

# Positive Impact 09/10

Consumer benefits from the OFT's work

July 2010

OFT 1251

© **Crown copyright 2010**

This publication (excluding the OFT logo) may be reproduced free of charge in any format or medium provided that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as crown copyright and the title of the publication specified.

# CONTENTS

<b>Chapter/ Annexe</b>	<b>Page</b>
1 Executive summary	4
2 Consumer savings by area	11
Competition enforcement	11
Merger control	13
Market studies, reviews of orders and undertakings, and market investigation references	16
Consumer protection enforcement	19
3 Wider benefits	21
4 Costs	27
5 Conclusions	29

# 1 EXECUTIVE SUMMARY

## Introduction

- 1.1 The OFT has a performance target agreed with HM Treasury (HMT) of delivering direct financial benefits to consumers of at least five times its cost to the taxpayer (referred to as the 5:1 target). This document presents the estimates of impact of OFT's work over the previous three financial years (2007/08 to 2009/10).
- 1.2 We estimate that the OFT has saved consumers at least **£359m** per year on average over the period April 2007 to March 2010. Table 1.1 compares the estimated consumer savings to the average annual OFT spend of £50m<sup>1</sup> over the same period, giving us a benefit to cost ratio of around **7:1**, putting us ahead of the 5:1 target.

**Table 1.1: Estimated consumer savings and OFT costs for 2007-10**

	Estimated average annual consumer savings 2007-10 <sup>2</sup>
Competition enforcement	£84m
Merger control	£125m

---

<sup>1</sup> The cost figure excludes - Consumer Direct that is not included within the 5:1 target, Anti Money Laundering and Consumer Credit Licensing that are self funded activities.

<sup>2</sup> Consumer savings are estimated as an annual average over 2007-10 except for consumer protection enforcement where estimates reported are annual averages over 2008-10 as we only started to estimate impact of this area in Positive Impact 08-09. These estimates are based on conservative assumptions and reflect the direct financial benefits to consumers of OFT work on competition enforcement, merger control, markets work, and consumer protection enforcement. The estimates in Table 1.1 do not include the benefits arising from the deterrent effect of OFT work in the above areas or those arising from (wider) benefits to competition (including increased consumer confidence, innovation or productivity gains). However, a more detailed analysis below allows for consideration of the potential deterrent effect of our work on mergers and competition enforcement.

Market studies, reviews of orders and undertaking, and market investigation references	£107m
Consumer protection enforcement	£42m
<b>Total benefits<sup>3</sup></b>	<b>£359m</b>
<b>Total OFT costs (averaged over 2007-10)</b>	<b>£50m<sup>4</sup></b>
Partial OFT costs (averaged over 2007-10)	£37m <sup>5</sup>
<b>Benefit/ Total OFT costs</b>	<b>7</b>
Benefit / Partial costs	10

## Overview of our methodology

- 1.3 Below we briefly describe our overall approach to impact estimation. For a detailed explanation of our methodologies, please see 'A guide to OFT's Impact Estimation methods' available on the OFT website.<sup>6</sup>

---

<sup>3</sup> All estimates of benefits by area have been rounded to the nearest million so they do not exactly add up to the total benefits figure.

<sup>4</sup> This is total OFT costs (actual spend) minus costs of Consumer Direct, Anti Money Laundering and Consumer Credit Licensing. We use a three year moving average for costs to make it consistent with the way in which we estimate benefits.

<sup>5</sup> This includes direct salary costs of OFT staff contributing to one of the four areas covered in this report for which we estimate impact, other costs such as external expert advice and research costs as well as share of overhead and management costs in proportion to employee headcount. We include all costs to the teams where the work directly and exclusively relates to the four activities. In the case of support teams (such as, for instance, Communications, economists and lawyers) who advise on several OFT work streams, we assign (based on internal analysis) a certain proportion of costs to the four relevant areas. The remaining costs are apportioned on a pro-rata basis, similar to the overhead costs.

- 1.4 The OFT's goal is to 'make markets work well for consumers' and our impact target focuses on the direct financial benefits to consumers. The independent review of our methods carried out by Professor Stephen Davies confirms that this is an appropriate measure as any alternative total welfare standard would require dynamic analysis that would not be feasible – especially within the context of a comprehensive impact estimation programme. Given the challenges associated with the quantification of dynamic impacts and their absence from this analysis, a methodology based on total welfare would be misleading since static total welfare would not provide a fair reflection of the value of our work.<sup>7</sup>
- 1.5 Our consumer savings estimate only includes the direct impact of our work on consumers. Many of the beneficial outcomes of the OFT's work are not quantifiable and are not included in the total benefits shown in Table 1.1 - for example, any psychological detriment averted by our actions, deterrence effect of our competition enforcement work, and impact of increased competition on productivity. In addition, it does not comprise the full extent of the OFT's work.<sup>8</sup> The total estimate of consumer savings is therefore conservative.
- 1.6 Most of the estimated consumer savings in this report are ex-ante as ex post estimates from in depth evaluations are only available for a very small subset of our projects. The ex-ante estimates are based on

---

<sup>6</sup> 'A guide to OFT's impact estimation methods', OFT 1250, July 2010, available on the OFT website [www.of.gov.uk/OFTwork/policy-and-research/evaluation/publications#named3](http://www.of.gov.uk/OFTwork/policy-and-research/evaluation/publications#named3)

<sup>7</sup> See paragraph 6.5, page 37 of 'A Review of OFT's Impact Estimation methods', S. Davies, OFT1164, January 2010, available on the OFT website [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/of1164.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/of1164.pdf)

<sup>8</sup> Activities not included are, for example, support provided to Trading Standards Services across the country, consumer codes, and consumer education campaigns. We continue to work to get a better understanding of our impact in these areas and aim to publish some estimates of the impact of our consumer education campaigns in the future.

the best information available at the time of estimation.<sup>9</sup> Where evidence is weak, the assumptions underlying the estimates are conservative.

- 1.7 The OFT and the Competition Commission (CC) together operate the merger and market investigations regimes and the consumer savings for these areas are jointly considered. We have agreed an 80-20 rule to split impact estimates with the Competition Commission where the majority of impact would go to the 'main actor' body. In the merger regime for example, the OFT would be the 'main' body where undertakings are accepted in lieu of reference, whereas the CC would be the 'main' body if the merger was referred. The CC would be the main body for market investigation references (MIRs) while the OFT would be for market studies (that could get referred to the CC) and reviews of orders and undertakings.<sup>10</sup> The specific percentages applied in the apportionment (80:20) is broadly based on costs incurred by the organisations on the mergers and market investigations.
- 1.8 For discrete, time-limited projects we will first include an estimate of their impact in the annual report for the year in which the project is completed. For market studies, or other work that recommends action by OFT or other agencies, we use ex post estimates from later evaluations when available and if not, rely on ex ante estimates of impact. We will publish ex ante estimates of impact in the annual report for the year that the recommendations are implemented. In the case of ex post estimates from evaluations of market studies, we

---

<sup>9</sup> The estimates are ex-ante to the extent that the full impact of the completed projects is not observable.

<sup>10</sup> For each intervention, the primary agency will estimate its benefits according to the methodology it considers most appropriate - on the grounds of proportionality and given that the primary agency is closest to the intervention, these estimates will be adopted by the other agency.

include those OFT interventions that have had an impact on consumers within the relevant financial period.<sup>11</sup>

- 1.9 We use the Consumer Price Index to take account of inflation. All figures are rounded to the nearest one million pounds. In line with Central Government techniques for discounting future accruals of benefits or costs, we discount future consumer savings by the HMT endorsed Social Time Preference Rate (3.5 per cent).<sup>12</sup>

### **Estimated consumer savings**

- 1.10 We estimate that consumers directly saved £84m per year on average over the period 2007 to 2010 from the OFT's work on enforcement of competition law, that is, investigating cartels and other commercial agreements, and abuses of dominant position in markets.
- 1.11 The total consumer savings from the merger regime is estimated at around £310m per year on average for the period 2007 to 2010. £125m of this may be attributed to the OFT and includes an 80 per cent share of consumer savings from undertakings in lieu<sup>13</sup> (UiLs) and mergers abandoned on referral to the CC (abandoned mergers) and 20 per cent from mergers blocked or amended by the CC following a reference.
- 1.12 We estimate that consumers directly saved £345m per year from our work on market studies, and reviews of orders and undertakings, and market investigation references carried out by the CC (we refer to this

---

<sup>11</sup> When including ex post estimates from evaluations, we ensure that ex ante estimates from the original investigation have not already been included so that there is no double-counting.

<sup>12</sup> 'The Green Book: Appraisal and Evaluation in Central Government', HMT. Available from: [www.hm-treasury.gov.uk/d/green\\_book\\_complete.pdf](http://www.hm-treasury.gov.uk/d/green_book_complete.pdf)

<sup>13</sup> Undertakings in lieu or UiLs are cases where the OFT accepts binding undertakings from the merging parties as an alternative to referring the merger to the CC. The undertakings must be aimed at preventing or remedying the adverse competition effects identified.

area as our 'markets work').<sup>14</sup> The estimate of consumer savings attributed to the OFT in this area is £107m per year.

- 1.13 The total impact of our consumer protection enforcement work has been estimated at £42m. Of this, £8m was from OFT actions to stop illegal scams.<sup>15</sup> The non-scams consumer work accounted for £35m per year on average over the period 2008 to 2010.

## Differences from Positive Impact 08/09

- 1.14 Positive Impact 09/10 builds upon the methodologies and assumptions set out in previous Positive Impact notes.<sup>16</sup> In 2009, we commissioned Professor Stephen Davies to carry out an independent review of our impact estimation methodologies.<sup>17</sup> The review confirmed the rigour and prudence of our methods and also suggested possible modifications.

---

<sup>14</sup> Note that this figure (£345m) for the direct financial benefits to consumers from market studies and reviews and MIRs is different from those presented as direct benefits for consumer from the market investigation regime (£317m) in the CC's Annual Report as: i) the former takes into account all OFT market studies, including those where referral to the CC is not considered a possible option, and ii) the latter includes referrals to the CC from other regulators and the OFT is not apportioned any benefits from these MIRs.

<sup>15</sup> We may not be able to report impact estimates for consumer protection enforcement under two separate categories (scams and non scams) in the future. In 2009, the OFT restructured the group previously responsible for consumer protection work (to further increase the impact of its consumer protection work) and the scams work was incorporated into the overall consumer protection enforcement umbrella.

<sup>16</sup> Previous Positive Impact notes can be found on the evaluation page of the OFT website [www.offt.gov.uk/advice and resources/resource base/evaluation/publications](http://www.offt.gov.uk/advice_and_resources/resource_base/evaluation/publications)

<sup>17</sup> 'A Review of OFT's Impact Estimation methods', S. Davies, OFT1164, January 2010, available on the OFT website - [www.offt.gov.uk/shared\\_offt/reports/Evaluating-OFTs-work/oft1164.pdf](http://www.offt.gov.uk/shared_offt/reports/Evaluating-OFTs-work/oft1164.pdf)

- 1.15 In response to the review's suggestions,<sup>18</sup> we have changed our default price overcharge assumption, to estimate the impact of competition enforcement actions, from 10 to 15 per cent. We have reverted back to using a standard default duration of 6 years as recommended by Professor Davies.
- 1.16 We have presented, where possible, range of estimates to reflect the uncertainty underlying the assumptions behind the calculations. We will however continue to present point estimates for the purposes of the 5:1 target. We view our methodology as a work in progress and will continue to develop it. In addition to the above changes, we are considering other suggestions made in the review as highlighted in the OFT response document.

## **Structure of the document**

- 1.17 Section 2 presents detailed estimates of consumer savings from specific areas of OFT's work covering: competition law enforcement, merger control, markets work, and consumer protection enforcement. In section 3, we discuss recent evaluation findings on some of the wider benefits of our work. Section 4 presents the total and partial OFT costs, and section 5 concludes by summarising the benefits and costs for the period 2007-10.

---

<sup>18</sup> 'OFT response to the review of impact estimation methods', OFT1164r, January 2010 available on the OFT website.- [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/oft1164r.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft1164r.pdf)

## 2 CONSUMER SAVINGS BY AREA

### Introduction

- 2.1 This section presents estimates of impact of our work for each of the following areas: enforcement of competition law, merger control, markets work, and consumer protection enforcement. The specific methodologies used to estimate impact in each of these areas have been explained in the document, 'A guide to OFT's Impact Estimation methods' published on the OFT website.<sup>19</sup>
- 2.2 The OFT is the first stage authority in a two stage process (referring cases where there are competition concerns for further investigation to the CC, the second stage authority). Our estimates of consumer savings from mergers and market investigations therefore include OFT's share of CC's estimates.

### Competition enforcement

- 2.3 The OFT engages in a range of activities to promote compliance with the Competition Act (CA98), including formally investigating and taking enforcement action against anti-competitive practices and giving informal advice. Under the Enterprise Act 2002 (EA02) we can also investigate and prosecute individuals who have dishonestly been involved in cartel activity.
- 2.4 We estimate conservatively that the OFT's interventions saved consumers at least £253m on aggregate between the financial years 2007 and 2010 resulting in an annual average consumer savings of £84m. We consider this to be a lower bound estimate as it is based on case-specific conservative assumptions about price overcharge and

---

<sup>19</sup> 'A guide to OFT's impact estimation methods', OFT 1250, July 2010, available on the OFT website - [www.of.gov.uk/OFTwork/policy-and-research/evaluation/publications#named1](http://www.of.gov.uk/OFTwork/policy-and-research/evaluation/publications#named1)

expected future duration and does not include the significant deterrent effect of our competition enforcement actions.<sup>20</sup>

### Range estimates

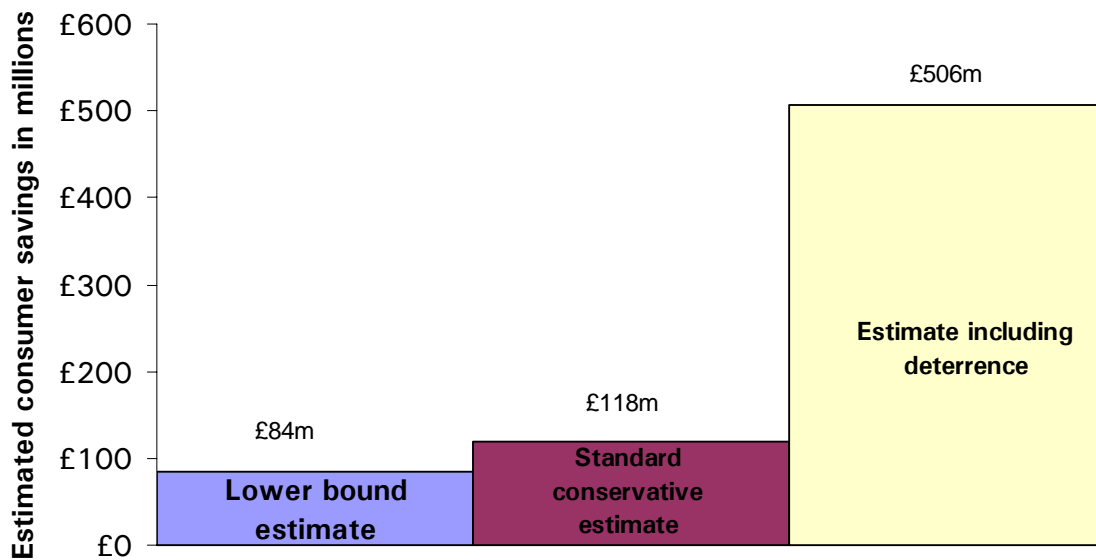
- 2.5 Professor Davies in his review of our methods suggested that rather than just point estimates, we report a range of estimates where the lower bound estimate would be based on current conservative assumptions and the upper bound would include an allowance for deterrence.
- 2.6 On this basis, we estimate that our competition enforcement work over 2007-10 has led to consumer savings in the range of **£84m to £506m** (see figure 2.1). The range of estimates have been calculated as follows:
- Lower bound estimate (£84m): based on case specific conservative assumptions about price overcharge and expected future duration. This is what we use to calculate the benefit to cost ratio.
  - Standard conservative estimate (£118m): using the default rules of thumb of 15 per cent price overcharge and six year expected future duration (in the absence of case specific evidence).
  - Estimate including deterrence (£506m): This is simply the lower bound estimate plus an allowance for the deterrent effect of our competition enforcement work, calculated by multiplying the lower

---

<sup>20</sup> See 'The deterrent effect of competition enforcement by the OFT', OFT962, November 2007. The research, based on surveys of competition lawyers and businesses, indicated the **ratio** of anti-competitive actions abandoned or modified because of the risk of an investigation to those resulting in a CA98 decision. According to the survey of Competition Lawyers the ratio was: five to one for cartels, seven to one for commercial agreements, and four to one for abuses of dominance. Corresponding ratios from the business survey were higher.

bound estimate by a factor of five.<sup>21</sup> We consider this to be a more realistic rather than conservative estimate of impact.

**Figure 2.1: Range of estimated consumer savings from our competition enforcement work, annual average over the period 2007 to 2010**



## Merger control

2.7 The OFT is the first stage of a two stage merger regime. Under the Enterprise Act 2002, it has the duty to review merger situations and refer to the CC any cases where there is a realistic prospect of a substantial lessening of competition (SLC) in UK markets. The OFT has the power to accept Undertakings in Lieu (of CC reference) (UiL) from the merging parties, if these are deemed to address potential concerns highlighted in the course of its investigations.

---

<sup>21</sup> See footnote 20 above. In the spirit of conservatism we adopt a factor of 5 to reflect the ratio of actions abandoned or modified to those resulting in a CA98 decision. See paragraphs 3.4 – 3.6 for further details.

- 2.8 Our estimates of consumer savings in this area include proposed mergers amended by the OFT through UiLs, proposed mergers that are abandoned on referral to the CC (abandoned mergers), and proposed mergers amended or prohibited by the CC. We have agreed an 80:20 rule to split impact estimates with the Competition Commission so that the OFT gets 80 per cent of the benefits from UiLs and abandoned mergers (with 20 per cent going to the CC) and 20 per cent of the benefits from CC's merger decisions (of which the CC claims 80 per cent).
- 2.9 During the past three financial years (2007 to 2010), the merger regime has saved consumers £310m per year on average, of which £125m per year is apportioned to the OFT.
- 2.10 Table 2.2 presents the average annual estimates of consumer savings from the merger regime for the years 2007 to 2010. The estimates for abandoned mergers and UiLs have been scaled down by a factor of 39 per cent (that is, to 61 per cent) to allow for the CC 'hit rate' (this equals proportion of mergers examined by the CC in the previous three years in which it found an SLC) to account for the uncertainty of the outcome of a CC reference.

**Table 2.2: Average annual consumer savings from the merger regime, 2007-10**

	Estimated average annual consumer savings
UiLs	£97m
Abandoned mergers	£8m
CC merger decisions	£205m
<b>Total – joint mergers regime</b>	<b>£310m</b>
<b>Benefits apportioned to the OFT</b>	<b>£125m</b>

### Range estimates

- 2.11 The independent review of our impact estimation methods suggested that we review the assumed elasticity values we typically use and take

into account efficiency savings when estimating impact of our mergers work.<sup>22</sup> We aim to act on these suggestions but the resulting changes will involve further work and take time to implement. In the meantime, we present a range of estimates (rather than a point estimate) to reflect the uncertainty surrounding the assumptions used to estimate impact.

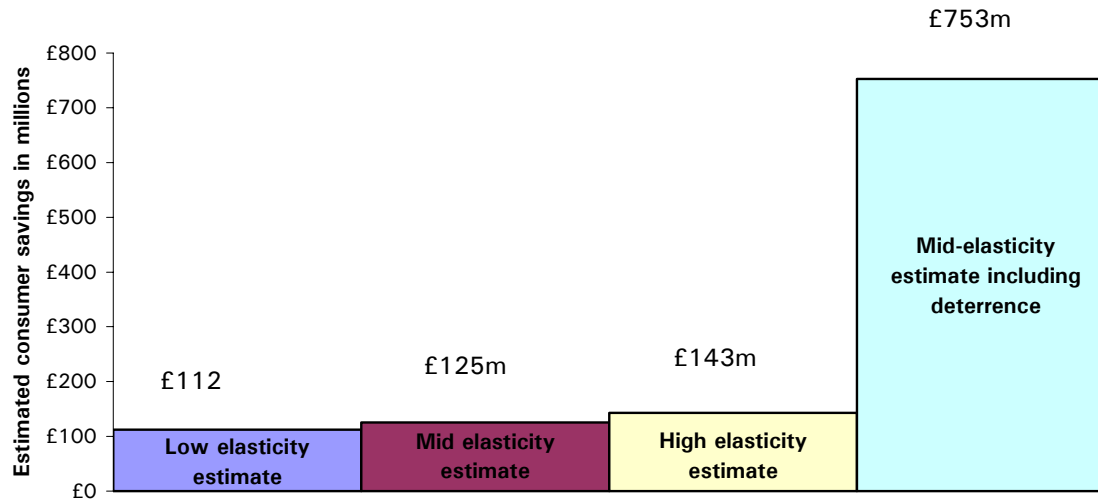
- 2.12 We estimate that our merger control work over 2007-10 has led to average annual consumer savings in the region of £112m to £753m. We typically estimate a range of consumer savings from a merger case by applying low, medium, and high elasticity (assumed) values but only report the 'reasonable' mid point estimate for the 5:1 target. Figure 2.3 below presents the range of impact estimates obtained by varying the assumed elasticity values. In addition, it indicates what the magnitude of impact might be were we to include the deterrent effect of our merger control work (five times), applying it to the mid-elasticity value estimate (see 3.4-3.6).<sup>23</sup>

---

<sup>22</sup> See paragraphs 5.5- 5.7, pages18-20 in 'A Review of OFT's Impact Estimation methods', S. Davies, OFT1164, January 2010, available on the OFT website - [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/oft1164.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft1164.pdf)

<sup>23</sup> The estimate including deterrence (£753m) is calculated by adding an allowance for deterrence (5x£125m) to the mid -elasticity estimate £125m. Please note that figures presented have been rounded off.

**Figure 2.3: Range of estimated consumer savings from our merger control work, annual average over the period 2007 to 2010**



## **Market studies, reviews of orders and undertakings, and market investigation references**

2.13 Typically, OFT market studies are examinations into the causes of why particular markets are not working well for consumers, leading to proposals as to how they might be made to work better. They take an overview of regulatory and other economic drivers in a market and patterns of consumer and business behaviour.

2.14 The OFT may refer markets to the CC for further investigation where it has reasonable grounds for suspecting that any feature, or combination of features, of a market is preventing, restricting, or distorting competition. In estimating consumer savings therefore, we consider the impact of the market investigations regime as a whole and include a proportion of impact of MIRs carried out by the CC. The CC, in turn, is

apportioned a proportion of consumer savings from OFT market studies and reviews.<sup>24</sup>

- 2.15 In addition, we only claim a proportion of the impact estimates from OFT projects that involved other government departments/ bodies or industry stakeholders. So, for example, where OFT recommendations from a market study are implemented by a government department, the impact estimates would be apportioned between the OFT and the relevant government department.

### **Monitoring impact**

- 2.16 We use both ex post as well as ex ante analyses to estimate the impact of our markets work. Ex post estimates of impact are robust and based on information gathered after the OFT recommendations have been implemented and the resulting impact realised but these are only available for a small subset of projects. Ex ante estimates of impact are based on the best information available at the time of estimation – which is typically when the recommendations have been implemented but the full impact from it is not observable. Therefore it involves impact estimation and monitoring of market developments.
- 2.17 The last three Positive Impact notes (07-08, 08-09, and 09-10) have included ex ante estimates of impact from the SME Banking Review. In 2009/10, we continued to monitor the SME Banking market by analysing tariff data for SME services that we received from banks. We also gathered qualitative information through a voluntary business survey. This is the last year that we will claim any benefits from this

---

<sup>24</sup> For market investigations carried out by the CC following a reference by the OFT, 20 per cent of impact is apportioned to the OFT and 80 per cent to the CC. For referrals to the CC from other regulators, the CC is attributed with 100 per cent of the impact. For the OFT market studies and reviews of undertakings and orders that involve or could involve the CC, 80 per cent is apportioned to the OFT and 20 per cent to the CC. For market studies where referral to the CC is not considered as a possible option, the OFT is attributed with 100 per cent of the impact.

project and there will therefore be no further monitoring of the impact of this intervention.<sup>25</sup>

2.18 Analysis of the tariff data revealed no significant changes and the information provided by the bank survey was admittedly limited. We have therefore relied on qualitative analysis. The responses to our survey suggest that there has been an increase in the number of new SME services offered and more information is now provided to SME customers - in particular to those looking to switch banks. There has been no evidence to suggest a decrease in competition in this market. As we are aware that there are other factors that may have influenced the market and it is not possible to attribute a certain proportion of any changes to OFT actions without more in depth research (beyond the scope of a light touch monitoring exercise), we assign £13m as average annual benefits from the SME banking review in Positive Impact 09/10. We feel that this is a conservative estimate and is in keeping with our prudent approach.<sup>26</sup>

### **Consumer savings estimate**

2.19 Overall average annual consumer savings from markets work are estimated at £345m for the three year period 2007 to 2010.<sup>27</sup> Of this, £107m has been apportioned to the OFT.

---

<sup>25</sup> This is notwithstanding our obligation to carry out wider monitoring of the SME market. Here we refer to the monitoring of key indicators in the market that inform the impact estimate.

<sup>26</sup> The average annual benefits are based on conservative assumptions about the increase in switching rates and cost savings for SME customers.

<sup>27</sup> Note that this figure for the direct financial benefits to consumers from the market studies and reviews and MIRs (£345m) is different from those presented as direct benefits for consumers from the market investigation regime (£317m) in CC's Annual report 09-10 as the former takes into account all OFT market studies, including those where referral to the CC is not considered a possible option.

**Table 2.4: Average annual consumer savings from our markets work 2007-10**

	Estimated average annual consumer savings
CC MIRs	£279m
OFT market studies, and reviews of orders and undertakings	£66m
Total	£345m
<b>Benefits apportioned to the OFT</b>	<b>£107m</b>

## Consumer protection enforcement

2.20 The OFT's consumer protection enforcement work seeks to change trader behaviour that contravenes consumer protection legislation using a range of interventions such as issuing informal warnings, accepting undertakings under the Enterprise Act, or obtaining Court Orders.<sup>28</sup>

2.21 All interventions are aimed at protecting consumers, particularly vulnerable consumers, from rogue trading, unfair commercial practices and other breaches of consumer protection legislation. Estimating the impact of consumer protection enforcement is a relatively new area for the OFT. The methodology is a work in progress and likely to be modified and future impact estimates in this area may be revised accordingly.

---

<sup>28</sup> Trading Standards are also responsible for consumer protection enforcement and tackling unfair trading practices. This section only considers the consumer savings resulting from OFT enforcement action. An evaluation of the impact of the fair trading work of local authority Trading Standards Services in the UK, June 2009, OFT1085 can be found at: [www.oft.gov.uk/shared\\_of/about\\_of/oft1085.pdf](http://www.oft.gov.uk/shared_of/about_of/oft1085.pdf)

## Consumer savings estimate

2.22 For the period 2007 to 2010, the total consumer benefits from consumer protection enforcement as a whole has been estimated at £42m per year on average.

**Table 2.5: Average annual consumer savings from OFT consumer protection enforcement, 2007-10**

	<b>Estimated average annual consumer savings</b>
Consumer protection enforcement (non scams)	£35m
Scam busting <sup>29</sup>	£8m
<b>Total</b>	<b>£42m</b>

---

<sup>29</sup> We may not be able to report impact estimates for consumer protection enforcement under two separate categories (scams and non scams) in the future. In 2009, the OFT restructured the group previously responsible for consumer protection work (to further increase the impact of its consumer protection work) and the scams work was incorporated into the overall consumer protection enforcement umbrella.

### 3 WIDER BENEFITS

#### Introduction

- 3.1 In addition to assessing the direct impact of our interventions to meet the 5:1 performance target agreed with HMT, we conduct evaluations and research on other benefits of the OFT's work, such as the deterrent effect (that is, the actions abandoned or significantly modified by businesses because of the risk of investigation) of our interventions, impact on consumer and business confidence in markets, and (wider) impact of competition on innovation, markets and productivity.
- 3.2 These wider impacts are very difficult to quantify but cannot be ignored as they are likely to be quite significant. This was confirmed by Professor Davies in his review where he recommends that deterrence be given more prominence by presenting range of estimates (rather than just point estimates), where the upper bound included a 'deterrence' multiplier.<sup>30</sup>
- 3.3 This section draws on findings from OFT projects that illustrate the impact of our competition and consumer work on deterrence and compliance. The findings from these discrete research projects suggest that key drivers of compliance with competition law are reputational risks/adverse publicity, individual sanctions (such as director disqualification and criminal penalties), and financial penalties. Reputational damage and financial penalties were also found to be key in driving compliance with consumer law.

---

<sup>30</sup> See paragraph 6.14, page 42 of 'A Review of OFT's Impact Estimation methods', S. Davies, OFT1164, January 2010, available on the OFT website - [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/oft1164.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft1164.pdf)

## Deterrent effect of our competition enforcement work

- 3.4 The OFT, as part of its evaluation work, commissioned **Deloitte** to analyse the scale of the deterrent effect and to provide further insight into the key factors driving compliance with competition law.<sup>31</sup> The report, published in 2007, drew on 30 in-depth **interviews** with practitioners and companies, a **legal survey** (of 234 senior competition lawyers in London and Brussels) and a **company survey** (of 202 companies of more than 200 employees).
- 3.5 The legal survey suggested that the deterrent ratio for mergers and competition enforcement was approximately five to one (so for example five mergers modified or abandoned for every merger decision by the OFT). Ratios are significantly larger for the company survey, a fact that could be (partly) explained by the existence of deterred activity on which external advice is not taken.<sup>32</sup> To provide a guide of the scale of the deterrent effect – the direct effect of competition enforcement and merger control over the years 2007 to 2010 was estimated to be around £210m annually on average (see Table 1.1). Assuming indirect benefits to consumers through deterrence could be five times as much; this would amount to some further £1000m per year.<sup>33</sup>

---

<sup>31</sup> See Deloitte report on 'The deterrent effect of competition enforcement by the OFT', OFT962, November 2007, available on the OFT website- [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/oft962.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft962.pdf)

<sup>32</sup> Another explanation may be that more lawyers (on average per agreement or initiative) advise on published CA98 cases than on deterred agreement and initiatives, so that the ratios from the legal survey are underestimates. Corresponding ratios from the business survey were: 16 to one for cartels, 29 to one for commercial agreements, and 10 to one for abuses of dominance. See footnote 31 for full reference of the 2007 Deloitte report.

<sup>33</sup> This figure should be viewed as an approximation that illustrates what the scale of the deterrence effect might be. It is based on the average deterrence effect of our competition

- 3.6 Both the legal and company surveys ranked criminal penalties as the most important factor in 'detering infringements'. The companies considered director disqualification and adverse publicity more important than fines, lawyers did not.

### **Drivers of compliance with competition law**

- 3.7 An OFT report published in May 2010<sup>34</sup> presented findings from qualitative research conducted to understand what motivates businesses to comply with competition law and what businesses have found worked well in practice to achieve this. It also looked at competition challenges that businesses might face in spite of their compliance effort and includes examples of the compliance activities undertaken by respondent businesses in order to provide ideas to businesses designing or refreshing their competition law compliance strategy and to share best practice.
- 3.8 Businesses responding to the surveys mentioned reputational damage, financial penalties, individual sanctions (such as director disqualification and risk of criminal proceedings), and commitment to compliance from the top of the organisation as key drivers of compliance. Some of the factors that increased the risk of non-compliance were lack of management commitment, confusion or uncertainty about the law, rogue employees etc. The report recognises that appropriate actions to achieve a compliance culture will vary by size of business and the nature of the risks identified.

### **Drivers of compliance with consumer law**

- 3.9 In 2010, the OFT undertook a programme of work to gain a better understanding of the factors which drive business compliance with

---

enforcement between 2000 and 2006, and thus may be different from the marginal deterrent effect of our current competition enforcement.

<sup>34</sup> 'Drivers of Compliance and Non Compliance with Competition Law', OFT1227, May 2010 available on the OFT website - [www.of.gov.uk/shared\\_of/reports/comp\\_policy/oft1227.pdf](http://www.of.gov.uk/shared_of/reports/comp_policy/oft1227.pdf)

consumer protection law, including the deterrent effect of consumer law enforcement. We commissioned both qualitative and quantitative research to inform our analysis.

- 3.10 Ipsos MORI was commissioned to carry out a systematic qualitative review of the compliance experiences of a wide range of businesses.<sup>35</sup> The work, based on in-depth interviews with businesses in different sectors and locations, highlights the experience of business, with a particular focus on small and medium enterprises. The report found that the main drivers of compliance were – consumer pressure, pressure from external organisations, and traders' understanding of consumer protection obligations and risks.
- 3.11 As part of OFT's evaluation programme, we commissioned IFF research<sup>36</sup> to quantitatively assess the factors affecting compliance with consumer law and the role of deterrence. The research involved a telephone survey of businesses. Key benefits to businesses from enforcement of consumer protection law cited in the report included – creating a level playing field, more satisfied customers and increased confidence in the sector. A third of interviewed businesses claimed to have been disadvantaged by competitors breaching consumer law, with around one-fifth claiming to have been disadvantaged by competitors' dishonest treatment of customers and the use of misleading advertising by competitors.
- 3.12 In addition, the IFF report provides valuable and new insights into the deterrent role of enforcement. It found that the risk of adverse publicity (including those associated with OFT enforcement action) and

---

<sup>35</sup> 'Qualitative research on the drivers of compliance and non compliance with Consumer Protection Law', OFT1225a, June 2010 available on the OFT website - [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/OFT1225a.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/OFT1225a.pdf)

<sup>36</sup> 'Factors affecting compliance with consumer law and the deterrent effect of consumer enforcement', IFF research, OFT1228, June 2010, available on the OFT website - [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/OFT1228.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/OFT1228.pdf)

reputational damage were as important as any financial penalty in encouraging compliance. This research follows on from the Deloitte report published in 2007 into the deterrent effect of competition enforcement by the OFT.

- 3.13 We also published an OFT report<sup>37</sup> that considers the main findings from the above qualitative and quantitative research and incorporates discussions with business and interested parties and learnings from reviewing research into regulatory compliance in other fields. It discusses key drivers of compliance under broad themes such as importance of reputation and influence of consumer pressure, business awareness of/attitudes towards consumer protection laws, and influence of competitive behaviour.

### **Evaluating OFT enforcement actions in the construction sector**

- 3.14 An independent evaluation of OFT's competition enforcement activities in the construction sector, published in June 2010,<sup>38</sup> found significant improvements in awareness and understanding of competition law and changes in business behaviour post intervention. The research, based on surveys of construction contractors and procurers, was conducted by Europe Economics. Results from a first phase, conducted in 2008, were compared with a second phase, conducted in 2010.
- 3.15 The OFT's approach to competition enforcement involves a relatively small number of high impact cases in order to create a strong deterrent effect across sectors. The report shows a significant rise in understanding of what constitutes anti-competitive practices, and

---

<sup>37</sup> 'Consumer Law and Business Practice, Drivers of compliance and non-compliance', OFT1225, June 2010 available on the OFT website - [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/OFT1225.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/OFT1225.pdf)

<sup>38</sup> 'Evaluation of the impact of OFT's investigation into bid rigging in the construction industry', OFT1240, Europe Economics, June 2010., available on the OFT website - [www.of.gov.uk/shared\\_of/reports/Evaluating-OFTs-work/oft1240.pdf](http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft1240.pdf)

marked improvement in business behaviour, amongst construction firms post OFT intervention.

## 4 COSTS

### Introduction

- 4.1 In this section we present the total costs of the OFT excluding Consumer Direct, Consumer Credit Licensing, and Anti Money Laundering<sup>39</sup> that are not included in the 5:1 HMT target. We also present the partial costs covering the areas for which we have presented consumer savings estimates.
- 4.2 Cost figures may fluctuate from year to year and as such will impact on the benefit to cost ratios reported in the Positive Impact reports. To smooth out any such fluctuations, we use a three year moving average for total and partial costs. This is consistent with the way in which we report estimated benefits.

### Average annual costs, 2007-10

- 4.3 The **average annual OFT costs over 2007-10** (including running costs, litigation costs and capital) minus direct operating costs attributable to Consumer Direct, Consumer Credit Licensing, and Anti Money Laundering is **£50m**.
- 4.4 We estimate the **average annual partial costs over 2007-10** covering the areas for which we present consumer savings (competition enforcement, merger control, markets work, and consumer protection enforcement) **at £37m**.<sup>40</sup> These include direct salary costs of OFT staff

---

<sup>39</sup> Consumer Direct is assessed separately under a separate target agreed with HMT of 3.5 to 1. Credit Consumer Licensing and Anti Money Laundering are excluded from the 5:1 assessment as they are self funding activities.

<sup>40</sup> Note that this figure may not be strictly comparable to partial cost figures in previous Positive Impact notes as we continue to refine our approach to apportioning costs to different OFT activities based on updated organisational and cost information.

contributing to one of the above four activities,<sup>41</sup> other costs such as external expert advice and research costs, as well as share of overhead and management costs in proportion to employee headcount.

---

<sup>41</sup> We include all costs to these teams where the work directly and exclusively relates to the four activities covered in this report. In the case of support teams (such as, for instance, Communications, economists and lawyers) who advise on several OFT work streams, we assign (based on internal analysis) a certain proportion of costs to the four relevant areas. The remaining costs are apportioned on a pro-rata basis, similar to the overhead costs.

## 5 CONCLUSIONS

5.1 We present in Table 5.1 estimates of consumer savings and OFT costs for the three year period 2007-10. The benefit to cost ratio for the period is 7:1, well above the 5:1 HMT target.

**Table 5.1: Estimated consumer savings and OFT costs for 2007-10**

	Estimated average annual consumer savings 2007-10 <sup>42</sup>
Competition enforcement	£84m
Merger control	£125m
Market studies, reviews of orders and undertakings, and market investigation references	£107m
Consumer protection enforcement	£42m
<b>Total benefits</b>	<b>£359m</b>
<b>Total OFT costs (averaged over 2007-10)</b>	<b>£50m<sup>43</sup></b>
Partial OFT costs (averaged over 2007-10)	£37m <sup>44</sup>
<b>Benefit/ Total OFT costs</b>	<b>7</b>
Benefit / Partial costs	10

<sup>42</sup> Consumer savings are estimated as an annual average over 2007-10 except for consumer protection where estimates reported are annual averages over 2008-10 as we only started to estimate impact of this area since Positive Impact 08-09.

<sup>43</sup> This is total OFT costs (actual spend) minus costs of Consumer Direct, Anti Money Laundering and Consumer Credit Licensing.

<sup>44</sup> This includes costs of areas included in this report for which we estimate impact.

- 5.2 The total benefits figure of £359m shown in table 5.1 is conservative as it does not comprise the full extent of the OFT's work. It only includes the direct financial benefits to consumers from OFT's work on enforcing competition and consumer law, and merger control, as well as its markets work.<sup>45</sup>
- 5.3 The figures in table 5.1 exclude any benefits arising from the deterrent effect of our work which is likely to be significant. To provide a guide of the scale of the deterrent effect – the direct effect of competition enforcement and merger control over the years 2007 to 2010 was estimated to be around £210m annually on average. Assuming indirect benefits to consumers through deterrence could be five times as much; this would amount to some further £1000m per year.<sup>46</sup>
- 5.4 In addition, many of the wider/dynamic benefits of the OFT's work are not quantifiable (for example, any psychological detriment averted by our actions, and impact of increased competition on productivity) and have therefore been excluded.

---

<sup>45</sup> For example, it does not include support provided to Trading Standards Services across the country, consumer codes, and consumer education campaigns. We continue to work to get a better understanding of our impact in these areas and aim to publish some estimates of the impact of our consumer education campaigns in the future.

<sup>46</sup> This figure should be viewed as an approximation that illustrates what the scale of the deterrence effect might be. It is based on the average deterrence effect of our competition enforcement between 2000 and 2006, and thus may be different from the marginal deterrent effect of our current competition enforcement. See section 3 for range of estimates for competition enforcement and mergers where the higher estimate includes an allowance for deterrence.