

The OFT's market studies

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Introduction

I am delighted to have this opportunity to speak to you on the subject of the OFT's market studies.

Many of you will know that Peter Freeman spoke last year on the role of the CC in investigating markets,² and my speech today, in focussing on the role of the OFT, should be seen as complementary to his, rather than as an attempt to give an overview of the UK competition and consumer authorities' collective approach in this area. I will concentrate on the OFT's work in this area in the five years since the coming into effect of the Enterprise Act 2002, which has not been the subject of as much scrutiny and analysis by academics and other commentators as, for example, our competition enforcement and mergers work. I hope that this speech will go some way to filling this gap in the literature.

Before coming to the OFT in 2005 I already had some experience of conducting market studies at the Irish Competition Authority. But by that time the OFT's work in this area was already well underway. My predecessor John Vickers had identified the benefits of complementing the OFT's enforcement activities by taking a broader look at how markets might be made to work better, and established a new team to carry out market studies. A large number of the

¹ This paper formed the basis for a Beesley lecture delivered by John Fingleton in London on the 16th of October 2008. The views expressed here are personal, and not necessarily those of the OFT. We are grateful to OFT colleagues, in particular Frances Barr, Matthew Bennett, Amelia Fletcher, Fiammetta Gordon and Jennifer Halliday, for their assistance in the preparation of this paper, and to Bill Kovacic for discussions on competition advocacy.

² www.competition-commission.org.uk/our_role/speeches/pdf/freeman_beesley_181007.pdf.

studies I shall refer to in the course of this speech were carried out under John's leadership³. Since then the OFT's expertise in this area has been recognised internationally, and we are now leading a project on market studies in the International Competition Network, bringing together best practice from competition authorities across the world.

The term 'market study' is not defined in UK law, but market studies play a central role in the UK competition and consumer protection system. They are becoming increasingly familiar to business, consumers and many parts of government as a result of high profile work by the OFT looking at such areas as homebuilding and personal current account banking.

The OFT's market studies are examinations of the way markets are working, leading to proposals as to how they might be made to work better. Consumer welfare has been an emerging global standard for competition and consumer policy. It is intelligent to interpret the consumer welfare standard from a longer rather than a shorter term perspective, and holistically, rather than looking at parts of any problem. An effects-based approach is a key complement to that. Within this approach, market studies can be a useful way of identifying harm to consumers and what is the best way to remedy it in the longer term, rather than focusing at the outset on the use of particular tools or on partial or temporary solutions.

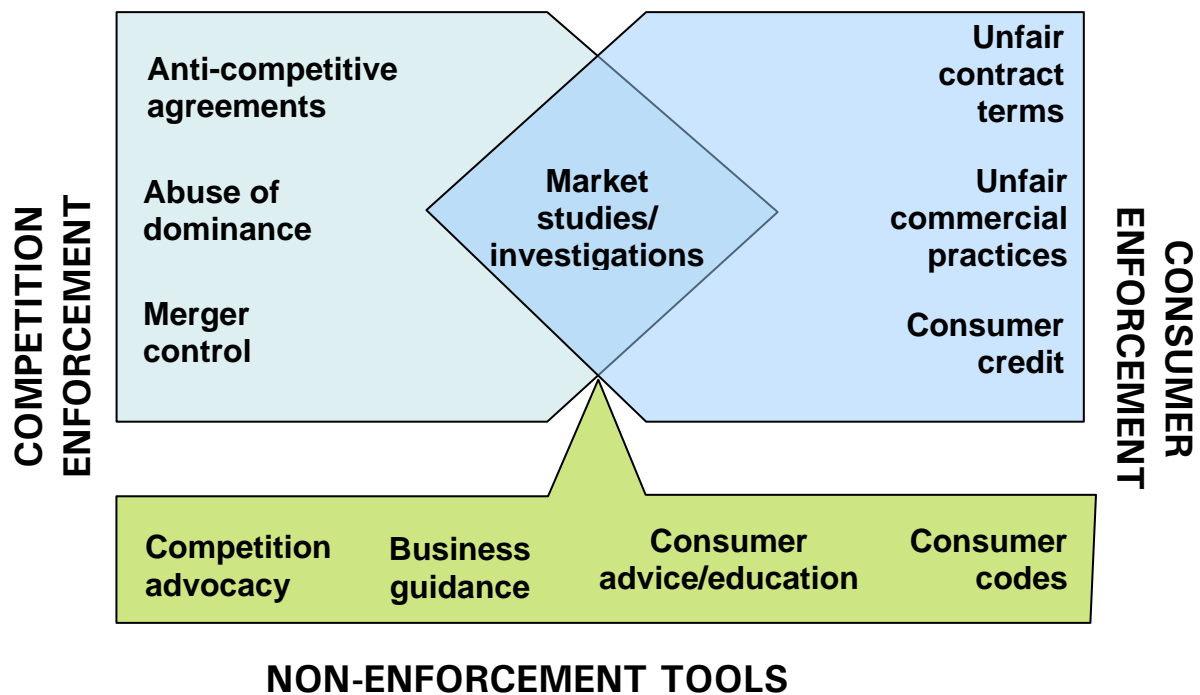
Market studies form one of a number of tools at the OFT's disposal to address competition or consumer protection problems, alongside its other advocacy and enforcement activities. They can be clearly distinguished from these other tools, and also from market investigations by the Competition Commission (CC). The latter are formal statutory investigations of markets which are referred by the OFT to the CC under the Enterprise Act 2002,⁴ on the basis that one or more features of the market prevent, restrict or distort competition; they may lead to legally binding remedies imposed by the CC to address any adverse effects on competition that are identified. Market studies may lead to a market investigation reference, but this is only one of a range of possible outcomes. Market studies are part of an international development in which the UK is generally a leader.

³ John Vickers also spoke about market studies, including in 2004 at the Competition Policy conference of the Regulatory Policy Institute.

www.offt.gov.uk/shared_offt/speeches/spe0404.pdf.

⁴ Under section 131 Enterprise Act 2002.

As can be seen from the diagram below, market studies enable the OFT to operate at the interface of competition and consumer policy, taking an overview of regulatory and other economic drivers in a market, and of any patterns of consumer or business behaviour. The flexibility of the market study tool means that it can be used to look at all restrictions that have a negative effect, regardless of source. This ensures that we can take a balanced and even-handed approach both as between business and governmental restrictions on competition and as between different sectors in the economy. Market studies appear at the centre of the diagram not because this speech is about them, but because this is naturally where they fit. Occupying a central role between competition enforcement, consumer enforcement and non-enforcement tools such as competition advocacy, market studies act as a complement to all three.



By combining competition and consumer policy, market studies help to drive a virtuous circle, in which on the one side informed consumers have the confidence to engage more proactively in markets, helping to drive competition between firms, and on the other vigorous competition drives firms to deliver higher quality, increased choice, greater innovation and lower prices, to the benefit of consumers.

Market studies enable the OFT to identify and seek to remedy, through dialogue, enforcement action or other means, conduct and other features of markets that

are harming consumers but that cannot be, or are not best, addressed by enforcement action. They can lead to a range of outcomes; these include giving the market a clean bill of health, publishing information to help consumers, encouraging firms to self-regulate, making changes to their agreements or their behaviour, encouraging consumer codes of practice, making recommendations to government or regulators, enforcement action, or making a market investigation reference to the CC.

Where problems relating to business practices are found, voluntary action (through self-regulation, whether by formally approved OFT consumer codes of practice or less formal codes or other means to change agreements or behaviour) may resolve the concerns identified sooner, and with lower burdens on business, than the alternatives of enforcement action or making a market investigation reference to the CC. A very recent example of this is our Sale and Rent Back market study, published in October this year. Another example is the Personal Current Accounts market study where we are looking at ways to improve information that banks make available to consumers. Information remedies have also often been a focus of the CC's work in market investigation references. Unlike in the EU, investigation or enforcement action as an outcome of a market study is not common.

Where possible, the remedies which market studies propose to address problems in markets which appear not to be working well for consumers are alternatives to regulation; indeed they may propose deregulation where appropriate to remove government-imposed restrictions on competition. In some cases, market studies may lead to a recommendation to introduce new legislation where increased consumer protection appears necessary.⁵ In other cases they may call on firms themselves voluntarily to address concerns which are identified as causing detriment to consumers.

Selected themes

Before looking at what the OFT has done on market studies, I want to mention three key benefits of market studies, as a complement to the OFT's other activities. First is their importance as a tool of successful competition advocacy. Second is their ability to address both competition and consumer issues and

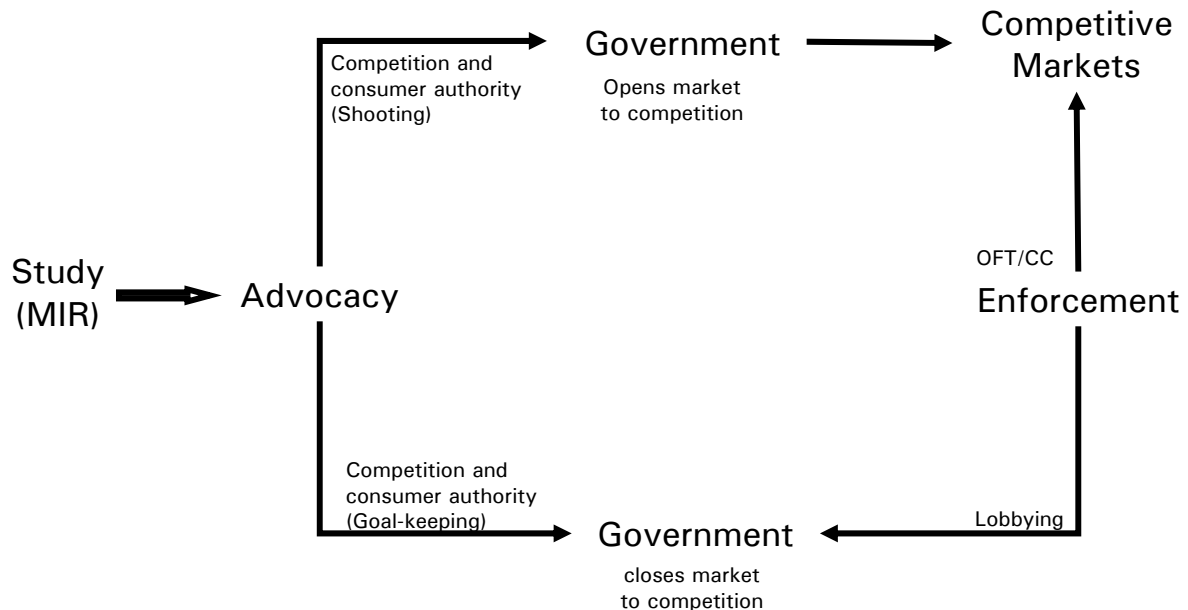
⁵ A recent example is the Sale and Rent Back market study, published at www.of.gov.uk/shared_of/reports/consumer_protection/oft1018.pdf where we recommended that the sale and rent back sector needs statutory regulation, with better protection for consumers.

provide a joined-up approach to resolving them. Third is their role as a diagnostic tool that allows the flexibility to choose the best means of achieving any change that is needed in the light of the evidence that emerges in the course of a study.

On the first theme, then, market studies are an effective way to tackle public restrictions on competition. As an advocacy tool to achieve this, they help us maximise the chance of change. Using a market study we can address any kind of public restriction, whether it be regulatory restrictions that impose barriers to entry (as in the case of the Taxis and Private Dentistry market studies) or issues relating to competitive neutrality as between public and private market players (addressed, for example in the Commercial Use of Public Information, Public Sector Procurement, and Pharmaceutical Price Regulation Scheme market studies), or distortions in markets caused by public funding (considered in our Public Subsidies market study).

Advocacy is a critical complement to enforcement action, in two key ways. First, it opens more markets up to competition – such that they become amenable to appropriate enforcement action. Second, enforcement action, when taken, can lead industry players to lobby for reduced competition scrutiny – and advocacy can help to head off such calls for protection from competition law. I like to describe these two functions of advocacy in footballing terms, as the OFT acting either in shooting mode (opening up markets to competition scrutiny) or goal-keeping mode (preventing lobbies from escaping from competition scrutiny). The diagram below illustrates these functions.

Studies, advocacy and enforcement



Two studies illustrate this point. Firstly, in Private Dentistry the OFT was in shooting mode. It recommended that restrictions on professionals complementary to dentistry (for example dental hygienists) should be lifted, so that they could supply consumers directly. This recommendation was accepted by the government and it legislated to make changes to the Health Act 1999 to remove the restrictions, as well as allowing the General Dental Council to register additional care professionals.

Secondly, in closer to goal-keeping mode, in the Pharmaceutical Price Regulation Scheme (PPRS) market study, the OFT found some drug prices were significantly out of line with patient benefits and with the price of substitute treatments. The OFT recommended introducing more competition into the market by replacing the 'profit cap and price cut' scheme with a value-based pricing regime which would reflect therapeutic benefit to patients. We estimated such changes would lead to cost savings to the NHS of around £500 million per year. The PPRS is now in the course of being renegotiated and an interim scheme is in place until December 2008. The government has formally rejected our recommendation of value-based pricing but is considering ways to ensure that access to medicines reflects their value to patients. It has agreed measures to reduce the price of out of patent drugs and action to give patients faster access to new drugs. Even though our principal proposals were rejected, we consider that our report informed the debate positively.

If the counterfactual of a goal-keeping market study is the introduction of new regulatory measures, then the benefit of the OFT carrying out this kind of study is greater cost-effectiveness: the application of the OFT's specialist resources (lawyers and economists) to examine the effects on competition and consumer welfare of proposed or likely new regulation is in the long run more cost-effective and leads to better outcomes than if this work were carried out by non-specialists.

In the current economic climate we think there may, unfortunately, be a need for more studies where the OFT plays this goal-keeping kind of role, to prevent the introduction of new regulatory restrictions on competition or new exemptions from the application of competition law.

My second theme is joining competition and consumer policy. As noted above, supply and demand sides in a market should, and often do, interact. In some cases, where a market does not function well there are failings in both sides of the market and dealing with one side only – as we commonly would when taking enforcement action – may be sub-optimal.

An example is our Personal Current Accounts market study, where we combined an examination of the inefficient market equilibrium that has evolved in the course of the banks' competitive activity, involving work on improving product information and ease of switching for consumers, with an investigation of unauthorised overdraft charges under the Unfair Terms in Consumer Contracts Regulations 1999. I return later to the specific problems we found in the course of this market study.

Another example is our Homebuilding market study, where we examined the levels of competition in the market, and gave a generally clean bill of health, yet secured agreement to voluntary measures that would improve consumer understanding and access to redress.

These examples illustrate that problems can arise from anti-competitive conduct – in which case we would use our enforcement tools – or from inefficient market equilibrium arising from competitive behaviour. A market study approach avoids inappropriate use of enforcement in the latter type of case. I will return to this point below.

My final theme concerns the use of market studies as a flexible diagnostic tool. Problems in markets may come to the OFT in many different guises. A common one is as a complaint calling for us to take action under our enforcement powers. As I have already hinted, enforcement action may not be the most appropriate tool – its use to address a particular problem may 'stretch' the prohibitions beyond their proper scope. Alternatively, enforcement action may not address the root cause of any problem, or behaviour across a whole market or markets. Market studies enable us to examine whole markets and to consider cause and effect, assessing the best basis and means to remedy any problems.

Two examples spring particularly to mind here. They are both cases in which regulation has interacted with market power, or allegations relating to market power, such that it was not clear at the outset what the most appropriate intervention (if any) would be.

The first case is the UK Airports⁶ market study. In this study, regulation of designated airports⁷ interacted with the residual market power of the former state monopoly BAA. Our study recommended that the Civil Aviation Authority advise the Department for Transport on whether to de-designate Manchester Airport.⁸ At the same time as reporting on our market study we also consulted on a market investigation reference, and later referred to the CC the supply of airport services in the UK by BAA so that the CC could consider, inter alia, structural remedies to address BAA's residual market power.

The second case is the Medicines Distribution⁹ market study.¹⁰ In this case we received a number of complaints under CA98 about the introduction of a new 'direct to pharmacy' distribution scheme by a leading UK medicine supplier and concerns that other suppliers were considering similar schemes. Stakeholders suggested a variety of different motivations, including abuse of market power

⁶ www.offt.gov.uk/shared_offt/reports/transport/oft882.pdf.

⁷ Airports that are designated by the Secretary of State under the Airports Act 1986 are subject to price control. For these airports, the Civil Aviation Authority sets a price cap on the charges to airlines for the use of airports and airport services. The price cap is reviewed every five years by the CAA, following a six month mandatory reference to the Competition Commission. The criteria for designation and (following our study recommendation) de-designation of airports are set out in guidance published by the Department for Transport. Prior to our study, the airports that were designated for price control were Heathrow, Gatwick, Stansted and Manchester airports.

⁸ In response to this recommendation the Civil Aviation Authority advised that Manchester Airport should be de-designated, and the Department for Transport followed that advice.

⁹ www.offt.gov.uk/shared_offt/reports/comp_policy/oft967.pdf.

¹⁰ Other examples are the market studies on Classified Directory Advertising Services and Groceries.

allegations relevant to the Competition Act 1998 and suggestions that the objective was to circumvent the price regulation in the market. We considered that a market study provided the best means of examining all the factors affecting the market. The study led us to conclude that there was a significant risk that the new arrangements would result in higher costs to the NHS. The best remedy for these concerns would be for the government to make changes to the Pharmaceutical Price Regulation Scheme to ensure that NHS medicines costs do not increase.¹¹ We also found that the 'direct to pharmacy' schemes did not raise sufficient further concerns to justify action under CA98 at that time: though more widespread use of exclusive distribution arrangements might lead to longer term competition problems, and we would monitor the situation as the market developed.

This was an example of a market study being used as a diagnostic tool, which enabled us to identify the best outcome to address problems in the market as a whole – rather than premature CA98 action against individual firms in circumstances where the competition concerns were not sufficient to justify it.

These three themes of advocacy, holistic competition and consumer analysis, and effective diagnosis of market problems show the unique flexibility and utility of the market study instrument.

What have we done?

The OFT has for many years reviewed the working of markets and produced reports which would now be referred to as market studies, initially using powers under the Fair Trading Act 1973. But the term came into general use with the entry into force of the Enterprise Act 2002, section 5 of which gives the OFT general powers to obtain information and conduct research, and provides the statutory basis for market studies. The Enterprise Act also brought into being two other tools which interact closely with market studies by the OFT: the market investigations by the CC which have already been referred to; and super-complaints by designated consumer bodies about market features which may be harming the interests of consumers, to which the OFT must respond within 90 days.

¹¹ See in particular Annex H to the market study, published at: www.offt.gov.uk/shared_offt/reports/comp_policy/oft967h.pdf.

The market study tool was given added force when the government committed to respond to recommendations made in OFT market study reports within 90 days of publication, stating whether it accepts them and what action it will take to address them. Since 2002 the OFT has conducted 32 studies¹² looking at, and where necessary proposing ways to address, a wide range of market problems.

Peter Freeman last year talked about the use of market investigation references to address government barriers, inefficient market equilibrium and unilateral, coordinated and vertical effects that fall outside of Article 81 and 82. It is useful to note the avoidance of corrupting the application of Articles 81 and 82, and this is a point I will return to below.

The OFT has found it useful to categorise the issues it has examined in market studies under three headings. These are: too little competition because of public restrictions; too little competition due to private restrictions; and markets not working well due to inefficient equilibrium.

Too little competition because of public restrictions

Public sector restrictions on competition can give rise to high levels of consumer detriment. They can raise barriers to entry into markets,¹³ distort the conditions under which market players compete,¹⁴ prevent competitive markets from developing¹⁵, and even take markets or sectors outside the scope of competition scrutiny altogether.¹⁶ Under this heading can be included those market studies which have looked at restrictions on competition imposed by government by means of legislation and public policy. Examples are our Taxis market study¹⁷

¹² This includes on-going studies, including: Personal Current Accounts in the UK (on which a report has been published but there is an open consultation) and Scottish Property Managers.

¹³ For example restrictions on licensing pharmacies prevent open access to the pharmacy market. We addressed these restrictions in our 2003 Pharmacies market study.

¹⁴ For example public subsidies granted to one market player may give it an anti-competitive advantage over its competitors. We addressed the competition effects of public subsidies in our 2006 Public Subsidies market study.

¹⁵ Restrictions on the licensing of unrefined public sector information, considered in our 2006 market study on the Commercial Use of Public Information, stunted the development of new markets for downstream refined information products.

¹⁶ For example certain agreements in the defence sector, and in the coal and steel sector are excluded from the Chapter I prohibition under Schedule 3 of the Competition Act 1998 (and Orders made under that Schedule).

¹⁷ This recommended that local authorities lift quantity restrictions on taxis in their licensing areas, so as to free up market entry. See: www.oft.gov.uk/advice_and_resources/resource_base/market-studies/taxis.

and our Private Dentistry market study.¹⁸ Also included here are studies covering markets in which public sector bodies operate, whether as supplier (see, for example, the Property Searches market study¹⁹ and the Commercial Use of Public Information market study²⁰) or customer (good examples are the market study on the Pharmaceutical Price Regulation Scheme²¹ and the market study on Public Sector Procurement²²). We have also considered ways in which public funding may distort competition in markets, and how to reduce these distortive effects, in our two-part market study on Public Subsidies.²³ This study was highly influential nationally – it led to publication of supplementary guidance to HM Treasury's Green Book. It also influenced the European Commission's state aids policy.

A market study approach is a particularly useful tool for looking at such restrictions, because they are typically not susceptible to enforcement action by the OFT. The 2001 White Paper *A World Class Competition Regime* anticipated and encouraged the use of market studies in this area, stating that it would like the competition authorities to advise on the impact on competition of laws and regulations, and committing the government to consider the advice received, balancing it against other public policy considerations, and to respond setting out its intentions within 90 days of receiving a report. Market studies thus allow for balance in the competition regime – so that we can look even-handedly at competition restrictions that are imposed by government as well as those put in place by business. Market studies are also essential in an effects-based approach that looks at all negative effects on consumers, regardless of their source.

Government has been very receptive to the market studies process, and relatively receptive to the outcomes in terms of the arguments as to why competition is good for consumers and for productivity. Increasingly, we work to persuade government that it can achieve its own policy objectives in alternative ways that do not compromise these benefits of competition. Our competition advocacy team, as well as our strong output of market studies,

¹⁸ This recommended, inter alia, that the restrictions on certain professionals complementary to dentistry (for example, hygienists) be ended, so that they were free to supply their services directly to consumers. Changes made to s 60 of the Health Act 1999 removed restrictions on certain professionals and allowed the GDC to register additional care professionals. See: www.offt.gov.uk/advice_and_resources/resource_base/market-studies/dentistry.

¹⁹ www.offt.gov.uk/shared_offt/reports/consumer_protection/oft810.pdf.

²⁰ www.offt.gov.uk/shared_offt/reports/consumer_protection/oft861.pdf.

²¹ www.offt.gov.uk/shared_offt/reports/comp_policy/oft885.pdf.

²² www.offt.gov.uk/shared_offt/reports/comp_policy/oft742b.pdf.

²³ www.offt.gov.uk/advice_and_resources/resource_base/market-studies/completed/subsidies.

have played a key role in this area. More recent reports have been more influential, as the OFT has continued to develop and refine its approach to stakeholder involvement and engagement with relevant government departments during the course of its studies,²⁴ which have helped to secure greater consensus on the case for change. We have also got better at following up our recommendations with government over time, and continuing to push for change.

For example, the outcome of the Pharmacies market study,²⁵ one of the first to address restrictions arising from government regulation, took the form of recommendations to government to remove entry restrictions which limit the number and location of community pharmacies. The aim was to open up access for all registered pharmacies with qualified staff to be able to dispense NHS prescriptions. We also recommended ending the distinction between controlled and non-controlled areas in England and Wales. At that time, early on in our experience of seeking buy-in to our market study proposals, the outcome was not as good as we had hoped. The government loosened entry barriers in certain areas only, and decided to modify the entry control regulations rather than abolish them. In Scotland, the Scottish Executive rejected OFT's recommendations because of concerns about loss of services in remote and rural areas.

By contrast, with changed engagement, the recommendations in the recent Commercial Use of Public Information market study²⁶ were well received. The government committed to looking more closely at public sector information held by trading funds (a particular kind of public sector body) to distinguish more clearly what is required by government for public tasks, ensuring this information is made available as widely as possible for use in actual and potential downstream markets. It also committed to a pricing policy based on the principle that information collected for public purposes will be made available at a price that balances the need for access with ensuring that customers pay a fair contribution to the cost of collecting this information in the long term.²⁷ In

²⁴ This was an area of learning for us because section 7 of the Enterprise Act 2002 gave the OFT a new function of making recommendations to Ministers and other public bodies on matters relating to its competition and consumer functions. In particular, market studies under the Fair Trading Act 1973 typically had not addressed restrictions arising from government regulation.

²⁵ www.offt.gov.uk/advice_and_resources/resource_base/market-studies/completed/pharmacies .

²⁶ www.offt.gov.uk/shared_offt/reports/consumer_protection/oft861.pdf.

²⁷ www.berr.gov.uk/bbf/competition/market-studies/public-information/page39978.html.

June this year the government announced a review of the trading fund model that will take forward these commitments.²⁸

The benefits of this study are several fold: there is the potential impact in this market that will come out of the work by government on the trading fund review, there is also the increased OFT understanding of complex competitive neutrality issues that are often hidden from competition and consumer agencies; in addition our work helped build a positive relationship with business.

Where public restrictions on competition are concerned, it is for the government to make the trade off between increased competition and other public policy issues, and it is right that the government takes the decision on what action, if any, to take. The role of the OFT is to estimate the cost of lost competition and to advocate change.

Too little competition because of private restrictions

This category covers both widespread concerns about consumer protection problems in markets, and studies where private restrictions interact with regulation in a way that appears to harm consumers.

In the area of consumer protection, market studies are appropriate in cases where possible breaches of consumer law or other concerns are prevalent in the market in question. In such cases, a market study that highlights the prevalence and type of breach or concern can be a more efficient way to achieve change than bringing more narrowly-based consumer law enforcement cases against individual companies. Consumer law issues considered have typically been in the areas of contract terms. At the same time we have often addressed an imbalance of bargaining power arising from factors such as lack of information, or the vulnerability of the group of consumers involved, using the study to empower consumers by seeking clearer information from businesses and encouraging them to be more selective on the basis of this information, or carrying out a consumer education campaign as we did at the end of the Internet Shopping market study.²⁹

²⁸ The terms of reference of the trading fund review are here:

www.shareholderexecutive.gov.uk/publications/pdf/tradingfunds250608.pdf.

²⁹ www.oft.gov.uk/advice_and_resources/resource_base/market-studies/completed/internet.

One example is the Care Homes market study,³⁰ where we found that people need easier access to information when choosing a care home, and that care homes need to ensure that fee related terms used in their contracts are fair and transparent. Another is the Ticket Agents market study³¹ as a result of which the OFT negotiated with the Society of Ticket Agents and Retailers for model terms of business, and the Committee for Advertising Practice amended its non-broadcast event advertising guidance and identified key points for consumers to check before buying entertainment tickets.

More recently, in our Homebuilding market study,³² the OFT found that there were few competition concerns in the market, but that many homebuyers experience some faults with a new home, and some suffer significant detriment. In addition we had concerns about the sales process for buying a new home, specifically about reservation fees and the clarity of information provided to homebuyers. We considered that some terms and conditions in many contracts used across the industry could be potentially unfair under consumer law.³³

In some cases (for example the Doorstep Selling market study³⁴ and the Estate Agents market study³⁵) studies in this category have led to recommendations for changes to the law to provide additional protection for consumers. Such changes are subject to the commitment by the government to respond within 90 days, and experience shows that the change itself can take some time. For example, the Estate Agents market study reported in March 2004, but it was not until November 2007 that the Consumers and Estate Agents Redress Act became law.

Most recently our Sale and Rent Back market study led to recommendations that the FSA should regulate sale and rent back transactions. We considered that such regulation could include: standards of disclosure around sale price, valuation, term and rent; giving consumers the opportunity to seek independent advice; and allowing consumers a minimum length of tenure under the rent back arrangements. In the interim we recommended that there should be increased self-regulation, and action by the OFT to raise consumer awareness of the risks of sale and rent back agreements.

³⁰ www.of.gov.uk/shared_of/reports/consumer_protection/oft780.pdf.

³¹ www.of.gov.uk/shared_of/reports/consumer_protection/oft762.pdf.

³² www.of.gov.uk/advice_and_resources/resource_base/market-studies/current/home1.

³³ The Unfair Terms in Consumer Contracts Regulations 1999.

³⁴ www.of.gov.uk/shared_of/reports/consumer_protection/oft716.pdf.

It is relatively rare for the OFT to recommend regulation. In this case, however, we judged it proportionate to do so because we found very serious consumer harm that was not illegal. We were concerned in particular about the asymmetry of the risks faced by consumers in comparison with those faced by businesses involved in the sale and rent back product. This shows our ability to be adroit about market issues and to respond quickly; this was a five month market study.

In the area of private restrictions interacting with regulation in a way that appears to harm consumers, market studies come into play as an important diagnostic tool that helps to assess the root cause of any problems, and to identify the most appropriate ways to remedy them. I have already mentioned the examples of UK Airports and Medicines Distribution, which fall into this category.

As noted, the flexibility of the market studies tool thus provides a means of addressing what might initially appear to be private restrictions on competition or sources of market power that are susceptible to action under Chapter 1 or Chapter 2 of CA98, but where, on closer inspection, CA98 enforcement action cannot, or cannot best,³⁶ remedy the problems found. Market studies are therefore not a substitute for enforcement action. Rather they can address issues that are unsolvable by enforcement action. In some cases they can address problems that might be susceptible to enforcement action, but where such action would be inappropriate, and an incomplete solution: using a market study we can address the root cause of a problem rather than trying to stretch our enforcement powers inappropriately to tackle individual examples of its consequences in a market.³⁷ The availability of market studies thus enables the OFT to limit the scope of CA98 to its primary purpose of sanctioning anti-competitive agreements and abusive conduct, without extending it into areas where it might substantially chill competition.

³⁵ www.offt.gov.uk/shared_offt/reports/consumer_protection/oft693.pdf.

³⁶ Enforcement action may, for example, address the behaviour of individual firms, yet leave in place distortive regulation or other market wide problems that, if remedied, would address concerns across the whole market from the outset.

³⁷ In determining the best remedy to any given problem we will always take into consideration our duties under Article 3 of Regulation 1/2003/EC.

Market not working well due to inefficient market equilibrium

A number of markets which have been the subject of market studies can be characterised as being in an undesirable state of equilibrium which is not working well for consumers. Typically these are oligopolistic markets where there appears to be a lack of competition, although there is no evidence of anti-competitive conduct or agreements capable of being addressed using the OFT's competition enforcement powers, and any market power is shared among several competitors all subject to normal merger control. Problems that exist have emerged from the exercise of the (often highly) competitive process – from firms' competitive best responses to each other over time – rather than from the absence or the suppression of the competitive process.

A common example is information failures. A key feature of markets that have developed into an inefficient equilibrium may be an insufficiency of information about pricing of component parts of bundled or add-on services or products, such that consumers are unable to assess the price of individual components against the price of competing components. This inhibits switching and dampens the competitive process. An absence of comparable measures of quality, range and service across a market may add to the dampening effect. To combat the inefficient equilibrium there may be a need for clear pricing of component parts of any product or service, possibly combined with agreed standards of quality range and service, to facilitate comparison.

Particular issues may arise in relation to pricing in consumer aftermarkets. Behavioural economics shows that consumers often only pay attention to upfront prices and may not fully consider charges later on, and that consumers are often overly optimistic when estimating their likely future demand for add-ons. Firms can exploit this optimism by extracting surplus from the consumers by a combination of lower up-front charges and higher later charges for the add-ons they did not think they would need. In these types of market, competition may drive firms to price below cost for the upfront product and price significantly above cost for any add-ons or follow on charges. The result is intense competition on some elements and very little competition on other elements.

In these kinds of markets the harm to consumers may be of a different nature to those markets where there are regulatory restrictions of competition, or where there is persistent market power combined with regulatory barriers to entry. In these types of markets there is the possibility of four types of consumer harm:

- First, it may not be clear that the excess profits being made through add-ons are competed away in the primary markets.
- Second, even if all profits are competed away in the primary market, acute discrepancies between price and the underlying cost provide poor allocative efficiency signals. As a result consumers may buy products they do not value and be reluctant to buy the add-on they do value.
- Third, these discrepancies may also provide poor signals for the development of new and innovative products if much of the revenues from these markets is shielded from competition.
- Finally, in some cases the consumers who pay the higher prices for the add-on may be a narrower group than those receiving the low up-front prices. The OFT may be concerned when the consumers who subsidise the rest are particularly vulnerable in society.

This is not to say that all add-on pricing is bad. In some cases it can be an efficient way of covering fixed costs. The purpose of the market study is thus to differentiate between these cases and cases where consumers are likely to be significantly harmed.

To sum up, in cases of inefficient market equilibrium there will typically be no deliberate action to restrict competition, indeed the harm arises from the working of the competitive process. This can be contrasted with harm in cases where competition enforcement action is needed, where detriment typically results from deliberate anti-competitive conduct – and OFT's enforcement policy will have a strong deterrence goal. Nevertheless, the market will have evolved into an equilibrium that causes harm to consumers and, because it may be market wide, the levels of consumer detriment may be quite high. Some intervention is therefore warranted – but the emphasis is on ensuring that any remedies are proportionate, workable and do not themselves create distortions. The best route in such cases may be to seek voluntary remedies from firms in the market, at least as a first step. This gives maximum scope for market forces to operate, allows firms – who are closest to their consumers – to determine what will work best, thereby maximising the likelihood of achieving workable remedies, and provides flexibility to innovate and adapt to changing market circumstances.

When addressing an inefficient market equilibrium, our preference will be for remedies that push the market to find that equilibrium for itself, rather than those (such as price regulation) which merely replicate it. The former may be less immediate and obvious in their effect, but are likely to be better for the longer term development of the market process.

If voluntary remedies are not forthcoming it may then be appropriate to consider calling into play the more formal remedial powers that may be available³⁸ in the event that the legal test for a market investigation reference is met. Market investigation references can complement market studies by the OFT where more formal, or binding, remedies appear the only workable outcome – as with the case of our study on UK airports³⁹ and the subsequent market investigation reference of BAA⁴⁰ – or where the CC's more formal processes would be beneficial. The OFT is mindful of the fact that a reference to the CC imposes additional burdens on the affected businesses by comparison with its own market studies, and will favour early voluntary resolution where this is possible.

A good and topical example of the OFT looking at a possible 'bad equilibrium' involving both kinds of harm outlined above is the market study into Personal Current Accounts in the UK,⁴¹ published in July this year.⁴² We found that the personal current account market was not working well for consumers because a lack of transparency focused competition on visible fees and not on less visible elements such as insufficient funds charges and foregone interest.

We found that the market was distorted in three ways:

- First, there was a cross-subsidy between consumers who pay insufficient fund charges and those who do not. This was, in many cases, a transfer from the more 'vulnerable' consumers – those on low incomes and with low savings – to consumers with higher incomes and savings.

³⁸ By way of formal undertakings (either in lieu of, or following, any reference) or an Order following a reference.

³⁹ www.offt.gov.uk/shared_offt/reports/transport/oft882.pdf.

⁴⁰ www.offt.gov.uk/shared_offt/reports/transport/oft912.pdf.

⁴¹ www.offt.gov.uk/shared_offt/reports/financial_products/OFT1005.pdf.

⁴² Other examples are the market studies on Store Cards and PPI.

- Second, there was misalignment between banks' revenues and costs on many services which could lead to inefficiency through under or over consumption of services by consumers.
- Third, there was a lack of consumer awareness of, and switching in relation to, the less visible elements of the personal current account product. This gave the banks little incentive to compete on these elements, which could impact on longer term productivity in the banking sector.

Improving competition in such markets is likely to require action on the part of suppliers, for example to introduce mechanisms to facilitate switching and to provide information to consumers about them; and proactiveness on the part of consumers to take advantage of the available opportunities and thus drive competition. As well as measures to help the industry as a whole to change, there is potential for the banks voluntarily to introduce remedies in response to the issues identified by the OFT. Such an approach, where it leads to genuine change, can be a good, quick and effective outcome, avoiding the need for prolonged investigation and an imposed regulatory solution. We hope that the consultation in the Personal Current Account market study will be just such a case.

Once we have explored the scope for voluntary action we can take a view on whether a market investigation reference is needed to remedy the problems found, using the process for securing undertakings in lieu of a reference to the CC if appropriate.

Summary

To summarise, market studies can complement enforcement work and facilitate the efficient working of markets in the following ways:

- in the public sector arena they can target regulatory and other public barriers to competition, promoting productive efficiency and helping to reduce rents
- in the private sector arena, they can help to target misleading sales practices and to pinpoint and propose measures to protect consumers

who may not be in a position to exercise power in markets, or help us to examine markets where a combination of factors appears to be at play, to diagnose the problem and arrive at the most appropriate solution, and

- they can also propose measures to address inefficient market equilibria, such as those caused by information deficits that can lead to severe cases of allocative inefficiency or vulnerable consumers significantly losing out through cross-subsidies.

Studies in any category will consider both the supply and the demand side of the market in question. As part of this, consumer side issues such as imbalances of bargaining power, information problems in markets, or the vulnerability of the group of consumers involved will often be examined. Information issues, for example, came up in both the Homebuilding and the Personal Current Accounts market studies. In this way market studies help to join up competition and consumer analysis, ensuring that we gain a comprehensive understanding of all interactions in a market.

How do we conduct studies?

The OFT's published guidance on its approach to conducting market studies covers how we choose markets to study and information on procedures.⁴³ We plan to update this guidance within the forthcoming year to reflect developments in the way that studies are conducted, drawing on our experience to date. What follows focuses in particular on three key aspects of process: how we select and prioritise markets for study; how we engage with stakeholders during the course of a study; and how we communicate, and follow up on our findings at the end of a study.

Selecting and prioritising markets for study

The OFT has limited resources at its disposal. In order to maximise the impact of these resources, it needs to make careful decisions as to the issues it chooses to address, and the most appropriate tool with which to address them. In identifying markets to study, the OFT draws on intelligence from a number of sources, including:

⁴³ OFT 519, at www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft519.pdf.

- complaints from businesses, consumers and other stakeholders
- super-complaints from consumer bodies
- consultation with stakeholders
- suggestions and requests from government, and
- own initiative concerns.

This intelligence is subjected to an initial fact-based filter to refine possible areas of study, together with preliminary thinking about theories of harm and possible remedies. Ideas for studies are then considered, alongside other potential projects from across the range of tools at the OFT's disposal. The basis for selecting studies was initially set out in our market studies guidance.⁴⁴ In September 2007 we published for consultation new draft prioritisation principles which apply to the majority of the OFT's work, including market studies.⁴⁵ We will shortly publish the final prioritisation principles, together with a summary of the points made to us during the consultation. The principles, which are designed to ensure that the OFT's finite resources are deployed to produce the greatest benefit to consumers, are:

- Impact
 - What is the likely direct or indirect impact on consumers?
 - What are the wider economic benefits?
- Strategic significance
 - Does the work tie in with the OFT's strategy and objectives?
 - Is the OFT best placed to act?
 - How would the balance of the OFT's portfolio be affected?
- Risks
 - What is the likelihood of a successful outcome?
- Resources
 - What are the resource implications of doing the work?

It can be a challenge to find constant fresh ideas, but Scottish Property Managers and Sale and Rent Back, our most recent market studies, are a good example of the selection and prioritisation process working.

⁴⁴ Ibid, at paragraph 2.5.

⁴⁵ www.of.gov.uk/shared_of/consultations/of953con.pdf.

Engaging with stakeholders

Once the decision has been taken to conduct a study, the OFT follows a now well-established approach to project management through the pre-launch phase, the launch of the study, data collection and analysis, consultation with stakeholders on provisional findings and outcomes, publication of its report, and following up any recommendations. Our processes are continually refined as a result of lessons learned from our experience and responsiveness to the views of stakeholders, and we place particular emphasis on ensuring our data requests are suitably focussed, the quality of our analysis, the effectiveness of our project management and delivery, and transparency in our dealings with stakeholders.

A criticism of our market studies has been that, unlike market investigation references, for example, they don't have a set process for engaging with stakeholders. This is factually correct, but means that our studies have the benefit of greater flexibility. In recent cases, for example, we have adopted innovative approaches to securing stakeholder input on remedies. Our consultation following publication of our study on Personal Current Accounts is just one example. Our goal is a final report in early 2009, containing recommendations that the banking industry can take forward, in consultation with government and other relevant parties. If this approach fails we will consider a market investigation reference, alongside other possible options.

Another example is the Homebuilding market study, where in June 2008 we published the following draft findings and evidence: the results of our consumer survey, indicating our concerns that, for a small proportion of buyers of new homes, defects are both serious and costly; an independent study of financing for homebuilders demonstrating that holding of landbanks reflects the need to have a pipeline of land at different stages of the planning process, rather than a reluctance to develop or a desire to prevent competition; our mystery shopping exercise about information provided to homebuyers; and an independent study of new home warranties and their shortcomings. These draft findings provided a basis for discussion with the industry, consumer groups and other stakeholders during the period from June to September. The industry acknowledged our concerns, and our early publication of these findings meant that, prior to publication on 25 September, a number of bodies had agreed to work towards a new code of conduct to address them, backed up with a recommendation to the government to legislate in the event that the industry fails to make adequate progress or to deliver an effective solution to the concerns raised, to introduce a

statutory redress mechanism for new homebuyers funded by a levy on the industry.

We have learnt that constructive engagement with stakeholders is critical to the success of any study. It is crucial to obtaining a strong evidence base, working up an accurate picture of consumer detriment in a market, and arriving at remedies that are workable and that industry and/or government will be likely to accept. We are developing the way that we engage with business and with government to maximise the likely impact of our studies.

Communication and follow-up on findings

Our findings, when they are ready, are published in the form of a report. We will typically annex to each report the results of surveys and other detailed evidence that underpins our findings.

If we are making recommendations to government these are included in our report and government will, within the agreed 90 day period, consider our recommendations and formally respond to them, setting out how far it accepts them and why, and what it will do to implement those it accepts. Where recommendations for legislative or other policy change are accepted,⁴⁶ government will carry out an Impact Assessment. OFT usually works alongside the relevant government department both during the 90 day period and afterwards – to explain its findings, advocate the recommended change and provide information for the Impact Assessment. When the outcome of our recommendations is new legislation, this may involve a significant commitment. An example is the Consumers and Estate Agents Redress Act 2007, which came out of recommendations in the 2004 Estate Agents Market Study, as mentioned earlier.

In cases that involve recommendations to industry or consumer bodies, we will typically work with those bodies for a period both before and after the recommendations are published to help ensure that they are workable, that they address the problems that we have identified, and that they are acted on. Sometimes this involves considering, and, if appropriate approving, consumer codes of practice under section 8 of the Enterprise Act 2002. An example is the

⁴⁶ If the proposal imposes or reduces cost on business or the third sector. See BRE Impact Assessment Guidance at www.berr.gov.uk/files/file44544.pdf.

Society of Motor Manufacturers and Traders' Consumer Code of Practice, which built in recommendations from the OFT's New Car Warranties market study.

The success of the market study approach thus relies on cooperation from government, business, and consumers:

- government to recognise the contribution that the OFT's recommendations to eliminate public restrictions on competition and empower consumers can make to efficient and productive markets, and respond positively to them
- business to help us to identify anticompetitive public restrictions, and to recognise the benefits of engaging actively with the OFT to implement proportionate remedies on a negotiated basis, thus reducing their own costs and bringing about timely resolution to the problems identified by market studies, and
- consumers to drive competition by taking advantage of the enhanced opportunities to exercise choice, for example by switching suppliers to secure lower prices or improved quality.

Success must be measured over time. Recommendations can take some time to be implemented, and even studies that don't result in immediate change can influence policy debate or business or consumer practice to nudge markets towards greater competition. It is important not to see non-implementation as defeat: we need to recognise that government is sovereign and that a good report will be valuable in the future.

The overall performance of market studies

The performance of the market studies regime can be looked at from several perspectives: evaluating the impact of individual studies; impact on business, and hence consumers, in terms of burdens etc; and wider systemic benefits. This section looks at each in turn.

Evaluating the impact of individual studies

The OFT is a world leader in ex post evaluation of its work. For all its work, including market studies, it has embedded into project plans a system of impact estimation that aims to measure the impact of the outcomes. Project teams

estimate the likely impact of their work, following the principles and process established in our publication *Approach to calculating direct benefits to consumers*⁴⁷ by setting out and regularly revising an Impact Estimation Plan that outlines what outcomes the study is designed to achieve, an estimate of the scale of impact, and how the impact will be measured. This process helps the OFT to demonstrate value for money. When the project has been completed, the Impact Estimation Plan is used to provide an estimate of direct financial benefits to consumers from the study. OFT annual reports will include estimates of consumer savings from those completed market studies whose recommendations were implemented in the reporting period. Overall annual consumer savings from market studies, and the related work of market investigation references to the CC and reviews by the OFT of undertakings and orders made as a result of CC reports, were estimated to be at least £266 million for the three year period 2005 to 2008. Of this, £122 million has been apportioned to the OFT.⁴⁸

More in-depth ex post evaluations of individual market studies are also carried out with a view to informing: the choice of what markets to study, helping the OFT to focus on those markets where it is likely to have the most impact; how to conduct studies so as to maximise their impact; and whether further action could be taken in the market. To secure suitable independence in the findings, these evaluations are undertaken by external economic consultants. It is not possible to evaluate many studies in this way because of the cost of doing so. However, the OFT is committed in its annual plan to commission an independent evaluation of the impact of at least one market study this year. We have published an evaluation strategy for market studies⁴⁹ which defines the criteria the OFT will use for deciding which studies to evaluate. It also describes how the OFT embeds evaluation in market studies through the definition of success criteria and monitoring arrangements for market studies published after April 2007.

⁴⁷ Published at: www.offt.gov.uk/shared_offt/reports/Evaluating-OFTs-work/oft955.pdf.

⁴⁸ Paragraph 6.3 Positive Impact 07/08, OFT 1007, published July 2008. The overall figure of £266 million includes the benefits flowing from studies that became market investigation references. The apportionment reflects a split between the value of the OFT portion of this work and the CC portion of this work. The estimates are low end figures as they only include two market studies, the recommendations from which were implemented in 2007/08. They do not include any other studies conducted or implemented during that three year period. More detail on the calculation of these figures is set out in Chapter 6 of the report, available here: www.offt.gov.uk/shared_offt/reports/Evaluating-OFTs-work/oft1007.pdf.

⁴⁹ www.offt.gov.uk/shared_offt/about_offt/oft862.pdf.

In 2006/07 and 2007/08 we evaluated the 2003 New Car Warranties market study⁵⁰ and the 2003 Taxis market study.⁵¹ The New Car Warranties evaluation found that the study led to savings for car owners and fleet operators of £120 to £170 million. The Taxis evaluation found that the study resulted in £2 to £5 million of actual consumer benefit, and a further potential £5 to £13 million consumer benefit from future de-restriction.

From both evaluations, the OFT was able to draw lessons about maximising the positive impact of studies. In the first of them we found that changing the rules of the market makes little difference unless market participants are informed. In the second, we learnt that benefits in the taxi market could have been increased if OFT had recommended not only that quantity controls on taxi licences be lifted, but also that regulated fares be brought closer to market clearing levels. If the lifting of quantity controls had been accompanied by a reduction in the regulated price, this would have addressed the productivity loss that resulted from our recommendations: more drivers entered the market because quantity controls were lifted, so consumers benefited from shorter waiting times – but there was reduced capacity utilisation because fares were set at a level that encouraged over-supply of drivers.

In 2008/09 we have evaluated the Extended Warranties on Domestic Electrical Goods Order 2005.⁵² The Order arose from a monopoly reference by the OFT to the CC under the Fair Trading Act 1973, following an OFT study⁵³ of the market for extended warranties on domestic electrical goods, published in 2002. We engaged LECG to carry out the evaluation, on an independent basis. LECG found that consumer awareness and behaviour in the extended warranty market had improved since implementation of the Order, leading to estimated yearly savings for consumers of around £19 million. On the other hand there had been limited compliance by industry with some of the Order's requirements. In the light of this finding, OFT has written to retailers that do not comply with the Order, and is working closely with industry bodies to ensure that stores that sell domestic electrical goods are aware of their obligations.

⁵⁰ June 2006, published at: www.offt.gov.uk/shared_offt/about_offt/oft852.pdf.

⁵¹ October 2007, published at: www.offt.gov.uk/shared_offt/reports/Evaluating-OFTs-work/oft956.pdf.

⁵² Published at: www.offt.gov.uk/shared_offt/reports/Evaluating-OFTs-work/oft1024.pdf.

⁵³ This was not a market study under the Enterprise Act, but was the last of our studies under the preceding legislation, section 2 of the Fair Trading Act 1973.

Evaluation in this way tells us not only about the benefits of individual studies but also informs us about how we could have done better.

Impact of market studies on business

The direct and indirect cost of market studies to business is an important theme that has emerged as our market study work has evolved. It surfaced particularly in our consultation with stakeholders during our recent internal review of our market studies work⁵⁴. Specifically, it has been argued that the regulatory burden of the OFT's intervention is disproportionate to the harm caused by the issues being investigated.

Consumer welfare is at the heart of the OFT's work, and direct and indirect costs to business matter crucially because ultimately these costs are borne by consumers, especially so in competitive markets. So it would not only be disproportionately burdensome to business, but also an abrogation of our objective of benefit to consumers, if the net effect on consumer welfare was negative because the cost to business exceeded the intervention.

For this reason, we take account of the fact that our studies impose costs on business, as well as on the public purse, when selecting markets or issues for study. In some cases, of course, notwithstanding our independence from government, and our aim of prioritising our own work in accordance with consistent criteria, we do not have full control of our agenda: our statutory duty to respond to super-complaints from designated consumer bodies, court decisions, and requests from government to take action, all influence the work that we do.

We also aim to reduce regulatory burdens by the way in which we conduct our studies. For example, we seek to keep information requests to a minimum, and we are always open to discussing with parties alternative ways of obtaining the evidence which is necessary to conduct our analysis. Interaction with related work by other regulators is carefully managed, to avoid overlaps and duplication, and where possible to coordinate information requests and other demands.

⁵⁴ The results of this work were discussed at our Market Studies Conference, held in June 2008. For further information go to www.offt.gov.uk/advice_and_resources/resource_base/market-studies/conference.

By comparison with other forms of intervention, market studies stand up well to scrutiny, both in terms of the costs they give rise to and the benefits they bring. By comparison with most other forms of intervention, market studies are 'light touch' – there are no formal powers of investigation,⁵⁵ and recommendations are often designed to reduce or remove regulation rather than impose it. Where studies do recommend changes in business practice, these are typically to be achieved by consensus rather than being imposed.

In weighing costs against benefits it is important to bear in mind that, while many of the costs (such as legal costs and management time during the study) are 'one-offs', the benefits will be felt on an ongoing basis following the implementation of the remedies, and may have knock-on effects in other markets. Simplistic comparisons between the cost of the study and the size of the market in terms of annual turnover are therefore not a valid measure. Even studies which lead to a 'clean bill of health' can bring about benefits to the market in question, for example by removing regulatory uncertainty or promoting consumer confidence.

An example is the CC's market investigation of Northern Ireland Banking. This followed a market investigation reference by the OFT, resulting from a super-complaint. No market study was involved but the principles are relevant to market studies nonetheless. In this case, firms argued that the costs to business of engaging with the market investigation – over £20 million – were disproportionate in a market with an annual value of £180 million. We understand this point of view. However, we consider, first, that the benefits of any study must be measured over a longer period. The benefits that come out of the Northern Ireland Banking market investigation will continue to be felt for years to come, and the discounted present value of these benefits is a more appropriate measure against the one-off costs of the work. Second, we consider that the clarifying effect of a study or investigation can also bring significant benefits. In this case the CC gave a clean bill of health in respect of claims of tacit coordination. Its work also produced important lessons for the wider UK banking market, informing the approach for industry and for the OFT in the context of OFT's market study on Personal Current Accounts in the UK.

⁵⁵ Unless the OFT is moving towards making a market investigation reference, and determines that it has the power to make a reference. At this point the formal investigation powers in section 174 Enterprise Act 2002 become available.

The benefits of increased clarity about how a market is working are not to be underestimated, and should be weighed in the balance against any costs.

Third, our market studies have often dismissed concerns that have been put to us, and where, for example, the benefits consumers receive relative to the counterfactual are not clear, they represent an opportunity for business to demonstrate that the market is working well. Examples of cases where some of the concerns raised with us have been found not to be valid include our market studies on Homebuilding and Personal Current Accounts in the UK, where we pointed to the existence of strong competitive pressures. Absent a mechanism for flexible examination of such concerns by a body that is independent of government, there is a risk that more interventionist measures – for example government regulation – would result.

We do not believe that explicit, up-front calculation of the direct and indirect costs to business of individual market studies is either necessary or useful, nor that it would represent a good use of our public resources. Instead we will strive to ensure that the gains from intervention, in terms of productivity as well as benefit to consumers, outweigh the costs, taking into account that benefits will only be felt by consumers to the extent that they exceed the study-related costs that will be passed on to them by business. The OFT has a target (not limited to market studies) that our work should deliver measurable benefits to consumers of at least five times our annual budget. We evaluate our work continuously to check how we are doing against this target. We have started to include the regulatory burden on business in our evaluations of individual market studies and we will explore other ways to take account of the cost to business of our work.

Our overall principle in selecting and conducting studies is that the benefits of intervention should outweigh all the costs. In most cases, as our evaluation process helps to demonstrate, the direct benefits vastly exceed the likely costs of the intervention. In some cases the direct benefits may not exceed the likely costs but the market study has other benefits. For example, giving aspects of the market a clean bill of health may be highly beneficial in a market where prior to the study being conducted policy makers were considering increasing regulation.

Wider benefits of market studies

When examining the data on costs and benefits of market studies, it is important not to lose sight of the bigger picture, namely: that market studies also have wider benefits both in terms of productivity and the public accountability of markets; and that market studies are increasingly recognised as a critical tool for competition and competition and consumer agencies internationally.

Productivity benefits

While they address different types of issue, all the OFT's market studies have as their aim to make markets more efficient and competitive. This is not only in the interests of consumers, whose welfare is the OFT's primary focus:⁵⁶ it can also have positive effects on productivity.

The OFT's recent paper on *Productivity and Competition* showed that competition can promote productivity in three ways:⁵⁷

- through 'within firm effects' whereby competition places pressure on managers to push their firms closer to their efficiency boundaries⁵⁸
- through 'between firm effects', whereby poorly performing firms either lose market share or are driven out of the market, and their share of the market is reallocated to more efficient firms, and⁵⁹

⁵⁶ We pursue a standard of long run consumer welfare. This helps us to: offset firms' profit maximising tendencies where this is not in line with total welfare, ensure that consumers are protected where they need to be, promote potential productivity gains. We believe this is the best way for us to help ensure that markets move, ultimately, towards total welfare.

⁵⁷ Published in January 2007 at: www.offt.gov.uk/shared_offt/economic_research/oft887.pdf.

⁵⁸ See, for example, Bloom, N. and Van Reenen, J. (2006) 'Measuring and Explaining Management Practices Across Firms and Countries', *NBER Working Paper*, No. 12216.

⁵⁹ See, e.g: Baldwin, J. R. and Gu, W. (2006), 'Competition, Firm Turnover and Productivity Growth', *Economic Analysis (EA), Research Paper Series*, No. 042, and Disney, R. Haskel, J. and Heden, Y. (2003), 'Restructuring and Productivity Growth in UK Manufacturing', *Economic Journal*, 113.

- through 'product and process innovation' where competition can provide firms with an incentive to innovate and to reduce costs, and thus keep ahead of their competitors.⁶⁰

Action by competition and consumer authorities has a part to play in promoting competitive markets, although there are other important drivers as well, such as openness to trade, and ability to innovate. Of the tools available to competition and consumer authorities, enforcement can prevent abuses of market power and agreements that restrict competition. Market studies can, however, look at other aspects of market structure and conduct and may thus be able to address factors affecting productivity which are beyond the scope of enforcement tools, such as regulatory barriers to entry. The UK competition regime leads the way in drawing together the links between increased consumer welfare and enhanced productivity.⁶¹

Public accountability of markets

There are further general benefits of market studies that are often ignored or underestimated. Market studies play a key role in terms of what we might call the public accountability of markets, and the part firms have to play in responsible conduct of their business that promotes the free flow of market forces. Businesses in most sectors of the UK economy enjoy enormous freedom in terms of entry, pricing and other decisions. This is true by international standards, and in historical terms, and the OFT supports open markets, on the basis that they generally produce good consumer outcomes.

Sometimes, however, the operation of the competitive process results in outcomes that are bad for consumers – as in the case of inefficient market equilibria. Sometimes the outcomes may appear bad for consumer welfare even where they are not. In these cases market studies play an important diagnostic role: distinguishing between the two scenarios; identifying remedial action when outcomes are bad for consumers; and giving an independent clean

⁶⁰ See for example, Geroski, P (1990) 'Innovation, Technological Opportunity, and Market Structure', *Oxford Economic Papers*, Vol. 42, Blundell, R. Griffith, R. & Van Reenen, J. (1995), 'Dynamic count data models of technological innovation', *Economic Journal*, 105, Griffiths, R. Harrison, R. and Simpson, H. (2006), 'The Link Between Product Market Reform, Innovation and EU Macroeconomic Performance', *European Economy Economic Papers* No. 243.

bill of health where outcomes appear bad for consumers but are not. Where outcomes appear bad but are not, the counterfactual will often be increased regulation. In these circumstances market studies help build support for the effectiveness of the market process and competition policy rather than regulated markets.

In this way market studies operate effectively as a quid pro quo for economic freedom, and ultimately a protection from what might be chilling regulatory intervention. Together with market investigation references, market studies provide the UK regime with an additional route to address problems that are not best addressed by enforcement action. Taken together they can be seen as beneficial to maintaining public confidence in open and free markets, empowering consumers to drive demand and make markets deliver what they want.

In our view the arguments on public accountability are an effective counterweight to concerns that legislators should impose hurdles on competition and consumer agencies before they can look at what business does.

Market studies internationally

The OFT is not alone among competition and consumer authorities in seeing the benefits of the market studies tool. Internationally, market studies have a respectable history. In the US, the legislation that created the Federal Trade Commission in 1914 empowered it to 'gather and compile information concerning ... the organisation, business, conduct, practices and management' of persons and of corporations. More recently market studies have grown more popular as a tool for competition (or competition and consumer) authorities.

Many agencies have powers to study markets generally, either through an explicit power or as part of their competition advocacy role. For example, in the EU context, the European Commission has the power⁶² to conduct 'sector inquiries' in cases where the trend of trade between the Member States, the rigidity of prices or other circumstances suggest that competition may be restricted or distorted within the common market. Sector inquiries are unlike market studies in that their principal purpose is to consider later enforcement

⁶¹ See, for example, the Taxis market study, the Pharmacies market study and the Private Dentistry market study referred to above.

⁶² Under Article 17 of Council Regulation 1/2003/EC.

action under Article 81 and or Article 82, and the Commission can bring to bear all the formal powers of investigation it has to enforce those Articles. It is notable that a number of other authorities are taking an increasing interest in the market study tool, and it is clear that the success of the UK's market studies programme has been influential in this.

The OFT is currently leading an International Competition Network project on market studies as part of the ICN's Advocacy Working Group. This will examine member countries' experience with market studies, focusing on selection, procedure and outcomes. It will consider developing a guidance document with procedure and evaluation criteria for market studies.

Summary

I have considered costs here at some length, in part because it is critical that the better regulation agenda understands the benefits, as well as the costs, of what competition and consumer agencies do. It is also critical, however, to assess the burdens we impose because these will, in all likelihood, be passed on to consumers.

In summary I believe market studies achieve outcomes that are beneficial not just to consumers but also, on a wider perspective, to business and to the economy as a whole in the way that they help to promote productivity and to make markets publicly accountable.

Conclusions and looking forward

In terms of conclusions, I hope this speech has clarified that the OFT sees market studies as an essential part of the system of competition and consumer policy. Taking an effects-based approach, market studies are a flexible diagnostic tool that joins consumer and competition policy, enabling the OFT to address areas and issues that cannot be addressed by its other tools, while avoiding the inappropriate use of enforcement action.

Market studies have brought measurable direct benefits in terms of the removal of government restrictions, supporting advocacy and a competition culture in government, changing business behaviour and driving productivity growth and consumer welfare. We recognise that there has been room for improvement in the way that we have used the market studies tool in some cases, and we are taking steps, in particular, to engage more effectively with stakeholders.

By using market studies as a diagnostic tool, we are able to improve the use of our other instruments, including our enforcement powers. We also see market studies as helping us to achieve greater understanding of perceived market problems, and giving a clean bill of health where warranted.

Market studies help to demonstrate that open markets are publicly accountable, and this builds a broader constituent base of support for competition and consumer policy. This approach is consistent with emerging international best practice.

Looking forward, the OFT expects market studies to continue to play a central role in its work to address public sector restrictions on competition and the competitive process, as well as private sector restrictions where there may be widespread consumer protection issues or where there is a need for diagnosis of the causes of problems in markets.

We will also continue to intervene in markets, such as that for personal current accounts, where there is an inefficient market equilibrium which we believe is capable of being addressed by proportionate measures which can be brought about by action on our part and the cooperation of the firms involved. There is significant potential to implement such measures and thus make markets work better without the use of compulsory remedies in cases where enforcement action is not appropriate. In this sense, market studies by the OFT can be seen as acting as a catalyst in a process of change management, in which the action necessary to make the market work better is for others to take. It is important, however, to maintain the possibility of using undertakings in lieu of reference, or a reference itself, if a consensual approach fails.

We anticipate that our market studies work will include some first phase work for market investigation references. We will continue in our practice of not using market studies as an alternative to enforcement action, but rather in those cases where enforcement action is not the most appropriate route to address underlying market problems.

It is unclear whether government restrictions or the incidence of inefficient market equilibrium will change in the new economic climate. We will adapt our priorities as needed to address these developments.

At the same time we will adopt a more systematic and transparent approach to prioritisation, applying our new prioritisation criteria, which we will soon publish in their final form. In selecting and conducting market studies we will continue to avoid disproportionate burdens on business, which ultimately would be passed on to consumers. A feature of our future work is likely to be increased and different engagement with parties and stakeholders, building on recent examples of collaborative working in the market studies on Homebuilding and Personal Current Accounts. Our aim will be to increase positive engagement and alliance with business outside of enforcement action.

By reducing regulation that impedes competition, and promoting a culture in which firms are accountable to consumers and consumers drive competition, we consider that the market study regime promotes productivity and supports the market process to the benefit of all its participants, and the economy as a whole.