Another stakeholder believes that their growth could indicate that consumers are now separating the purchase of the DEG from that of the extended

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<sup>82</sup> Under the Order a customer can now terminate an extended warranty at any time and get a pro-rata refund. A customer may however find terminating a pay-as-you-go more straightforward since they only need to cancel their payments.

<sup>83</sup> For instance, when a customer purchases a television they might purchase an extended warranty, which applies only to that television.

warranty. It believes that this could in part be due to the provisions of the Order.

- 6.36 Stakeholders have told us that there has been an increase in the availability of free extended warranties. As previously discussed, there has been a trend for manufacturers to provide free extended warranties with DEGs. Some manufacturers are offering free extended warranties that last for as long as ten years.<sup>84</sup>
- 6.37 Stakeholders have told us that these have been introduced as a means by which suppliers differentiate themselves in the market. Manufacturers that we spoke to advised us that the offering of free extended warranties was a dimension of competition in the supply of DEGs.<sup>85</sup> The manufacturers told us they did not introduce the free extended warranties in response to the Order.
- 6.38 To conclude, despite the prevalence of new products in the market, in itself a positive development for consumers, we have found limited evidence that retailers or manufacturers introduced them as a direct result of competitive pressure created by the Investigations and the Order.

### **Impact on quality of service**

- 6.39 If the Order had improved competition we might expect to see an increase in the quality of service provided to consumers making a claim on their policies.
- 6.40 We asked the stakeholders we spoke to whether they believed that quality had improved and if so whether this was a result of the Order.

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<sup>84</sup> In addition to manufacturers, stakeholders have told us that retailers are also offering more free extended warranties.

<sup>85</sup> Manufacturers introduced free extended warranties to provide a guarantee of quality compared to cheaper DEGs.

We also asked consumers about their own experiences through our consumer survey.

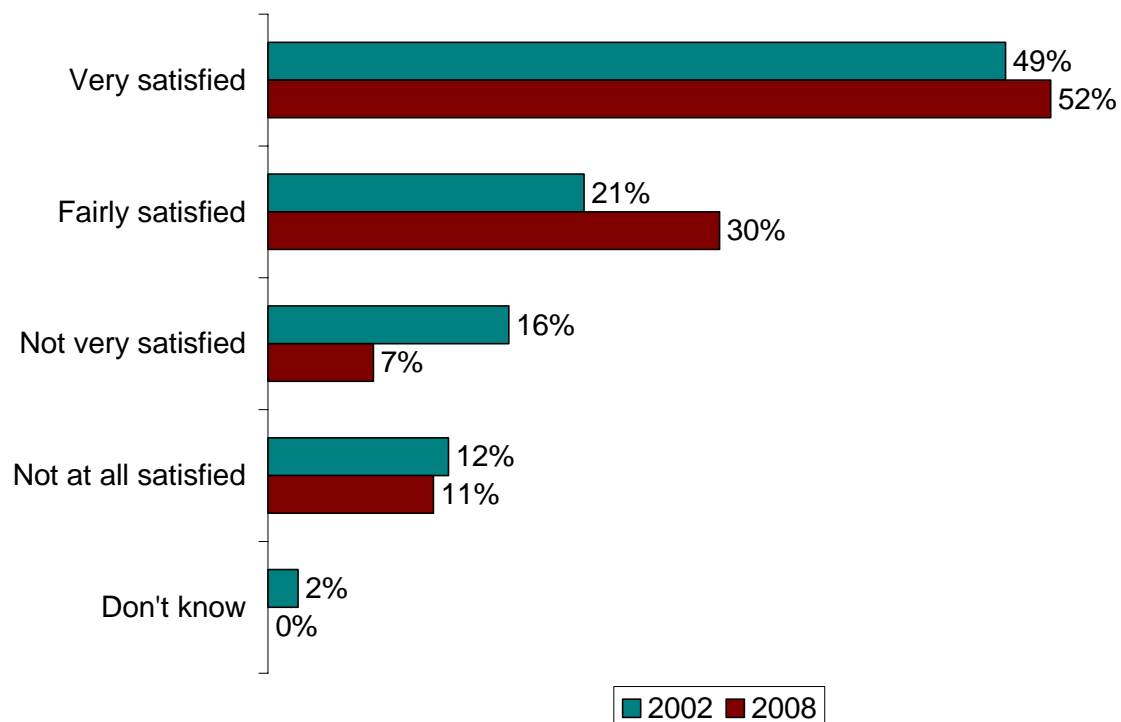
### Views of stakeholders

- 6.41 Stakeholders' views on the impact of the Order on the quality of repair service are mixed. Most stakeholders we spoke to believe that the level of service offered with extended warranties has not changed much and the demand for quicker service is not related to the Order. However, some stakeholders note that consumers are better informed and their expectations have changed.

### Consumers' experience

- 6.42 We used the consumer survey to test whether there had been any improvement in the level of consumer satisfaction. We asked respondents how satisfied they were with the speed of the service and the repairs themselves. We set out the results of the survey, with a comparison to the equivalent question in 2002, in the charts below.

**Chart 6.2: 'How satisfied were you with the speed of the repairs?'**



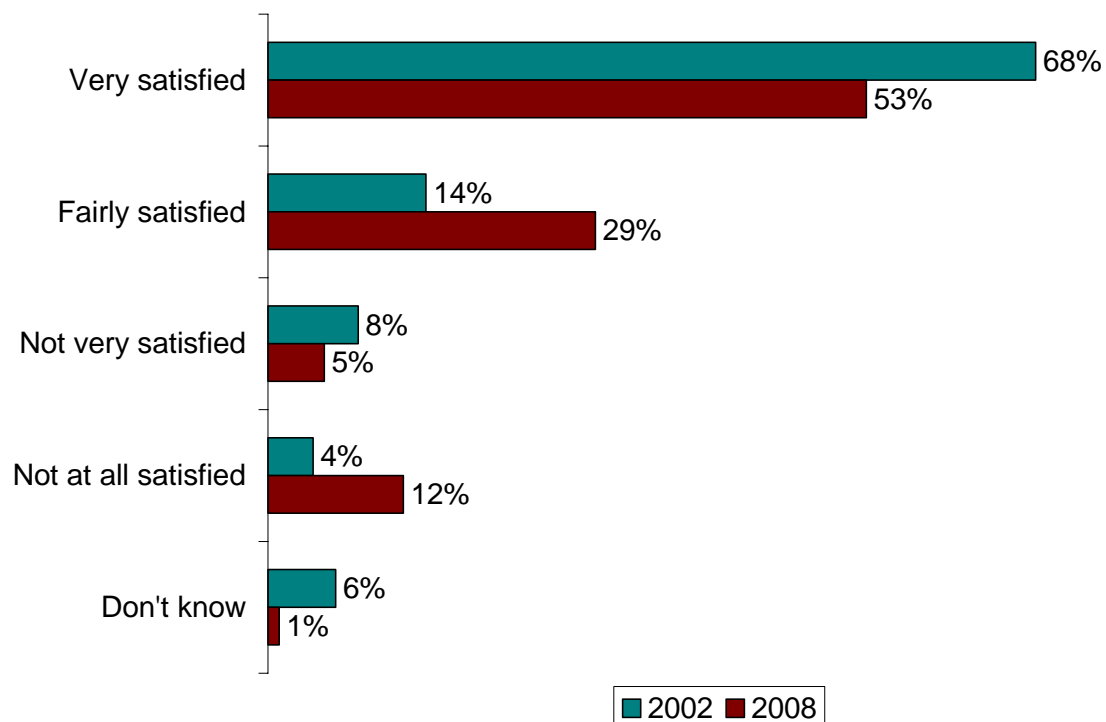
Notes: (i) Sample size: 2002 = 486, 2008 = 169.

Source: OFT consumer survey Q28, Marketing Sciences consumer survey Q22

6.43 The chart shows that the proportions of respondents who were 'Very satisfied' and 'Fairly satisfied' both increased, while the proportion of respondents who were either 'Not very satisfied' or 'Not at all satisfied' decreased. The proportion of respondents that were satisfied with the speed of repair (that is, either 'Very satisfied' or 'Fairly satisfied') increased by 12 percentage points. These findings suggest that there has been an overall increase in the level of satisfaction and a decrease in the level of dissatisfaction with the speed of repairs.

6.44 We also used the consumer survey to test whether consumers were satisfied with the repairs themselves. We show the findings in the next chart.

**Chart 6.3: 'How satisfied were you with the repairs themselves?'**



Notes: (i) Sample size: 2002 = 424, 2008 = 169.

Source: OFT consumer survey Q29, Marketing Sciences consumer survey Q23

6.45 The chart shows there was a decrease in the proportion of respondents who were 'Very satisfied' with the repairs by 15 percentage points, while there was an increase of the same amount for those respondents who were 'Fairly satisfied'. The proportion of respondents who were 'Not at all satisfied' increased by eight percentage points.

### **Conclusion on impact on non-price competition**

6.46 To conclude, the evidence suggests that there has been some innovation in the extended warranty market. However, that innovation does not appear to be due to the Order (although some stakeholders thought multiproduct warranties had become more prevalent because of the Order). The evidence is not clear on whether quality of service has changed.

## **Impact of the Investigations and the Order on entry**

- 6.47 If consumers were shopping around more for extended warranties, one might expect that this would create opportunities for new entrants to the market and expansion of non-point-of-sale suppliers. Although there is some evidence of entry and expansion, the degree to which this can be attributed to the Order is not clear.
- 6.48 A new entrant to the extended warranty market is supermarkets. But although supermarkets have entered the market since the Competition Commission's investigation, we have been advised that this entry is not related to the Order. Supermarkets have started offering extended warranties to complement their expansion into supplying DEGs.
- 6.49 As we discussed above there has been an increase in the share of supply accounted for by non-point-of-sale suppliers. Both insurers and (in particular) manufacturers have grown their share significantly. Stakeholders that we spoke to believe that this is in part due to the increased cancellation period of 45 days. A longer cancellation period increases the opportunity to make offers to consumers before the cancellation periods ends. A second reason that manufacturers have increased their share is due to the increased use of free promotional extended warranties.

## **Conclusion on the impact of the Order on market outcomes: prices and non price competition**

- 6.50 In this section we have analysed whether the increase in information and the change in consumer shopping patterns has impacted on the degree of competition in the market. Our conclusions are as follows:
- Prices appear to be stable or have decreased, which is likely to be a fall in real terms. To the extent that prices may have decreased it is not clear whether that would have been caused by the Order or by other factors.

- Quality of service appears to be stable or has improved, although again the evidence is not clear.
- There have been new entrants to the extended warranty market (supermarkets) but the evidence suggests this is not due to the Order. Non-point-of-sale suppliers now account for a greater share of supply, which appear to be at least partly a result of the Order.
- There has been some innovation in extended warranties, but that innovation does not appear to be due to the Order (although some stakeholders thought multiproduct warranties had become more prevalent because of the Order).

6.51 Although we did not identify a clear improvement in competition due to the Order we do not believe this is evidence of 'no effect'. In particular, consumer shopping habits take time to change and it is possible that the impact of the Order has not yet fully materialised.

## 7 IMPACT OF THE ORDER ON REGULATORY BURDEN

7.1 In previous sections we have considered whether the Order has benefited consumers, by enabling them to make better informed choices and/or by driving down prices, or putting pressure on providers to innovate and raise service levels. However the Order has also created costs for suppliers. To assess the effectiveness of the Order we need to take account of these costs.

7.2 We describe below how the Order has affected suppliers' costs. We distinguish between:

- the 'one-off' costs incurred when the Order was implemented, and
- the 'on-going' costs incurred in subsequent years.

7.3 Stakeholders commented on the various compliance and implementation costs created by the Order. Although we asked suppliers to quantify the impact on their costs virtually none of the suppliers were able to provide us with this information. The exception was one supplier who provided an estimate of the one-off costs.

7.4 We note that the DTI Regulatory Impact Assessment did not anticipate that the costs of complying with the Order would be high for businesses. The main cost it estimated was the cost of changing in-store advertisements and literature to ensure extended warranty prices were displayed. It estimated that this one-off cost would not be more than £1.5 million for the whole extended warranties sector.<sup>86</sup>

### One-off costs

7.5 Retailers told us that the Order meant they had to redevelop their IT systems. The retailers' computer systems had to change to cope with

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<sup>86</sup> See DTI. 2005. "The supply of extended warranties on domestic electrical goods Order 2005: Regulatory Impact Assessment".

providing a pro-rata refund, written quotations, and they also had to redesign their websites to ensure they displayed the required information.

- 7.6 Retailers also told us that they had to develop new training programmes that incorporated the provisions of the Order, monitoring systems to ensure sales staff complied with the Order and new sales processes. Other costs that retailers identified include redesigning their ticket templates, amending information leaflets and amending other product literature.
- 7.7 Although no data were given on these costs it seems unlikely that they would be significant.<sup>87</sup> However, retailers told us that, taken together, these one-off costs imposed a material burden. Only one retailer provided an estimate of the one-off costs it incurred to comply with the Order. If we divide the cost by its approximate market share in 2005, an estimate for one-off costs for the total market would be £4.9 million.<sup>88</sup> We note that £4.9 million equates to only 0.7 per cent of retailers' extended warranty turnover in 2005.<sup>89</sup>

### **On-going costs**

- 7.8 The DTI Regulatory Impact Assessment did not anticipate the Order would create significant on-going costs since they would be incremental to processes that retailers already carried out. In general, the retailers' comments were consistent with this view.

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<sup>87</sup> In the case of the leaflets, the retailers update these regularly to take account of changes in prices and for other reasons, so the changes due to the Order could be incorporated into that process.

<sup>88</sup> This estimate is based on the assumption that the costs incurred across the market are similar to the costs incurred by one retailer. In reality, costs may differ between retailers.

<sup>89</sup> 0.7% = £4.9 million / £671 million. See Mintel. 2006. *Extended Warranties, Financial Intelligence*, November 2006, p. 21.

- 7.9 Retailers told us that they incur on-going costs, including (i) compliance costs, (ii) re-ticketing costs, (iii) restocking leaflets and monitoring compliance.<sup>90</sup>
- 7.10 Although retailers told us that they had to introduce compliance training, most retailers already had some form of staff training that they were able to incorporate this into. Some retailers also claim to have introduced their own monitoring systems to ensure compliance.
- 7.11 In most cases the price of the extended warranty will change with the price of the DEG, so there will be no additional re-ticketing costs. It is only in those cases where the extended warranty has changed relative to the DEG price that the retailer will face an additional re-ticketing cost. We understand that this will be rare, since retailers change the price of their extended warranties only once or twice per year.
- 7.12 The requirement to provide a leaflet is unlikely to impose significant costs on retailers. Prior to the Order most extended warranty suppliers already provided customers with a leaflet and our evidence in fact suggests there has not been an increase in the availability of leaflets.
- 7.13 We have not been provided with any data from retailers with which we could estimate on-going costs, therefore we do not provide an estimate. However, the retailers' comments suggest that on-going costs are not significant.

## **Summary**

- 7.14 Some retailers claimed that the Order imposed material one-off costs. Before the Order most retailers did not list the information about the

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<sup>90</sup> Retailers also noted that there were other on-going costs that the Order imposed, but were difficult to quantify. For instance, one retailer's main concern was that listing the extended warranty information next to the price of the DEG made the advertisements look cluttered and took away space that it might have used to offer another product. Although it believed the information was useful for extended warranty customers, it was demanding on retailers to provide the information.

extended warranty next to the price of the DEG, or have the facilities to provide written quotations or pro-rata refunds. Therefore most retailers incurred costs in meeting those requirements. However, the information provided by the only retailer who quantified these costs does not suggest they were large relative to retailers' extended warranty turnover.

- 7.15 Although the Order has imposed on-going costs such as staff compliance training costs, most retailers did not believe that these added a significant burden. Retailers incorporated compliance training for the Order within their existing training programmes. However, some on-going costs are difficult to quantify due to their intangible nature.

## 8 CONSUMER BENEFIT AND DETRIMENT

- 8.1 The OFT has a target that its work should generate benefits to consumers which are five times greater than the OFT's costs.<sup>91</sup> To assist the OFT in assessing the benefits of its actions we have estimated the net benefits of the OFT and Competition Commission's work in the extended warranties market. This provides a measure of the benefits to consumers which one can compare to cost of the OFT and Competition Commission investigations. The full analysis and the data that we used is set out in Annexe G. In this section we set out the results of this analysis.
- 8.2 The Competition Commission found that a complex monopoly existed in the supply of extended warranties which operated against the public interest. The Competition Commission's analysis of the retailers' return on capital earned (ROCE) in comparison to their weighted average cost of capital (WACC) found that they could have priced up to a one-third lower. In comparison, the Competition Commission found that insurers did not earn a ROCE in excess of WACC. Therefore our starting assumption was that those customers who purchased from retailers faced monopoly prices while those that purchased away from the point-of-sale enjoyed competitive prices.
- 8.3 Based on these assumptions, we estimate the total consumer detriment in the base year (2002) incurred by those consumers who purchased extended warranties at the point-of-sale at monopoly prices. As described in Section 5 above, we found that the proportion of extended warranty consumers who purchased at the point-of-sale fell from 82 per cent to 68 per cent. We estimated the reduction in consumer detriment as the reduction in prices paid by the 14 per cent of consumers who switched away from point-of-sale suppliers.
- 8.4 However, not all of this benefit is due to the Order – in particular, we estimate that a large proportion of the increase in the share of non-point-

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<sup>91</sup> See OFT (2008) *Approach to calculate direct consumer benefits*, para. 1.2.

of-sale suppliers is accounted for by manufacturers offering free extended warranties. We estimate that around 9 percentage points of the 14 percentage points decrease (i.e. around two-thirds) in the proportion of extended warranties purchased at the point-of-sale is accounted for by free manufacturer extended warranties.

- 8.5 We then further adjust this figure to account for the factors that prompted customers to shop around. We make this adjustment because customers might have shopped around for reasons other than the Order, therefore it would not be appropriate to include all switching as a benefit of the Order. We used the results from the consumer survey question that asked 'What prompted you to compare products?' to make this adjustment.<sup>92</sup>
- 8.6 Using this approach we estimated that the benefit to these consumers resulting from the Order and the Investigations was £18.6 million per year.
- 8.7 Having estimated the benefit from the Order we then estimated the costs that the Order imposed on suppliers. We estimated a one-off cost of complying with the Order of £4.9 million. The Order is also likely to have imposed on-going costs to retailers but, on the basis that these costs are unlikely to be significant and also due to the lack of data, we have assumed that those costs are zero.
- 8.8 Last we calculated the net present value of the benefits of the Order minus the costs it created. We estimated the net present value of the benefits that the Order has created so far (i.e. three years of benefit). We anticipate that there will be further benefits in the future but do not attempt to quantify them. This represents a conservative approach to estimating benefits, since we would in practice expect the benefits to continue for longer than three years.

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<sup>92</sup> The proportion of customers that compare products is 15%.

- 8.9 Using this approach we estimated that the net present value of the benefit of the Order is £51 million (in 2008 prices). This compares to an estimated annual detriment of £366 million and the OFT's and Competition Commission's combined investigation costs of £4.6 million (in 2008 prices).
- 8.10 This is a conservative estimate of the benefit of the Order that is likely to underestimate the actual impact, but it is sensitive to a number of assumptions. We have therefore performed a sensitivity analysis on the results. The full sensitivity analysis is in Annexe G. For example, the model is very sensitive to the price of non-point-of-sale suppliers. If non-point-of-sale suppliers price above competitive levels, the benefit falls quickly. However the net benefit is positive over a plausible range. Alternatively, a small improvement in the point-of-sale suppliers' offer increases the size of the benefit significantly. The results are not significantly affected when we include any plausible estimate of ongoing compliance costs.

## 9 CONCLUSIONS AND LESSONS LEARNT

### Conclusions

9.1 In this section we set out our conclusions and lessons learnt. This evaluation sets out to identify the impact that the Investigations and the Order have had on the market for extended warranties. In summary we found:

- There is evidence that retailers are providing more and better information about extended warranties, although there is room for improvement. Possibly as a result of this increase in information, consumers have demonstrated some knowledge about extended warranties and there has been a change in consumer shopping patterns. In particular, more consumers are shopping around (although it is still a low number) and purchasing away from the point-of-sale.
- Despite the change in consumer shopping patterns there was no clear evidence that there had been an improvement in the level of competition in the market. The evidence seemed to show that: prices were stable or had decreased which is likely to be a fall in real terms; service was stable or had increased; there are new entrants and expansion by non-point-of-sale suppliers. The evidence was not clear however, and furthermore it is unclear how much one can attribute any changes to the Order or other exogenous factors.<sup>93</sup>
- It is clear however that the Order has contributed to a small increase in the proportion of extended warranties purchased away from the point-of-sale. We estimated that this has created a net benefit of £51 million so far.

9.2 We set out our conclusions in more detail below

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<sup>93</sup> We discuss some exogenous factors that might have impacted on extended warranty prices in Annexe D.

## **Implementation of the Order**

- 9.3 A primary intention of the Order was to increase the information available to consumers and it has partly achieved that goal. Suppliers are now providing more information although there is room for improvement.
- 9.4 As a direct result of the Order, leaflets provided by extended warranty suppliers now contain more relevant information. However, we found that five out of the 13 leaflets we reviewed had one or more pieces of required information missing and we did not find evidence that leaflets were more widely available compared to 2002.
- 9.5 Our mystery shopper exercise found that retailers displayed extended warranty price and duration information on some or all of DEGs in over one-half of all DEG areas that we surveyed. Although this is an improvement on the situation prior to the Order, there were many DEGs that had no information listed next to them which indicate that some retailers are not complying with the Order.
- 9.6 In most cases, shop assistants gave correct information about extended warranties to our mystery shoppers although in as many as one-third of cases they did not.

## **Impact on consumer behaviour**

### **Consumer awareness**

- 9.7 As a result of the increase in information we might expect consumers to show awareness of their rights. The evidence showed some indications that consumer awareness had improved.
- 9.8 The consumer survey results showed that half of consumers found the new information required by the Order helpful or very helpful.
- 9.9 The consumer survey also found that fewer people (13 percentage points) were under the impression that they had to make an instant decision on whether to purchase an extended warranty.

- 9.10 Around 71 per cent of people were aware that cancellation rights exist but most respondents were unsure of the exact details. However two-thirds of respondents were not aware of termination rights.
- 9.11 It is likely that any increase in consumer awareness is in part due to the Order but also to the media coverage of the Investigations. These are both benefits of the Investigations.

### Consumer shopping behaviour

- 9.12 If consumers are more aware of their options we might expect to observe customers changing their purchasing behaviour. We found that more consumers are now shopping around and purchasing away from the point-of-sale.
- 9.13 There has been an increase in the proportion of extended warranty customers who considered alternative offers (an increase of 11 percentage points) although the overall level is still low at 15 per cent.
- 9.14 The proportion of customers who buy their extended warranties from retailers fell from 82 per cent in 2002 to 68 per cent in 2008. This evidence suggests that the point-of-sale advantage enjoyed by the retailers has declined. The evidence indicates that the Order (in particular the longer cancellation period) provided manufacturers and insurers with a better opportunity to offer extended warranties to consumers. However, we estimate that around two-thirds of the change was due to manufacturers offering free extended warranties rather than as a result of customers changing shopping behaviour for extended warranties.
- 9.15 We have not found evidence that consumers are using written quotations to shop around. This may be in part because retailers have interpreted the Order as requiring them to provide written quotations only once the customer has committed to buying the DEG.

### Impact on the market

- 9.16 If consumers have changed their shopping patterns we might expect to see a more competitive market for extended warranties. We however did

not find clear evidence that prices had decreased, service had improved or entry had occurred due to the Order. Despite the lack of clear evidence it may simply be that the impact of the Order has not yet fully materialised.

## Prices

- 9.17 Prices were very difficult to compare. The evidence seemed to indicate that prices had either remained stable or decreased, which is likely to be a fall in real terms.
- 9.18 Our analysis of the change in extended warranty prices indicates that prices have decreased for the larger retailers between 2002 and 2007, but rose for medium retailers. During this period there have been exogenous factors, such as DEGs price deflation and an increase in disposable income, that have had an impact on the market. Given the scope of the evaluation and the available data it was difficult to distinguish the impact of the Order from other influences and reach a robust conclusion on the impact of the Order on market outcomes.
- 9.19 Stakeholders also told us that the prices of extended warranties have either decreased or remain unchanged. Retailers believe the Order is partially responsible for any change in offerings but identified the increase in competition from supermarkets and internet suppliers as the primary reason.

## Innovation, variety and quality of service

- 9.20 The evidence from the consumer survey on changes in the quality of service is mixed. Quality of services has either improved or stayed the same. Again, any improvements appear to have been driven by exogenous factors such as the increased competition from supermarkets and internet suppliers, as well as the rising expectations of consumers.

## Entry and expansion of competitors

- 9.21 Although there have been new entrants to the market (such as supermarkets) the evidence suggests this resulted from increased competition in the supply of DEGs rather than from the Order. We were told by stakeholders, however, that the increased cancellation period provided non-point-of-sale suppliers a greater opportunity to compete in the market, which might account for some of the increase in the proportion of extended warranties sold away from the point-of-sale. The increase in share of manufacturers is in a large part due to the offer of free-of-charge extended warranties.

### **Impact on costs**

- 9.22 Although the Order has provided benefits to consumers we must also be aware of the costs that it has imposed on suppliers.
- 9.23 One high-street retailer provided an estimate of the one-off costs that the Order had imposed. When this cost is divided by the retailer's market share, we can get an estimate of the total one-off costs for the market of £4.9 million. This one-off cost did not appear significant when compared to the overall turnover of the extended warranty market in 2005 of £671 million. The evidence does not suggest that the Order has imposed significant on-going costs, although some costs are difficult to quantify.
- 9.24 Retailers felt that the requirement to provide a written quotation imposed a burden on retailers without providing a clear benefit to consumers.

### **Impact on consumer detriment**

- 9.25 Our estimate of the consumer benefits arising from the Investigations and the Order is £51 million. Before taking account of the costs that the Order has imposed on retailers, this is equivalent to a benefit of £18.6 million per year. This compares to an estimated annual detriment of £366 million and the OFT's and Competition Commission's combined investigation costs of £4.6 million (in 2008 prices).

9.26 This is a conservative estimate of the benefits of the Order that is likely to underestimate the actual impact, but it is sensitive to a number of assumptions. For example, the model is very sensitive to the price of non-point-of-sale suppliers. If non-point-of-sale suppliers price above competitive levels, the benefit falls quickly. However the net benefit is positive over a plausible range. Alternatively, a small improvement in the point-of-sale suppliers' offer increases the size of the benefit significantly.

## Lessons learnt

- 9.27 We found that the Order and the Investigations have benefited consumers. But the benefits we identify are very small when compared to the consumer detriment identified by the Competition Commission. We have therefore considered what could be done, or could have been done, to increase this benefit.
- 9.28 Our suggestions are based on our evaluation of the impact of the investigation and the Order. We believe though that the following points apply to remedies that involve other complex products. Based on the findings of this evaluation, our suggestions distinguish between three points in time: 'before', 'at' and 'after' the point-of-sale.
- 9.29 First, we believe that correcting an informational market failure involving complex products such as extended warranty contracts requires providing guidance to consumers before they reach the point-of-sale. For example, consumers would have to be aware of their preferences or needs and have some way to assess whether the product available at the point-of-sale satisfies their needs.<sup>94</sup> This implies that intervening in a

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<sup>94</sup> There is evidence to suggest that consumer knowledge of extended warranties could improve in some areas. For instance, although most consumers are aware of cancellation rights, two-thirds are not aware that termination rights exist. Furthermore, although more consumers are aware they do not have to make an instant decision on an extended warranty, few consumers are aware they can purchase an extended warranty virtually anytime after the purchase of a DEG. There may be a limit to how much consumer awareness could be increased by requiring suppliers to provide information at the point-of-sale.

market to solve an informational market failure requires measures that go beyond any remedies imposed on market players.

- 9.30 We believe there is scope for increasing the information available to consumers before the point-of-sale. We suggest that the OFT should consider providing guidance to consumers on how to buy complex products such as extended warranties. It seems that this guidance could be easily provided on the Consumer Direct website, for example.
- 9.31 Second, remedies on the amount and quality of information aim to help consumers by requiring suppliers to provide them with access to the relevant information at the point-of-sale. In practice this information might not always be made available or might be of poor quality.<sup>95</sup>
- 9.32 We believe the OFT should continue to monitor the extended warranty market to ensure retailers comply with the Order. The OFT should consider how best to monitor the extended warranty market proactively and effectively in the future.
- 9.33 Third, the Order creates the opportunity for consumers to consider, after they have bought an extended warranty at the point-of-sale, whether it is likely to satisfy their needs at a competitive price.
- 9.34 We find that cancellation and termination rights are an effective way to create an opportunity for consumers to 'pull out' from contracts that turn out to have been a poor purchasing decision.
- 9.35 However, the effectiveness of measures such as a 30-day written quotation is not clear. We have not found any evidence that this provision benefits consumers. This may be because its implementation does not reflect the actual sales process, or it may be because it is superfluous given the other provisions of the Order. We suggest that

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<sup>95</sup> There is some evidence to suggest that retailers are not fully complying with the Order. The evidence does not show an increase in the availability of leaflets since the Order, there is a high proportion of DEGs that do not have the price and duration information of an extended warranty listed beside them, and some sales assistants are giving incorrect information.

when the OFT and the Competition Commission next review this market they consider whether the provision should be amended or dropped. This leads to the following more general point.

9.36 We suggest the following steps to ensure that information-based remedies are effective in achieving their goals:

- set out how the information remedies are meant to affect consumer behaviour and/or supplier behaviour
- road testing (where possible) of the remedies to ensure consumers and retailers react to the remedies in the expected manner, and
- setting a benchmark for success against which the performance of the remedies can be measured.

9.37 In regards to setting benchmarks, while we have identified benefits from the Order it is not clear to us whether or not their scale meets the Competition Commission's original expectations for a successful outcome. In particular, in order to properly assess the effectiveness of these types of remedies more information would be needed on the Competition Commission's quantifiable objectives for the remedies and their expected impact on consumer behaviour.