MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

NOT GOVERNMENT POLICY

Search & Switching Costs in the Services Sector

Literature Review

New Zealand Government

Context Statement

This report was written by Maisie Prior as part of a Summer Research Scholarship provided by the Ministry of Business, Innovation and Employment and Victoria University of Wellington and has been further revised and edited for publication. Contained in this report is a review of the literature on search and switching costs. This incorporates behavioural insights into consumer motivations around switching, with a particular focus on services. It also provides a focus on interventions used overseas to reduce search and switching costs.

Disclaimer

The opinions, findings, recommendations and conclusions expressed in this paper are those of the author(s). They do not necessarily reflect the views of the Ministry of Business, Innovation and Employment. The Ministry of Business, Innovation and Employment takes no responsibility for any omissions or errors in the information contained here.

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Executive Summary

Search and switching drives competition

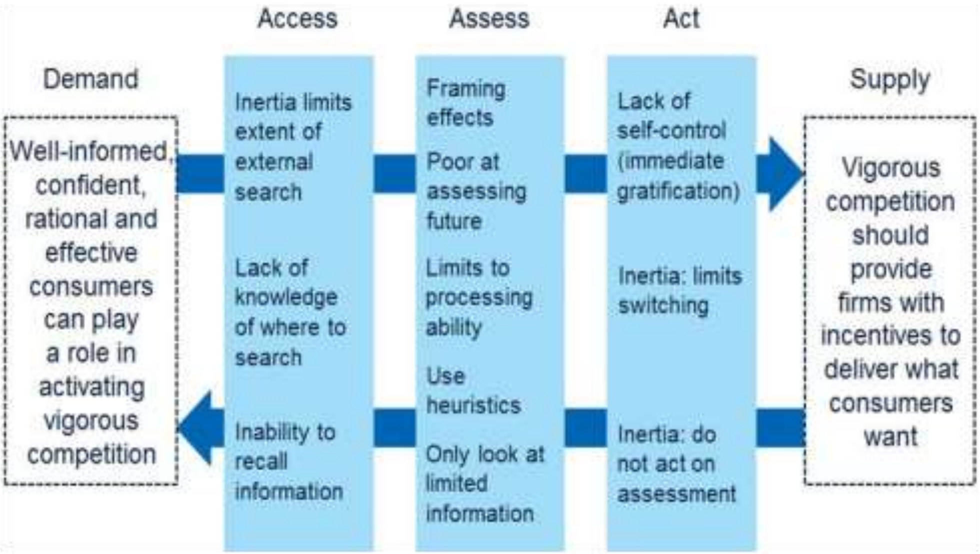
The New Zealand Productivity Commission in 2014 highlighted that competition is an important driver of outcomes in New Zealand markets. Much of the focus of competition policy in New Zealand and internationally has been on supply-side issues such as removing unnecessary barriers to entry and provisions around monopolistic behaviour. However, demand-side behaviour also plays an important role in activating the process of competition (Productivity Commission, 2014).

Two determinants of the effectiveness of competition on the demand-side of the market are search and switching costs. Supply-side attempts to promote competition (such as competition law) will have limited impact on price, choice and quality if a customer is not easily able to find information and make purchasing decisions on this basis.

For consumers to drive competition they need to be able to access, assess and act upon information

For consumers to drive competition between service providers, they need to:

- Access information about the offers in the market
- Assess the offers in a well-reasoned way, and;
- Act on the information and analysis by purchasing the service that offers them the best value.



Source: Oxera (April 2015), adapted from OFT (2010).

Search costs refer to how easy it is for consumers to access and assess information about different sellers in a market and the qualities of goods or services they provide. These include:

- The cost and time taken to understand the qualities of the goods or services, their relevance to a consumer's needs, how they are comparable; and,
- The cost and time taken to compare the price of goods and services.

It is not just the availability of information that matters. Consumers are also influenced by:

- **Framing and anchoring effects**: the way information is presented can affect consumer preferences.
- **Choice overload**: a higher number of options increase consumers' desire to delay decision making and choose the default option or rely on heuristics.

Choice and range typically contribute positively to a consumer's welfare. However, firms may have the incentive to increase the complexity of their offers, or how their offers are communicated, to increase search costs. When consumers have too many services, features, or contracts to compare, they will likely get confused, and this will lead to random choice, or even failure to make any choice (Xavier, 2011). It is not necessarily more information that consumers require but better, or even less information, that is presented and framed in a structured and easily understandable format.

Switching costs are the costs borne when switching providers**,** associated with consumers acting on information and analysis. These consist of:

- **Procedural costs**: relating to the procedure of switching, these include uncertainty, search and evaluation, learning, and setup costs. These costs primarily involve the expenditure of time and effort, such as filling out paperwork to arrange a transfer between service providers, or making it difficult to cancel a contract (Burnham, Frels & Mahajan, 2003). Often, these relate to the "hassle factor" of switching.
- **Financial costs**: Consisting of lost benefits (e.g. rewards schemes) and financial-loss/sunk costs, these involve the loss of financially quantifiable resources, such as fees for terminating a contract early (Burnham, Frels & Mahajan, 2003).
- **Relational costs**: These consist of personal relationship and brand relationship loss costs, and are emotional costs relating to ending a personal relationship with a supplier (Burnham, Frels & Mahajan, 2003).

Along with search costs, switching costs can be exacerbated by behavioural factors such as:

- **Loss aversion**: consumers tend to feel the pain of losing more than the pleasure of gaining (endowment effect). The perceived risk of switching, including uncertainty about how much better the other provider will be and how much hassle it takes to switch can exacerbate this factor.
- **Status quo bias and inertia**: the tendency to stay with a previous decision or not act at all. This is pronounced in the case of high search and switching costs.

Switching disciplines firm behaviour. Even when there are many firms, if switching costs are high or uncertain then competition might be dampened. Negative impacts of lower competition may be realised, such as: higher prices for rolled over contracts or aftermarket services; lower quality; less innovation; or a narrower range of service. Firms in a market can actively impose switching costs (e.g. financial costs, not allowing number portability) or passively impose costs (such as not making comparator information available).

Consumers may not switch because they may be receiving a good deal (the best deal on their assessment of what is available in the marketplace). It is also likely that in services especially, customers may not be price sensitive, and so even if there is a "better" deal elsewhere and switching costs are low there may still be stickiness in switching behaviour.

Different types of services give rise to different types of search and switching costs…

The literature notes that different types of services will vary in the amount of price information they display and the degree to which quality can be assessed. Broadly, these can be divided into:

- **Routine services** (e.g. haircuts, restaurants, cinemas) often display information on price and quality. A consumer can easily perform their own evaluation of these services, and for many consumers are purchased for leisure. The emergence of comparator sites (price and quality) has also reduced search and switching costs in these markets.

- **Ongoing services** (e.g. utilities, banking) display price information. Although product pricing is transparent, the product and service differentiation (and different bundling of products and services) can make comparison difficult for consumers. This has increased both search and switching costs. Firms may often use contractual conditions as a means to lock-in consumers.

- **Professional services** (e.g. doctors, dentists, accountants, lawyers) display little information on the price of their service and assessing and comparing quality can be difficult. There is potential for some degree of lock-in for these services when switching costs are high. For example, visiting a dentist for a check-up (already costly) may result in another high price being quoted for subsequent services (such as fillings). Getting a second opinion may involve an additional cost, or switching to another dentist might be difficult if the consumer cannot tell what the cost of getting another filling at a dentist may be.

  Competition in these services usually focuses on non-price elements. Emphasis is placed on developing a relationship with the customer, contributing to lock-in. Because of this, price display is unlikely to become a feature in these markets unless mandated. Some professional service organisations also deter, or lobby to prohibit, advertising based on price due to concerns that the quality of their service will decrease. Occupational regulation, however, ensures that service quality does not drop. The literature also finds evidence that price competition can also increase the quality of the service provided to consumers, since price competition can incentivise switching, encouraging firms to provide better quality service to give customers an incentive to remain.

… meaning that interventions need to be tailored to specific markets

Interventions aimed at reducing search and switching costs require a thorough assessment of market conditions. The structure and nature of various service markets can mean that an intervention that may have worked in one particular service market or jurisdiction may not be applicable in another.

Although price transparency is one of the main ways by which to reduce search and switching costs for consumers, this will make firms more aware of the prices that competitors are charging. This is especially important in markets where price coordination is of concern. The literature on the retail fuel market suggests that price transparency may produce anti-competitive effects where:

- There are few firms in the market;
- These firms are selling homogenous products; and,
- Consumers have little countervailing power.

Overseas interventions to reduce search and switching costs in services have also included:

- Providing consumers with their consumption and transaction data. The midata reforms in the UK allow consumers to access and provide their usage data (in ongoing services, e.g. in banking) to rival competitors. However, there have been implementation issues around deriving common standards for use, as well as slow consumer uptake. So far, this has only been implemented in the banking sector, with little information on its overall effectiveness.
- Restricting the way firms can present their prices to consumers. There is ongoing debate in the UK's energy markets as to whether restricting pricing frames has hindered competition.
- Mandating price disclosure for professional service providers. In legal services, for example, the UK's Competition and Markets Authority is encouraging firms to publish pricing on hourly legal fees and for fixed-fee services.
- Ensuring that contracts for ongoing services allow consumers to actively consider switching (e.g. reminds and allows them to switch when a contract is up for renewal), presents any price variation clauses upfront. Reducing procedural switching costs. A range of interventions have been implemented in markets internationally and domestically, including simplifying the process of switching (e.g. by allowing mobile number portability, allowing contracts to be cancelled the same way they were entered).

Comparison sites have been shown to benefit consumers, making search easier and increasing switching rates. Ensuring that these are unbiased (e.g. are clear about the rankings of providers they offer) is crucial for consumers to be able to use them to find the most suitable deal for them. Lack of price and quality information in some services markets may hinder the establishment of comparison sites, as well as a lack of common data formatting standards, or even low consumer uptake and usage. This creates a lack of incentives for private comparison sites to emerge, whether these are free (and rely on advertising or lead generation) or pay-to-use for consumers. Government provision of these comparison services can also be costly (as evidenced by the Consumer Switching Fund, which was used to establish the PowerSwitch website).

When considering any market-specific intervention to reduce search and switching costs, a thorough assessment of market conditions will be required. Some of the recent economic literature has also shown that search and switching costs can produce procompetitive effects, leading to better services (in terms of price and/or quality) provided to consumers overall. This literature suggests that a policy decision to attempt to reduce search and switching costs should consider (Davis, 2016):

1. The reasons why it is believed that on average prices will fall and not increase if barriers to search and switching are removed.
2. A quantitative evaluation of the net benefits to intervention. This would take into account the effects of discounts offered to acquire new customers, in anticipation of customers who are switched to standard retention products or higher priced services at the end of the discount period.
3. Whether current market outcomes have advantages (or disadvantages) due to increased (decreased) investment and innovation relevant to an appropriate counterfactual (e.g. having removed search and switching costs by a realistic amount).
4. Whether search and/or switching costs help or hinder market entry.

Search and switching costs can have a material impact on markets. When considering options to reduce these, a generalist approach will not necessarily work. Given that markets are diverse in nature, search and switching costs will differ according to how the market is arranged. Considering this heterogeneity, any intervention to reduce search and switching costs needs to be tested, taking into account how the market operates.

1. Introduction and overview of sections

The New Zealand Productivity Commission's 2014 report "Boosting Productivity in the Services Sector" recommended that a further analysis of search and switching costs should be undertaken. This literature review responds to that recommendation and is intended to serve as a starting point when considering whether interventions to reduce search and switching costs in specific markets are warranted.

Section 2 examines the consumer search process, and how search costs play into this process. Lack of availability of information in services has an impact on this process. However, it is not just information availability that has an impact. Behavioural economics provides insights as to how choice overload, framing effects, and heuristics can affect the decisions that consumers make. In turn, the way in which firms on the supply-side present their offerings to consumers can affect market outcomes.

Section 3 discusses access to information about service providers' products and pricing in New Zealand. It appears that price and quality information remains limited, and differs across services markets in New Zealand. The structure of various types of services markets may contribute to potential lack of access to information.

Section 4 considers interventions adopted overseas to reduce search costs. This section describes the two main approaches adopted by regulators and the private sector overseas to reduce search costs: information disclosure, including price and quality transparency and advertising, and comparison websites. Comparison sites operate to lessen consumers' search costs by providing prices and other means of comparing firms in a particular market in one place, as section 4.2 discusses. Lack of available information may be hindering their development. Price and quality transparency and advertising, discussed in section 4.1 is believed to generally produce pro-competitive effects. Better informed consumers are likely to be more capable of making purchases that suit them, and this incentivises firms to improve their services, and comparison sites are able to be established. However, more transparency may have unintended consequences in particular sectors or for particular services.

Section 5 considers how switching costs impair consumers' switching process. Switching costs refer to real or perceived costs incurred when changing provider. These can reduce consumer flexibility and lower the pressure exerted by the prospect of a consumer moving to a competitor (Xavier & Ypsilianti, 2008, cited in Productivity Commission, 2014). These costs include financial, relational, and procedural costs, and can be exacerbated by certain behavioural biases. The greater the switching costs, whether financial or otherwise, the stronger consumers' status quo bias and inertia is likely to be.

Section 6 of the report investigates the impact of switching costs on competition. Switching costs can have benefits, providing a certainty of revenue to firms and lower overall prices to consumers. Section 6.1 examines the pricing outcomes resulting from switching costs. Section 6.2 discusses that simply making switching costly can mean that a new entrant might not be able to win enough business to make entry viable. When considering intervention to remove switching costs, the balance between the costs and benefits of proposed remedies to reduce switching costs can differ by country if market conditions vary, and this has policy implications (Oxera, 2014).

Section 7 analyses efforts taken by overseas regulators to reduce switching costs. Efforts to reduce financial, procedural, and relational switching costs relate to regulating the contract terms provided to consumers, as well as aiming to make the procedure of switching easier. The section also finds that simply making consumers aware of their behavioural biases can increase search and switching rates.

Section 8 concludes the report, and summarises the key findings from the literature on search and switching costs.

2. Consumer Search Process

Consumers engage in search to find a provider of a good or service. Generally, customers seek to compare a number of providers to mitigate perceived risk and uncertainty associated with purchasing a product or service (Urbany et al, 1989, cited in McColl-Kennedy and Fetter, 1999).

The search process is often more complex for services as opposed to goods. Limited availability of information, intangibility, relative importance to the consumer, and the heterogeneous nature of services often make consumer search more difficult.

Both standard and behavioural economics recognise that search costs arise during this process. Search costs can be defined *as "the costs incurred by a consumer in identifying a firm's product and price, regardless of whether the consumer then buys the product from the searched firm or not"* (Wilson, 2012). For this reason, search costs cannot always be assimilated to switching costs.

Search costs can arise when the consumer is 'spoilt for choice' and finding the best option for their requirements takes some research, or because little information is available about other providers (OFT, 2003).

Standard economic models assume that consumers incur just enough search costs to optimise their choice of a good or service. This assumes that consumers are able to perfectly assess the expected benefits of search and compare these to the relevant search costs. Behavioural economics, however, recognises that consumers experience a number of behavioural biases that exacerbate these costs (DellaVigna, 2009).

2.1. Searching for Services and Information Asymmetries

Standard economic literature recognises that search costs may be higher in services markets than in goods markets due to greater information asymmetries between the buyer and seller. When information asymmetries exist, a rational consumer will continue to search until the cost of finding information exceeds the benefit from finding that new information.

2.1.1. The Level of Information Asymmetry depends on the Service Offering

- **Credence services** are services with qualities that cannot be fully evaluated by the consumer even after purchase. This makes it difficult for consumers to assess their utility. Often, high levels of information asymmetry characterise these services, where it is the seller who determines the customer's requirements (Mortimer and Pressey, 2013). Some examples include legal, financial and insurance services, which are difficult for a consumer to evaluate both pre and post-purchase, unless they can be compared. In some markets, comparison, for example by getting a second opinion, can make the service evaluable by the consumer. Customers in these markets are also less likely to be price sensitive (Mortimer and Pressey, 2013). In these types of services, quality regulation is important given the inherent information asymmetries between the consumer and the service provider.

- **Experience-based services**, such as hairdressers and movie theatres are services that can be evaluated post-purchase. Again, information asymmetries may exist between the service provider and the consumer, since consumers are unable to evaluate the service until after it has been performed. However, these are usually one-off purchases, and if consumers are dissatisfied with the level of service provided, they can go to another provider of the service in the next round. Previous purchases of an experience service can improve a consumer's information about whether to repeat purchase from the same provider or switch to another (OFT, 2008).

In the case of services where higher information asymmetries exist, consumers will use different information sources in their search, but their search process may not necessarily be more extensive (Mortimer & Pressey, 2013). Purchasers of credence services place more emphasis on the opinion of salespeople, consumer reports, and the experience of friends. Conversely, for experience-based services, consumers can use their own information sources (Mortimer & Pressey, 2013).

Although purchasers of credence services recognise their importance, they may have a low level of interest in them. Lack of technical knowledge or capability, and lack of motivation to overcome such information asymmetries may mean that consumers do not fully engage in the search process.

Drawing this distinction between credence and experience-based services highlights the importance of trust and relationship development in the purchase of credence services. Consumers may find it valuable to be able to source impersonal, independent information and compare service providers so they can engage in an effective search process. Consumers can then have an informed discussion with a service provider about their purchase before making their decision, instead of having this decided for them.

2.1.2. Categorising Services

Although the literature recognises the difference in the levels of information asymmetries between credence and experience-based services, further categorising services is useful in determining what influences consumers' search process and what information may be available to consumers. These categories will be used throughout the report.

Type of Service	Characteristics	Effect on Consumer Search Process
Professional Services e.g. doctors, dentists, accountants, lawyers, engineers.	Exhibit credence properties (hard for the consumer to asses even after purchase), and so there are inherent information asymmetries. The scope of the service is not easily determined by either party e.g. a lawyer may have a transparent hourly fee but may not know how long proceedings would take. Price information is difficult to find. Professions generally have a code of ethics/minimum entry requirements, and so existing licensing requirements provides minimum quality standards. These can be one-off services or can require an ongoing relationship with a provider.	Search can be inhibited by consumers' inability to find pricing information – consumers may not be finding the best value service for their needs. Search process heavily relies on relationship development, as most consumers are lacking in technical knowledge of what they require from these professionals. Relationships are founded on the basis of individual trust. Although licensing of professions can act as a signal of quality and lower search costs, consumers may be unsure of how good the service provider may be (due to its credence properties). Advertising and discounting can work to get customers to test new providers.
Ongoing Services e.g. banking, electricity, broadband, insurance, telecommunications.	Base service is homogenous, can be 'tailored' to the consumer in different ways i.e. differentiated Can exhibit some credence properties, particularly if comparison is very difficult or the service is	Search may be inhibited by limits of consumers to process various tariffs in the market, and compare these amongst providers if different price frames are used. Customers may also not be aware what service is

	technical. Consumers can find price information easily, as the base service is homogenous and so firms have incentives to voluntarily advertise prices. However, they may adopt various price frames to make comparison between services different. One point of contact with a customer service representative is generally required in order for the consumer to 'sign up' to a service; however this can also be initiated online.	appropriate for them (for example, which electricity plan to take because they cannot easily assess their usage and then analytically compare offerings). Consumers recognise the importance of such a purchase, but may not engage fully with it due to difficulties in assessing what product best fits their needs– will place trust in the recommendations of others.
Routine Services e.g. haircuts, movie theatres, restaurants.	Most are experience-based (able to be evaluated after the service has been performed). These are generally not essential services for the consumer and are often related to leisure. Less risk and uncertainty attached to service offering as opposed to professional and ongoing. If consumers are dissatisfied with the level of service provided, they can go to another provider of the same service in the next round. Price information is typically easily available and quality is able to be inferred from different price points or through other means (i.e. with cinemas and restaurants online reviews are useful).	Consumers can use their own information sources in searching for a provider. Consumers are interested in the purchase, and engage with searching for a provider as they can more easily understand and assess the benefit they receive from using the service.

2.2. Contribution of Behavioural Economics

Consumer reluctance to search and switch is driven not only by a fully rational assessment of the costs and benefits of doing so, but also by certain behavioural biases (Oxera, 2016).

Behavioural economics is founded on the assumption of 'bounded rationality.' Consumers are limited by behavioural factors that undermine a rational and extensive search process. The United Kingdom's Competition and Markets Authority (CMA) highlights some causes of these limitations: *"barriers could take many forms, including product or pricing complexity, level of choice, extensive personalisation of prices to meet consumers' individual circumstances, or even a lack of consumer interest in the product or service in question*" (CMA, 2016).

2.2.1. Behavioural Limitations to the Consumer Search Process

Consumers may not make a full and complete search for the lowest price or best product to suit their needs due to mistaken beliefs, present bias, framing effects, and choice overload.

- **Mistaken beliefs**

Consumers may mistakenly believe that there is little to be gained by fully engaging in search, and/or that the process of searching and switching may be unduly complex and time consuming (Oxera, 2016).

- **Present bias**

Consumers may not search enough (or at all) due to upfront search costs with benefits only to be realised later (Oxera, 2016).

Consumers place a high discount rate on decisions they have to make in the future, and procrastinate searching among providers. For example, a consumer may be willing to give up time tomorrow to search for a cheaper energy provider, saving money in the future, even if they would not give up their time today for the same task (Oxera, 2016).

During the search process, consumers' bounded rationality (their ability to process and understand information) may inflate perceived search costs or lower perceived returns to search, leading to inertia (Grubb, 2015). For example, present bias can lead to inertia in energy markets. Even if consumers know it is in their best interest to search or switch providers, they may put searching off since this involves time and effort costs in the present, while savings from lower energy bills would only be collected in the future (Oxera, 2016)

Present bias is also an important part of the switching process, since the immediate search costs may outweigh the benefits from switching providers, as consumers may heavily discount the future savings they may make as a result of switching. Conversely, consumers can misweight costs imposed in the future and may choose the wrong provider, if the provider offers a cheaper upfront price but has high prices in the future or exit fees. For example, some internet providers may offer a cheap upfront price for the first six months, and then the price may increase after the promotional offer ends. Present bias in the case of switching will be further discussed in section 6 of this report.

- **Framing effects**

Framing effects arise as a result of consumers' preferences shifting when the same choice is framed in different ways (Tversky & Kahneman, 1981, cited in Behavioural Insights, 2016). Attribute framing, anchoring, and salience effects can hinder effective search, especially when firms adopt different price frames and strategies. Three types of framing effects have the greatest effect on consumer search:

- Attribute framing: consumers may react differently depending on how a product or service's attributes are framed – for example, whether a fee is shown in percentage or absolute terms (Oxera, 2013). Attributes can also have loaded meanings: charges that appear to be externally imposed may be treated differently (on fairness grounds) than those that have been imposed by a provider.

- Anchoring**:** this is a framing effect where consumers' preferences, and subsequently their evaluation of alternatives, are affected by what the initial reference point, or 'anchor' is (Oxera, 2013). Consumers may perceive an option at the top of a price-comparison website as being better value than one at the bottom, even though there may be no real difference between the two (Oxera, 2013). Another example is when firms frame their service as being '40% faster than other operators.'

- Salience effects: when consumers face complex information, they may use the information that they perceive to be the most salient as a reference point (Oxera, 2013). They may focus on prices provided 'up-front' and ignore add-on fees; they may compare some features of a product and ignore other features (e.g. they may choose a credit card for the rewards scheme it offers as opposed to the interest rate); and they may place weight on fees charged rather than on prospective returns (e.g. in savings accounts). Some of these are due to framing, while others concern the content of the information provided and relate more to decision making (Oxera, 2013).

- **Choice overload**

When consumers are faced with large amounts of information about a product or service, their capacity to process that information becomes overloaded, resulting in choice fatigue and confusion (Aljukhadar, Daoust and Senecal, 2010). Choice overload makes consumer perception and consciously processing options difficult (Oxera, 2013).

The implication of this is that giving consumers more options may not necessarily lead to better outcomes (Lyengar & Lepper, 2010 cited in Behavioural Insights, 2016). Trying to mitigate information asymmetries by providing more information or options in services may not actually make the consumer search process easier. Instead, this may cause consumers to procrastinate making their decision, or they may simply select the default or recommended option (Oxera, 2013). That is, consumers may become inert and "decide not to decide," or they may make sub-optimal choices (Oxera, 2013).

In contrast to economically 'rational' decision-making, such responses can occur even when consumers are given more options, and can be greater for more vulnerable consumers who are not as knowledgeable or are less financially able (Morrin, Bronjarczyk & Inman, 2012 cited in Behavioural Insights, 2016). It has been found that choice overload is likely to occur when consumers are faced with time constraints, complex choice sets and have a lack of expertise in judging the costs and benefits of different options (Cherney, Bockenholt and Goodman, 2015, cited in Behavioural Insights, 2016).

Choice overload is especially pronounced in markets for ongoing services, as often comparability between various types of offers is difficult due to the intangible nature of these services, as well as identifying upfront costs and benefits.

Key Finding

Access to information on services presented and framed in a structured and easily comprehensible format is important to reducing search costs (Xavier, 2011). This is because behavioural limitations in the search process mean that more information does not always reduce search costs. It is also possible that more providers in the market will more significantly improve competition if their services are able to be compared properly.

- Complexity and Choice Overload

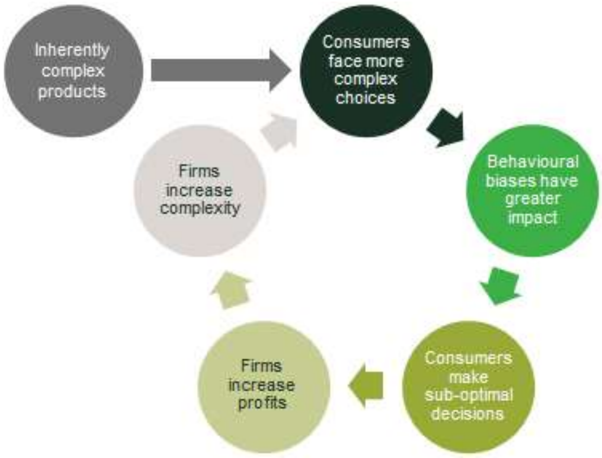
When the number of dimensions of a consumer's choice change (e.g. in terms of amount, time period, or optional extras), comparison friction occurs. This increases the effort required to compare alternatives, which prevents consumers from making a comprehensive search (Kling et al., 2012, cited in Behavioural Insights, 2016). Where consumers cannot make a full search, it is likely that the choice they make will result in a suboptimal outcome. Empirical evidence shows that this is exploited by firms, who have the incentive to create additional, and more confusing options to inflate consumer search costs, which leads to higher prices (Carlin, 2009; Kalayci, 2011; Kalayci & Potters, 2011, cited in Behavioural Insights, 2016).

This has often been termed a "confusopoly." Firms can create this by:

- adding more services to their range
- adopting various price strategies to make comparison difficult both between services and providers – for example, offering introductory deals that involve the price changing over time, or splitting prices into smaller parts
- offering add-ons such as free gift vouchers, or
- bundling services and offering a wide range of bundles, which requires greater computation (Oxera, August 2016).

Ongoing and professional services are already inherently complex for consumers to understand. It may be beneficial for service providers to increase the complexity of their services to ensure they can charge a higher price. In banking, for example, some interest rates are quoted on a monthly basis, while others are quoted on a semi-annual or annualised basis. As a result, firms may create a 'cycle of complexity' by making their services more difficult to compare. As illustrated in the diagram below, this leads to firms experiencing higher profits than in a market with perfect information.

Cycle of complexity



Source: Oxera (August 2016).

Key Finding

Choice and range typically contribute positively to a consumer's welfare. However, firms may have the incentive to increase the complexity of their offers, or how their offers are communicated, to increase search costs. When consumers have too many services, features, or contracts to compare, they will likely get confused, and this will lead to random choice, or even failure to make any choice (Xavier, 2011).

2.2.2. Real or Perceived Search Costs Can Lead to the Adoption of Heuristics or Inertia

When consumers have either real or perceived search costs, two potential outcomes that may arise are:

- Consumers using heuristics, or
- Consumers experiencing inertia.

In both cases, these have the potential to lead to sub-optimal outcomes. This may reduce consumer welfare, as consumers may not have found themselves the best deal for their needs.

Standard economic literature has recognised that consumers may satisfice. When consumers are confronted with a vast number of options, or a confusing range of options, most consumers may settle for services they perceive to be good enough. In this way, consumers may not actually find the best service for their individual circumstances (Gamper, 2012). More recent behavioural economics literature extends the idea of satisficing into the concept of 'heuristics,' discussed below.

2.2.2.1. Heuristics

Consumers will often take shortcuts (e.g. by following rules of thumb) if their decision environment is too complex relative to their mental and computational abilities (Xavier, 2011). Heuristics often save a lot of time and effort, especially when dealing with complex problems and choice overload, but can be imperfect and open to exploitation by firms (Oxera, 2013).

Individuals may make quick decisions based on:

- a selection of the information provided in the marketplace,
- their memories of recent experiences
- looking to what others are doing, or
- focusing on the salient aspects of the information.

In the services context, representativeness heuristic is likely to have an impact. A consumer may assess a problem and design a solution given the degree of resemblance of the problem to another situation or stereotype. For example, a consumer may take advice from a financial adviser because they like them, as opposed to basing their choice on assessment of the quality of the advice (Oxera, 2016).

Consumers may also rely more heavily on brand names as opposed to evaluating all products when faced with choice overload (UKRN, 2016). When choosing from a wide range of options, consumers may choose the most familiar, well known brands and avoid the ambiguous or uncertain, or pick from the first option on a list (UKRN, 2014). When using comparison sites, consumers may also select the first option listed as opposed to looking at alternatives.

Consumers may also begin their search with one particular prominent firm. Consumers, who do not have unlimited attention, might naturally start their search process on the internet by first clicking on the top result that a search engine delivers (Huck & Zhou, 2011). Or, they might begin their search by looking at prominent firms. This can lead to consumers ending their search process early, potentially reducing the match-efficiency of a product and leading to a suboptimal outcome.

2.2.2.2. Inertia

With complexity, boundedly rational consumers find it harder to compare alternatives, and this creates customer inertia (Centre for Competition Policy, 2013).

When faced with choice overload, consumers are likely to maintain a default or perceived default option. That is, consumers will make no choice at all, or choose a default option, such as a default energy tariff rate. Inertia and status-quo bias are also elements of the switching process, and is further discussed in section 5.4 of the report.

2.3. Search and Switching in a Consumer Decision Making Model

In order to consider how search and switching costs can impact consumer decisions, it is generally useful to think of how they interact within a consumer decision-making framework. This also helps to consider how behavioural economics contributes to understanding how the demand- and supply-side of the market can behave to increase search and switching costs.

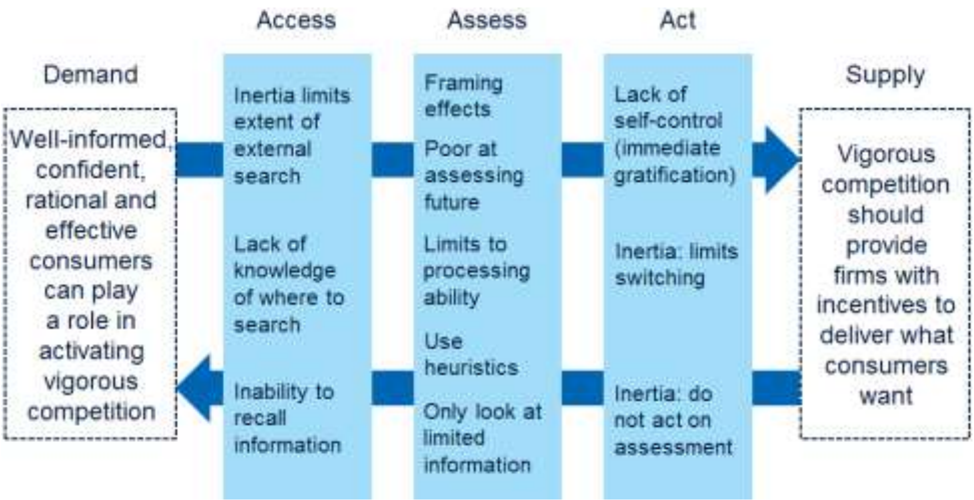
The UK's Office of Fair Trading (OFT) developed and "Access, Assess, Act" framework in 2010 that can be used to consider how these behavioural biases can impact on consumer decision making. In order for consumers to drive competition between services providers, they ideally need to:

- **Access** information about the offers in the market
- **Assess** the offers in a well-reasoned way, and
- **Act** on the information and analysis by purchasing the service that offers them the best value (OFT, 2010).

The OFT (2010) recognised that the idea of search and switching costs is not new to standard economic literature. Search costs affect how much information on a service a consumer might seek, while switching costs limit consumers' ability to act. Both can have an impact on consumers' decision making processes. Behavioural economics, however, provides insights into behavioural biases that may cause search costs (and affect access) and switching costs (which limit action).

The framework also highlights that consumers may find it difficult to assess and compare information across providers, which may also contribute to search costs. Consumers may experience choice overload and subsequent inertia (or reliance on heuristics), and may not fully search the market.

The 'Access, Assess, Act' Framework



Source: Oxera (April 2015), adapted from OFT (2010).

Firms on the supply side may also seek to take advantage of consumer biases during each of the three stages (Oxera, 2013):

- **Accessing information -** Firms can make it more difficult for consumers to perform searches. As consumers are less likely to look at pricing terms when they are not provided upfront, firms may exploit this by putting more of the price into add-on services, adding clauses, or making searching harder using price frames such as drip pricing, causing consumer inertia and limiting search (Oxera, 2013).

- **Assessing offers -** Firms may make it more difficult for consumers to assess what the best deal may be. Since consumers have difficulty comparing differently structured offers, firms may exploit this by making their prices less clear, increasing the number of options available, or raising the degree of complexity (Oxera, 2013). They may also use price promotions or adopt different price frames to distort consumer decision making.

- **Acting on information** - Firms can make it more difficult for consumers to act and get the best deals. Consumers may display more inertia than traditionally thought, perhaps due to overconfidence in their capacity to improve their situation at a later time. Firms, aware of this, can raise switching costs, for example by requiring existing customers to use registered post to cancel, using defaults and automatic renewals, or time limited offers (Oxera, 2013).

Regulators, especially in the UK, attempt to incorporate behavioural undertakings into remedy design. Regulators in Australia have also begun to adopt a similar framework, as it provides a useful tool to consider both the demand-side and supply-side of the market react to certain behavioural biases, not just in terms of search and switching costs, but in terms of a complete decision-making model.

Key Finding

Behavioural economics demonstrates that consumers can be sensitive to the way that information is framed and have differing limits to their ability to make decisions, and this has implications for their preferences, decisions and behaviour. In turn, the way in which firms on the supply-side present their offerings to consumers can affect market outcomes. Crucially, firms may have an incentive to exploit or exacerbate consumer biases (Oxera, 2013).

3. Access to Information about the Price and Quality of Services in New Zealand

Globally, the internet has increased the amount and ease of accessing information available to consumers. However, this information provision has lagged in the services sector across countries.

Providers of ongoing services usually publish information on price, since it is easier to publish pricing information on clearly defined or relatively homogenous services. However, they may adopt various pricing frames and may try to differentiate themselves on quality.

Routine service providers also differentiate their services to appeal to different customers. For example, some hairdressers may only offer basic haircuts, while others may offer a cut and blow-dry, and these services will display their prices in addition to these factors in order to compete for different types of consumers.

Professional service providers in New Zealand and overseas often do not provide information on price on their websites, and only limited (perhaps biased) information about their quality. Some professional services are customised to a point where it is difficult to identify price points, especially in legal and medical services. However, pricing guidelines can be useful for consumers, and providers in other jurisdictions are able to indicate pricing and quality. For example, in dentistry, overseas providers publish prices for a raft of simple procedures. Some firms indicate quality through customer reviews, quality code marks, registrations to industry bodies and awards.

The lack of information and level of customisation in professional services can make it difficult for customers to accurately compare offerings. This lack of information also impairs the ability of comparison websites to emerge for these services. Price comparison sites are more effective when datasets are available (such as the Informed Sources data on petrol prices in Australia, or hotel room information submitted to TripAdvisor) rather than 'scraped' data which is more costly to gather. There are ways of making data available; there is a project to increase the availability of publicly held data (through LINZ), and some companies will not make their datasets available in New Zealand (insurance companies)

3.1. Key Structural Aspects Relating to Services Markets

Most services markets are structured as either monopolistic competition or oligopolies (Karel, 2004):

- **Monopolistic competition** is characterised by the selling of differentiated products, either by branding or quality, and hence one service may not be a perfect substitute for another. Such markets include hairdressers, legal services and mechanics (Karel, 2004). Service markets are more likely to be differentiated than goods markets. The heterogeneous nature of these services means that they are not perfect substitutes either. It is possible to have many different retailers selling the same good, which is not necessarily possible with services.

- **Oligopolistic markets** are those dominated by only a few large firms, where advertising and service quality provide the major source of interfirm rivalry (Karel, 2004). Some examples include the telecommunications and energy markets in New Zealand. In situations such as these, advertising outlays are strategic complements. If one firm decides to increase advertising it is in the other firm's best interest to also increase advertising (Karel, 2004). Similarly, if one firm increases its price then it may be in the other firm's interests to do the same. If price transparency is required in these markets, then it is sometimes thought that this may enhance coordination among firms, who end up charging higher prices to consumers. This will be addressed later in the report.

These market structures may give rise to product differentiation, sunk costs (for example, in advertising) and asymmetric information (Karel, 2004). As discussed earlier, asymmetric information drives search costs in services markets, as many service providers have more information than most customers about their service offering. This is especially pronounced in the case of credence services, as customers cannot evaluate the quality of the service even after consumption. Regulation in these markets regarding quality, advertising claims and quality code marks are particularly important in these services. For example, a real estate agent may not need to belong to the Real Estate Agents Authority but this may give a customer confidence in the service.

Consequently, these market structures can give rise to intense non-price competition, and services firms may have incentives to differentiate on the quality or extent of the service being provided, in addition to price grounds, according to consumers' preferences (Karel, 2004). A focus on aspects of non-price competition, through advertising or other forms of marketing, means that service providers may not focus solely on pricing measures to induce competition.

3.2. Display of Pricing and Quality Information in Routine, Ongoing and Professional Services

A desk-based survey, conducted via a web search of various service providers in the Auckland and Wellington regions, as well as national service providers (where applicable) in December 2016 found the following.

In markets for routine and ongoing services, pricing information was displayed:

- Routine service providers (e.g. hairdressers, movie theatres etc.) used pricing information in addition to other information about their service offering/experience to engage in differentiation.
- Ongoing services also displayed information on pricing. However:
    - Information on quality may be difficult to infer. For example, claims that a broadband provider has the 'fastest broadband available' may be difficult for some consumers to evaluate.
    - Price frames often differed between providers. Some providers even adopted different price frames for different services they provided. In banking, for example, some banks quoted different current account fees on across their own product ranges (i.e. semi-annual, annual, and weekly fees).
- Comparison websites have emerged in ongoing services markets, which help to standardise the format that various offers are presented to consumers in, such as account fees. Some websites, such as Canstar, use star rating systems to convey quality to consumers. However, the factors that contribute to these ratings do not appear to be explicitly stated.
    - Because quality is difficult to infer in ongoing services, investigating how to give information about quality to consumers may be required.

In professional services markets, little pricing information was displayed online:

- Dentists, lawyers, and accountants, for instance, provided little information on pricing.
- Information on quality, in the form of customer testimonials and descriptions of the service offering were provided on these websites.
    - The question arises as to what extent customer testimonials can be used to judge the quality of many services. In many cases, it is logical that service providers will only provide positive customer feedback on their website, which means that consumers are likely not getting the full picture. Third party rating sites are more compelling as they are likely to be independent. For example, a Google search of 'best dentist Wellington' the Google results include a star-rating system based on Google reviews.
    - Descriptions of the service do, however, offer consumers a more objective view as to what these services provide.

Further explanations for why professional services may not disclose their prices are discussed in the next section.

3.2.1. Price and Quality information in Professional Services

The lack of pricing information displayed in professional services markets has not been confined to New Zealand markets; other jurisdictions have also been grappling with this issue.

One potential explanation for this is that these services focus on developing a relationship with the customer instead of having to compete with other firms on price. *Relationship development* dominates the marketing literature for professional services, and therefore these service providers will often adopt practices in line with principles of relationship marketing. However, this does not necessarily offer a justification as to why consumers cannot also access information on price.

In New Zealand, professional service providers are not restricted from advertising their price. The Advertising Standards Authority (ASA) is a self-regulatory body that monitors how advertising practices are carried out – its jurisdiction appears to include advertising on websites. In addition, many professions have their own code of conduct, none of which appear to restrict firms disclosing their prices, instead ensuring that firms comply with the Fair Trading Act and other relevant legislation so that consumers are not misled. The Commerce Commission, on their website, notes that in the healthcare sector, restrictions on advertising can produce anti-competitive effects if they limit the extent to which health practitioners can compete on quality or price (Commerce Commission, 2013). However, certain restrictions have been posed by various industry bodies for consumer protection.

Pricing information is not likely to become a feature of many professional services markets on its own. Service providers are reluctant to publish their prices online as this facilitates price comparison, and moves the focus away from non-price competition (Gamper, 2012). Allowing price comparison fosters pricing rivalry, which erodes service providers' profit margins (Gamper, 2012). Professional service providers will therefore be unlikely to post their prices online if this is not an existing market feature, which in many cases it is not.

One argument advanced against professional service providers competing on price is that the quality of the service will decrease. This is not necessarily likely to be the case. Quality measures for professional services are already inherent across professional service industries in New Zealand. Many of these services have minimum standards for entry (e.g. occupational licensing), and often the industry itself will have incentives to uphold high standards (e.g. through the use of accreditation schemes). Both of these can help to signal quality to the consumer, but there still may be uncertainty as to what a 'good' professional service provider may do or provide. There may be further scope for other quality to measures to emerge across these professions.

Another argument advanced by some members of professional services industries is that individual services are tailor-made to suit the diverse range of needs required by consumers, and therefore they are unable to publish pricing online. However, the UK Legal Services consumer panel notes that empirical evidence from the UK legal services market shows that consumer demand for fixed fee legal services is growing, and the take up rate for firms offering fixed-fee services is high (UK Legal Services Consumer Panel, 2016). Additionally, although some services must be tailor-made to consumer needs, routine services – such as dental check-ups or car servicing – will generally have a fixed price attached to them. As the OECD notes in its report on Competition in Professional Services (1999), *"some professional services are more standardised and routine than others. It is for such services, which are often offered at standard fees for completed work, that permitting price competition and truthful advertising has proven most beneficial to consumers."* (OECD, 1999, p.20).

This is not to say that professional service providers should solely focus on price competition, as consumers will not be able to fully understand the service without other information. Although quality may be inherent across New Zealand's professional services markets, there may be further scope to display quality information to consumers. This will be discussed in the next section.

Key Finding

Price information is already displayed in markets for routine and ongoing services. In routine services, this can be used in addition to descriptions of the service in order for the consumer to make a purchase decision.

In ongoing services, although price information is displayed, this has potentially been made confusing for consumers to compare providers due to providers adopting different pricing frames (i.e. some banks quoting account fees, insurance premiums having various add-ons to a base level of services). Quality is also difficult to infer due to the intangible nature of these services, so consumers may have further trouble making comparisons between providers.

In professional services, price information is rarely displayed, and is unlikely to become a market feature as firms do not have the incentive to publish this, instead engaging in aspects of non-price competition to get customers.

4. Reducing Search Costs in the Services Sector – Overseas Approach

In reducing search costs, the literature describes two prominent themes: to allow information disclosure and give consumers the ability to interpret and compare that information across providers. These have been adopted by regulators, especially in the U.K.

New Zealand's Productivity Commission highlights two approaches to reduce search costs in their 2014 Report:

- Government-mandated information disclosure can be a light-handed way to reduce search costs and satisficing behaviour provided that information is accessible and understandable.
- Comparison websites reduce search costs by comparing prices and other product attributes online.

Both initiatives aim to mitigate the potential for consumers to experience choice overload and inertia and allow them to make increasingly accurate comparisons over service offerings.

Interventions across services tend to differ, in terms of the level of information disclosure required for consumer search costs to be significantly reduced. This reflects the type and complexity of the service being offered, as well as general consumer understanding and knowledge of the service. It is not just the level of information disclosure required, but how well consumers can evaluate the searched information and go on to make a decision based on that information, as highlighted earlier in the report.

4.1. Price Disclosure

Many consumers require information on price when they undertake the search process for services. It is important to note, however, that in professional services especially, price transparency alone would not be enough for consumers to make a complete and informed search for a new provider. Solely facilitating price comparison alone could mean that service quality decreases, or that providers end up creating various 'add-on' costs to the base service.

In the UK, price transparency has been cited as one of the main ways to reduce search costs in the services sector. This has been implemented mainly across the energy, financial and telecommunications markets. Price transparency in professional services markets is also being investigated. The UK's Legal Services Consumer Panel (2016) noted that price information was important for promoting transparency in legal services. They also noted that this must be balanced with a requirement for information relating to the service itself, as well as information on quality, in order for consumers to make a complete evaluation.

In response to the Legal Services Consumer Panel report, the Competition and Markets Authority announced in December 2016 a package of measures that include:

- Requirements for legal providers to display information on price, service, redress and regulatory status to help potential customers. This includes publishing information for particular services online.
- Revamping and promoting the existing 'Legal Choices' website as a starting point for consumers seeking help, information and guidance on how to navigate the market and purchase legal services.
- Facilitating the development of comparison websites to allow consumers to compare providers in one place by making data collected by regulators easily available (CMA, December 2016). Comparison websites will be discussed further in section 5.2.

In 2014, the CMA addressed the issue of price competition and price transparency in the private healthcare sector. It recommended that the industry should *“make it easier for patients, insurers, GPs and consultants to assess a private healthcare facility or consultant’s suitability in terms of quality and price.”* (CMA, 2014). These recommendations led to most private hospitals in the UK publishing their self-pay services. A study by Private Healthcare UK (2016) found that:

- Average national prices in 2016 reduced compared to 2015. However, they were not clear whether this was a result of price competition or more accurate pricing by providers.
- Pricing consistency improved. However, they noted that the description of procedures offered required improvement and needed to be more standardised across providers. Variations between descriptions of similar procedures by different providers were still present.
- There was still a wide variation in pricing range across procedures (from lowest to highest price), as well as pricing variation depending on location (Private Healthcare UK, 2016).

In Hong Kong, the government announced in late 2016 that they would roll out a pilot price transparency programme in the private hospital market in partnership with the Hong Kong Private Hospital Association (HKPHA). Under the pilot programme, all 11 private hospitals in Hong Kong will try out three transparency measures on a voluntary basis: encouraging hospitals and doctors to provide budget estimates for patients receiving non-emergency operations/procedures as a reference for overall costs involved, publicising fee schedules for all major chargeable items (such as charges for common nursing procedures) on hospital websites, and publishing historical cost statistics for common treatments/procedures (such as birth delivery) on hospital websites.

However, although price transparency is desirable, it does come with some issues. This will be discussed in the next section.

4.1.1. Price Disclosure: Effects on the Market

The OECD (2012) addressed the issue of price transparency, noting its effects on competition: “*Greater transparency in the market is generally efficiency enhancing and, as such, welcome by competition agencies. However, it can also produce anticompetitive effects by facilitating collusion or providing firms with focal points around which to align their behaviour.”* (OECD, 2012, p.2). When analysing the success of transparency policy on the market, it is important to recognise the effects on the demand- and supply-side of the market.

4.1.1.1. Demand-side effects

Greater market transparency undeniably lowers search costs. Giving consumers more pricing information, provided it’s easy to understand, lowers the time and effort required to carry out the search process. Consumers become more price-sensitive, and demand becomes more elastic. In theory, this enhanced consumer knowledge about pricing should facilitate more competitive outcomes.

Whaley (2015) conducted an empirical study of US medical markets to study the effect of transparency platforms on consumer search costs. In many US states, price transparency in medical services has been mandated, allowing online price transparency platforms to gain prominence. The study examined the impacts of price transparency on the prices that lab test providers and physicians charged for their services. While price transparency caused substantial price reduction for lab test providers, it only caused small reductions for physicians. The difference in these results follows economic intuition that lab tests are far more homogenous than highly differentiated physician services.

In addition, as providers lowered their prices, the reduction in price led to an overall reduction in the average cost per procedure. However, price dispersion (variation in prices by sellers of the same service) increased slightly as markets became segmented. The study of the US medical market demonstrated the overall benefits of reducing search costs in healthcare but also demonstrated how reducing search costs can lead to price dispersion (Whaley, 2015).

4.1.1.2. Supply-side effects

- **Price coordination**

Although there is little empirical evidence on price transparency interventions in services markets, studies of retail gasoline markets provide some insight as to the success of transparency interventions.

In Australia, a study of the Fuelwatch scheme, conducted by Byrne and de Roos (2017) on the Perth retail gasoline market, discovered that coordination emerged in a market with a price transparency policy. The market was concentrated, with a few large companies taking up most of the market share (BP, Caltex, Mobil and Shell) with a few smaller companies (Coles and Woolworths) and independent service stations. Each firm was made to post their retail prices to the government online every day. Byrne and de Roos (2017) note that although the policy was implemented for consumers benefit, firms in the market were also able to perfectly observe the prices other firms were offering. They found that this allowed BP, the largest firm in the market, to use the Fuelwatch platform to initiate coordination. When viewed through the lens of a tacitly collusive model, this policy facilitated communication among firms through prices and monitoring of rivals' conduct.

Byrne and de Roos (2017) concluded that ultimately, the Fuelwatch policy may have been fundamental to the initiation of coordination and the increasing of retail prices and margins. It is important to note that although this may have facilitated coordination, there may still have been a net benefit to consumers. It may have been easy for BP to ring up/drive around to its competitors to find out prices compared to the effort required for each individual consumer to do this, so coordination could have occurred even without the comparison site (although the comparison site may have made it easier).

The study also found that it took time for coordination to emerge:

> Through price leadership and experiments, we find that BP establishes mutual understanding among rivals regarding pricing focal points that are fundamental to a tacitly collusive pricing strategy. Tacitly initiating collusion in this way is, however, challenging: in a homogenous product market with perfect price monitoring we find it takes 12 years from the start of a price transparency policy for oligopolists to develop a stable collusive pricing structure. (Byrne & de Roos, 2017, p. 40-41).

They also note the importance of the ability for regulators to digitally take data of price to detect coordination:

> It is possible that in emerging data-rich environments in retail markets, anti-trust authorities can similarly employ high frequency and long panels on firm behaviour similar to ours. With such data, pricing conduct can be monitored, and the initiation of tacit price coordination and transitions to collusive equilibria can be more easily identified. (Byrne & de Roos, 2017, p. 41).

Byrne and de Roos (2017) note at the end of their report:

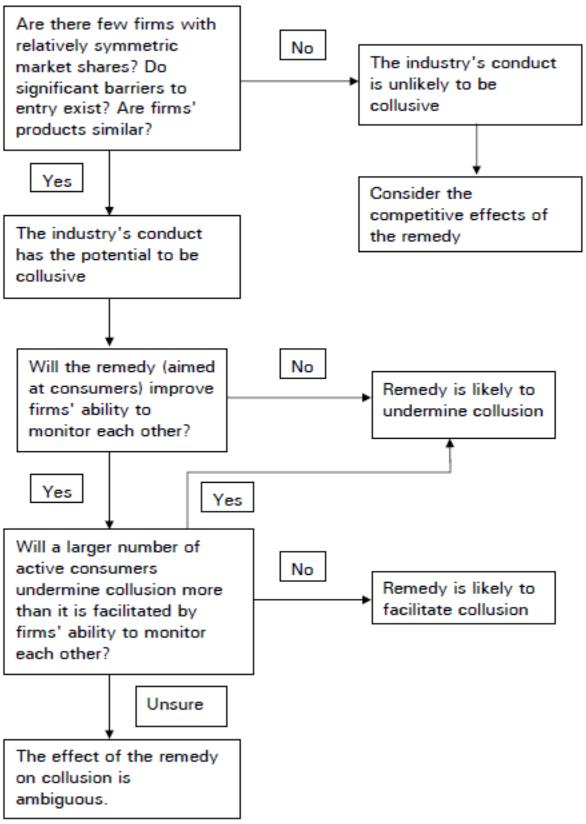
> Our analysis emphasizes the role of firm size asymmetry in generating coordinated effects and initiating tacit collusion: as the largest player in the market, BP exploits the size of its station network to signal the timing and magnitude of price changes to its rivals, and establish focal points for tacit price coordination. (Byrne & de Roos, 2017, p. 41).

A contrasting study in the Italian retail gasoline market, which has a greater number of firms and more symmetry than that of the Perth retail market, found that when consumers were better informed about prices, gas stations responded by reducing their prices (Chintagunta and Rossi, 2015). Petrol stations were mandated to post fuel prices on billboards along a section of the Italian motorway. The price reduction by a focal station was not only triggered by the price information consumers acquired about the station (and the other stations on that sign) but also the availability of price information about subsequent stations posted on signs further down the road. Their analysis of prices between stations found that the posting of prices had little effect on the price difference between service stations.

It appears that market concentration and structure has impacts on whether coordination may occur. Market structure may be crucial in determining whether firms conduct may be pro- or anti-competitive with the implementation of a transparency policy. The UK's Office of Fair Trading (now the Competition and Markets Authority) published a framework in 2008 which can help regulators to assess whether a transparency intervention is likely to facilitate coordination.

OFT Framework to Assess the Potential for an Intervention to Facilitate Coordination

FIGURE A.1 – IS THE INTERVENTION LIKELY TO FACILITATE COLLUSION?



Source: OFT (April 2008). Figure A.1.

There are a number of additions that can be made to this framework that incorporate recent findings emerging from retail fuel markets.

- It may not just be firms in a market having relatively symmetric market shares that can facilitate coordination. Asymmetric market shares may further increase the potential for coordination.
- The question as to whether the remedy will increase the number of active consumers may be crucial. For example, in reference to the 'Access, Assess, Act' framework, will greater access lead to greater action?

In addition to the steps identified by the OFT (2008) in their framework, it is also important to recognise that:

- Whether the good/service is homogenous will have an effect.
- The elasticity of demand also will have an effect: whether the purchase is discretionary (non-essential) or compulsory, or whether there is a switching cost is involved (e.g. in fuel, location changes the cost).
- Standard/fixed fee services may cause issues where a transparency policy is implemented. This would likely cause issue only in an oligopoly sense.

Key Finding

The conclusion that is generally reached is that markets that are more concentrated selling relatively homogenous services are more likely to facilitate coordination. Although it is usually believed that market share needs to be relatively symmetric, dominant firms can sometimes also facilitate coordination (as in the case of the Perth retail gasoline market), as firms have the ability to punish firms that try to undercut their prices (e.g. by lowering their prices in turn and cutting their competitor's profit margins).

Where services are homogenous, price transparency policies may have more benefits than costs, especially where the transparency service is digital. This makes monitoring prices easier, as real time information that is digitally provided can make pricing algorithms easier to create.

The importance of regulators monitoring pricing data from sectors where a price transparency policy has been implemented is also essential. As Byrne and de Roos (2017) note, the ability of regulators to digitally keep records of pricing data can help to detect whether a price transparency policy facilitates coordination. The knowledge that it will be monitored may be sufficient to incentivise them not to collude.

- **Price obfuscation**

Another way firms may react to transparency requirements that make comparisons easier is by engaging in price obfuscation. They may make their prices unclear and more complex by including add-ons or other features. It has been found that policies which prevent one form of obfuscation may cause firms to shift to other forms of obfuscation, and in some cases weak restrictions may cause price comparability to fail entirely (Piccione and Spiegler, 2012; Chioveanu and Zhou, 2013 cited in Grubb, 2015).

For instance, in the UK, existing rules stated that dentists must have a price list displayed prominently in their surgery and be clear about the costs of treatments provided. However, consumer organisations found that dentists often were not being clear about the fee for the service consumers were receiving. Some even broke the rules and did not have their prices displayed in their offices.

In late 2015, the UK government announced it intended to tackle opaque and confusing prices in dentistry, arguing that prices which are transparent and accessible empower patients to make the best choices (Legal Services Consumer Panel, 2016).

Key Finding

Economic theory suggests that increased price transparency can enhance competition, and incentivise firms to improve their products and services, as better-informed consumers are more capable of making purchases that suit them. In practice, however, more transparency can have unintended consequences. As found, disclosing pricing information can:

- On the supply-side, give some firms the ability to collude more easily by providing them with ways to monitor rivals' pricing and identify deviations from coordination.
- On the demand side, consumers may focus unduly on the publicised information to the detriment of non-publicised information (e.g. prices against quality factors) (Oxera, June 2014).

The risk of these unintended consequences may depend on:

- The structure of the market – if providers already publish pricing information regarding their services, the risk of coordination as a result of further proposed transparency provisions may significantly increase if pricing (and potentially quality) information regarding their services is already in the market. This depends on whether sellers and purchasers have access to the information, and whether purchasers use that information effectively.
- The weighting of other product features – for example, prices, contractual conditions, and quality features, thus reducing any risk of consumers unduly focusing on only one of these when choosing their provider.

If proposed transparency obligations could arguably be implemented by operators at a low cost (i.e. they require operators to make information available without having to provide detailed advice to consumers) then these provisions may generate more costs than benefits.

4.2. Quality Disclosure

4.2.1. Overall Quality Disclosure

Information on quality is important when price transparency is a requirement (Legal Services Consumer Panel, 2016). Price transparency without quality data may result in consumers fixating on price to the detriment of other important considerations, encouraging a race to the bottom (Legal Services Consumer Panel, 2016).

Quality disclosure policies have been implemented across a range of services in the UK:

- The UK's telecommunication regulator, Ofcom, publishes factual service-level data to enable consumers to compare different aspects of telecommunications services. This data, from 2011 onwards, has reported on levels of satisfaction amongst consumers who have contacted customer services with a complaint. Consumers are asked to score various aspects of the provider's customer service, the speed with which issues were dealt with, the standard of advice given and the attitude and ability of the advisor. These findings are then aggregated, and firm-specific information is also given. Ofcom emphasises that this type of monitoring is part of its wider statutory responsibility (Legal Services Consumer Panel, 2016).
- The UK Financial Conduct Authority published a thematic review into the Consumer Credit Market in July 2015. The review covered the quality of advice: assessing whether debt advice was suitable, in the customer's best interests and that recommended debt solutions were appropriate and sustainable. The review also looked at transparency and disclosure: assessing

whether customers received clear, fair and not misleading information (including the 'small print') to enable them to make informed decisions relating to dealing with their debts. The FCA found significant shortcomings in the market and responded by providing detailed feedback to firms, but they did not name the firms that were of lower quality (Legal Services Consumer Panel, 2016).

- The National Health Service (NHS) and the Care Quality Commission (CQC) publish a range of quality and performance indicators that patients can use to compare providers. The NHS publishes its indicators on the NHS choices website, where consumers can also write their own reviews. Examples of hospital indicators include the percentage of registered nurse night hours and unregistered care staff day hours filled as planned (UKRN, 2014). Another indicator used is the "friends and family" test that aims to provide information to consumers about whether patients would recommend the services they have used. This acts as a mechanism for highlighting good and poor practices, which is then published on the NHS choices website. Examples of indicators published for GP practices include the results of the GP practice survey and scores on criteria such as recommendations, opening hours and the experience of making an appointment (UKRN, 2014).
- The CQC also utilises a traffic light ratings system, in order for consumers to understand the comparative information available. Providers are rated either: outstanding (green star), good (green light), requires improvement (orange light) or inadequate (red light) based on the results of CQC inspections. Criteria for these ratings include whether a provider is safe, effective, caring, responsive and well-led, as well as the performance of specific services such as intensive/critical care and outpatient services (UKRN, 2014).

As these examples have shown, the data on quality required for consumers to make more informed choices differs according to the type of service offered, and the sectors in which these services operate. Consumers of credence services, for example, also need objective information on the service provided and its characteristics, rather than just focusing on ratings systems. This will help consumers have a greater understanding of the service they are being offered.

Key Finding

There is a general challenge with attempting to articulate, measure and present information on quality in a meaningful way, not just for consumers, but also as a good practice tool that would improve standards in the sectors (Legal Services Consumer Panel, 2016). The Legal Services Consumer Panel concludes that regulators are in the best position to decide the scope, focus and extent of their primary or secondary investigations into quality, including how they might credibly go about gathering and publishing this information.

4.2.2. Publishing Complaints Data

Complaints data can help consumers to assess whether a service provider has provided what other consumers would deem satisfactory, and can be used as a proxy for quality. This has the potential to improve market transparency and to help consumers make informed decisions (Legal Services Consumer Panel, 2016). The publication of complaints data can also:

- give commentators more complex information that they can give to consumers in an understandable format
- deter poor behaviour by firms even if all consumers do not read complaints information
- provide a performance indicator for organisations.

Customers may benefit by being able to access information relating to how many customers are satisfied/dissatisfied with a particular service. In UK financial services market, for instance, the Financial Services Authority (FSA) (now the Financial Conduct Authority) found in a 2012 survey that 38% of customers said that they would use complaints data to make a choice of financial service provider (Legal Services Consumer Panel, 2016). The FSA/FCA ensures that regulated businesses publish information about the number of complaints they receive, in order to incentivise businesses to improve their performance, both because a regulator can monitor their conduct and because this information then becomes visible to consumers (UKRN, 2014). Consumers also use this to make informed decisions. The FSA/FCA found that 22% of consumers were aware of complaints data published by financial services firms, and of these, 38% had used it when considering a new financial services provider.

Complaints data has also been used by consumer advocacy groups to establish league tables. In the UK, Consumer Focus uses league tables to help consumers make better-informed decisions, for example in energy markets.

Various regulators in the UK have recognised that it is important that complaints data is balanced with positive reviews supplied in order to properly contextualise the information (Legal Services Consumer Panel, 2016). Deciding when complaints data should be published is also an important consideration, for example, after dispute resolution has occurred (i.e. where the consumer and supplier able to come to a suitable arrangement after the complaint was made). If this is not contextualised properly, then consumers may end up receiving biased, negative information. The flip side of this is that if complaints data is not published, consumers may end up receiving biased, positive information, for example, only receiving customer testimonials.

Key Finding

To be useful, complaints data needs to be accessible and contextualised in a way that consumers' can understand (i.e. uses percentages, is placed in the context of positive reviews and discloses how customer complaints were dealt with). The contextualisation and accessibility of this data will differ according to the specific market. There is no incentive for firms to show complaints data unless regulation requires it to be published.

4.2.3. Regulating how information is framed

Addressing framing effects can help to reduce consumers search costs. Many examples exist as to how regulators overseas have put in place remedies that seek to present information to consumers more effectively. Plain disclosure of contract terms and pricing is believed to enable consumers to make better informed decisions (Behavioural Insights, 2016).

The UK financial services regulator, the Financial Conduct Authority (FCA), regulates to ensure that firms do not hide information in small print or overwhelm consumers with irrelevant information. This acts as a nudge only, that is, it does not restrict products or pricing (Oxera, 2016). New Zealand's Credit Contracts and Consumer Finance Act 2003 (CCCFA) has similar requirements and is enforced by the Commerce Commission.

In the UK's energy markets, Ofgem introduced a Tariff Comparison Rate in 2010 to assist consumers in comparing the value for money of different tariffs across suppliers. This intervention partially addressed the underlying issue that consumers over-simplify complex pricing, leading to errors (Behavioural Insights, 2016). While the energy Tariff Comparison Rate allows easy comparison between different standing and unit charges, its success is limited due to heavily caveated assumptions used in its calculation of charges (Behavioural Insights, 2016).

Policies to overcome framing effects may reduce providers' ability to design different pricing structures, hindering competition and innovation. There is ongoing debate in the UK's energy markets as to whether 'simpler choices' (which limited the tariff structures providers could use) has helped or hindered competition in the energy sector. This was implemented as a result of the energy regulator Ofgem's Retail Market Review rules. The Competition and Markets Authority (CMA), in their 2016 Energy Market Investigation recommended that Ofgem remove these tariff restrictions. Given that electricity is a homogenous product, companies are expected to differentiate themselves through financial and commercial innovation, and the CMA believes that Ofgem made competition matters in retail electricity markets worse rather than better (CMA, 2016).

Key Finding

Although policies to overcome framing effects may improve static efficiency, it is also important to take into account dynamic efficiency when considering policy options. This ensures that firms' ability to innovate is not hindered by overly regulated and restrictive price frames.

4.2.4. Providing Consumers with their own Consumption Data: Midata

Midata, developed in the UK and USA, allows consumers to access their personal usage information from a service provider. This aims to reduce the complexity of the search process, in markets where suppliers can gather individuals' consumption and transaction data over time.

Midata initiatives currently focus on markets where consumers sign contracts for the ongoing provision of services, such as in the utilities and banking sectors. Since some markets offer too many contracts to consumers, automated product and price comparisons can help to simplify consumer choice, allow them to narrow down their options, or rule out disadvantageous deals (Lunn, 2014).

Firms provide consumers with their historical data, at their request, in standardised electronic form. The consumer can then share this data with a competitor, or upload it to software designed to undertake price comparisons or search for deals that offer a good match to the consumer's usage pattern. This allows consumers to check how their current contract compares with others, to locate the best deal, or to reduce their choice set to a manageable size (Lunn, 2014). It is believed that such initiatives empower consumers to investigate the market and give them confidence that they are finding the best deals (UKRN, 2016).

Midata initiatives may only be beneficial to some types of consumers. While the aim is to simplify consumer choice, an understanding of how this data can be used, as well as being able to handle computer files is required on behalf of the consumer (Lunn, 2014).

Although the UK tried to introduce the midata schemes on a voluntary basis, there was little to no uptake by private companies. In 2013, the UK government legislated to introduce regulations to compel companies to supply such data on request. These regulations applied this to the energy, mobile phone, current account, and credit card markets (Lunn, 2014). The European Union (EU) contained a similar consumer right to standardised personal consumption and transaction date in the EU Data Protection Regulations, passed in April 2016. The implementation of midata initiatives in the UK has been significantly delayed by lack of progress on common standards for formatting the data. Uptake by consumers has also been slow (CMA 2016; DBIS (UK) 2014, cited in Australian Productivity Commission, 2016). In 2015, a midata initiative was implemented in the UK banking sector. GoCompare (Gocompare.com) offered online comparisons of current accounts using midata, however these comparisons did not cover the entire retail banking market – instead they only included the major banks. They found that almost a fifth (19%) of current account comparisons are made using midata files, and that people who use midata are almost five times as likely to go on to switch as those who use standard 'best buy' tables (UKRN, 2016).

The UKRN (2016) also notes that open application programming interfaces (APIs) have been developed by price comparison sites in the financial sector, following on from midata initiatives being implemented. The use of APIs allows comparison websites to offer tailored comparisons based on consumers account usage, which leads to greater information and more personalised recommendations for consumers.

In Australia, the Productivity Commission published their draft report on Data Availability and Use in October 2016. They concluded that there may be scope for such data initiatives in Australia:

> The capacity for individuals, as consumers, to copy their data between service providers is an integral part of facilitating competition in markets and reducing barriers to market entry. In some circumstances, the consumer may see benefits in having a copy of their data provided to an entity that is not a competitor (for example, provision of medical records to a life insurance company or provision of utility payment information to a credit provider). In other cases, it will be to form a new customer relationship, or obtain a quote that may lead to one, at the consumer's discretion. (Australian Productivity Commission, 2016, p.18).

4.2.4.1. Issues with Providing Consumers with Individual Data

The Australian Productivity Commission notes that there are numerous issues with making service providers willing to give up the data they hold about consumers:

> The MyHealth Record in Australia has had some recent success, but implementation has been difficult due to poor incentives to participate and reluctance within the medical profession… And reforms to improve the access to and sharing of bank customer information in Australia and the United Kingdom have had limited success to date, although there are some recent moves on this front.
>
> For individuals to derive the most benefit they can from accessing their personal information, they should be able to use their data to move their custom to another preferred product or service provider or use their data to make more informed decisions about products and services of benefit to them, including being able to authorise a third party to do so on their behalf. Existing frameworks do not readily allow individuals to do this.
>
> Information may not be provided in a machine-readable format, and even when it is, the format of provision may not be able to be read by another service provider and/or the data variables may be incompatible with product offerings of different providers… Thus the lack of formal standards is a serious potential impediment to the ready transfer of regained information, and thus to an individual's ability to benefit from it. Current Australian comparator sites are weakened by the limited supply of data from consumers. The United Kingdom is better, in part due to its midata reforms. (Australian Productivity Commission, 2016, p. 300).

In the European Union, the Right to Data Portability has been made law in the European Union's General Data Protection Regulation. This regulation applies to data processors in countries located outside of the EU under certain circumstances. Controllers must make the data available in a structured, commonly used, machine-readable and interoperable format that allows the individual to transfer the data to another controller. (European Commission, May 2016, Article 20).

Key Finding

Providing consumers with their individual consumption and transaction data is an initiative that proposes to significantly lower search costs.

The midata reforms in the UK allow consumers to access and provide their data to rival competitors, but had implementation issues around deriving common standards for use, and have experienced slow consumer uptake.

Common standards need to be developed to ensure that information is provided in a machine-readable format that can be analysed by another supplier. This will help to ensure that comparison sites can work optimally for consumers by providing them with services that best suit their needs.

4.3. Comparison Websites

Comparison websites help to reduce consumers' search time, by allowing them to find and compare competing service providers in one place. These have become prominent across Europe, the US and the UK, and are becoming more prominent in Australia and New Zealand (Productivity Commission, 2014).

The Australian Competition and Consumer Commission (November 2014) notes that comparator sites can have benefits for consumers:

- Comparator websites provide value-adds that can assist consumers by simplifying complex information and helping them to make informed choices in situations where they would otherwise experience information overload and make no decision (or poor decisions).
- Comparator websites can assist consumers to break down complex plans by attempting to standardise retail plans to make it easier to compare like-for-like.
- There is preliminary anecdotal evidence to suggest that comparator websites can place downward pressure on prices and foster product innovation.
- Comparator websites can reduce search costs, thereby potentially making the process of researching and choosing products easier (ACCC, 2014, p.2).

An increasing number of comparison websites compare providers on more than just price. Consumers find it difficult to compare price without also knowing about service characteristics, and in many contexts consumers want other measures of quality (CMA, 2016).

Comparison websites can be funded by the government, consumers, or through advertising:

- Government or consumer 'pay to use' websites are believed to be ideal, as they aim to act in a consumer's best interests. However:
    - These can be costly for the government to administer (as evidenced in New Zealand with the Consumer Switching Fund).
    - Consumer uptake of a pay-to-use comparison site is low due to the existence of free websites.

- Comparison sites that generate revenue through advertising or lead generation are privately provided. They have competing incentives. On the one hand, they want consumers to use their website to find a deal that they are satisfied with. On the other, they want to generate as much revenue as possible from retailers listed on their site (Gamper, 2012). Concerns exist as to whether this model acts in the consumer's best interests.

4.3.1. Government Provided Comparison Websites

Overseas governments have funded and provided comparison websites. Government provided websites are generally viewed as the 'gold standard,' as they solely focus on providing comparisons of providers in order to benefit the consumer.

In Australia, the government implemented an 'Energy Made Easy' website in 2016 (aer.gov.au). The energy price comparison feature is available in territories where the National Energy Retail Law has commenced (since June 2016). Energy Made Easy allows users to compare all generally available gas and electricity offers, including details such as GreenPower options or solar feed-in tariffs, discounts and incentives and key terms and conditions. Their aim for this website is to make it much simpler for consumers to find an offer that suits their needs. They can use it to find a retailer for a new connection, or to check how their current retailer compares.

As discussed in the next section, however, these may be costly to implement and maintain, and may have greater costs than benefits.

4.3.1.1. Consumer Powerswitch

As part of New Zealand's electricity market reforms in 2009, the Consumer Switching Fund (CSF) was introduced by the government. This $15 million fund was used by the Electricity Authority to develop the '*What's My Number?'* website – showing consumers the annual savings they could make by switching provider, improve the functionality of the *Consumer Powerswitch* comparison website and pay for advertising campaigns to support these two initiatives.

During the period of the CSF, the Electricity Authority conducted national consumer surveys, including a baseline survey in 2011, to measure consumer awareness, attitudes and behaviour regarding switching. These surveys generally indicated that the *What's My Number?* campaign was successful in raising consumers' awareness of their competitive choices and propensity to switch.

In 2013, because of the significant amount of money involved in the CSF, MBIE commissioned Covec to undertake an independent quantitative evaluation of the CSF. They used data over the period from May 2011 to July 2013, noting that it is possible that the CSF has longer term effects on competition that had benefits that they couldn't quantify.

The conclusions Covec reached include:

- Residential switching rates increased by 62,000 to 79,000.
- They estimated that savings attributable to the CSF (i.e. to those who switched) ranged from $16.5 million to $41 million, assuming the savings persist for between 18 months and 3 years. Most of the consumer gains from switching were welfare transfers from electricity retailers, as opposed to gains in allocative efficiency.
- They estimated that the allocative efficiency (net increase in welfare due to increased consumption of electricity by those customers who switched and the lower prices they faced) was around $2.10 per customer per year, or a total of around $500,000 over three years, which is small in comparison with the $15 million cost of the fund.
- Covec did not quantify other efficiency benefits such as productivity improvements by retailers and better products or services, which would be expected from greater retail competition over time.
- They also found no evidence of a net effect of the CSF on electricity retail prices; however the data they used did not reflect the impact of door-to-door sales and other ad-hoc discounts.

- The results on competition (measured by the Herfindahl Index) are mixed over the period of their analysis, but competition between retail brands appeared to increase. Covec also noted that the CSF could have longer term dynamic efficiency benefits from increased competition.
- They also noted that there was some evidence that the number of retail brands increased during the period of the consumer switching fund, and there have been improvements in non-price dimensions of competition among retailers during this time, including the rate at which retailers approach consumers directly with offers.

As a result of the small allocative efficiency gain ($500,000) relative to the initial investment ($15 million), the government decided not to renew funding for the CSF. In evaluating the success of the policy, although quantitative measures were helpful in determining the economic viability of continuing the funding, dynamic efficiency benefits were unable to be considered – especially over the long term. Additionally, the data Covec used did not include ad-hoc discounts or the impact of door-to-door sales on pricing, which may have limited some of their analysis. Non-price elements of competition between retailers also improved, which could perhaps have been further considered in evaluating the policy.

Additionally, there may have been a lack of qualitative analysis of the *Consumer Powerswitch* and *What's My Number?* campaigns. Although the Electricity Authority conducted surveys around consumer awareness, attitudes and behaviour regarding switching, perhaps a more complete evaluation of the website was required, i.e. could the functionality of the website have been improved? What additional information might consumers want from a comparison site in order to facilitate switching?

The Electricity Authority has now sought additional funding from Consumer NZ, the Gas Industry Company and electricity retailers in order to continue operating the Powerswitch website. However, this website may not be user-friendly enough for consumers. Although it gives deals to consumers based on their electricity needs, it only displays price information prominently, and does not display the contract terms, exit fees etc. that may be attached to contracts.

4.3.2. Privately Provided Comparison Websites

Many comparison websites overseas and in New Zealand are privately run. Given that New Zealand has a small population relative to other jurisdictions, the market for private comparison sites has remained small, and it may not be hugely profitable for private providers. Websites such as Canstar (comparing banking and insurance services), Canstar Blue (comparing telecommunications and broadband providers), and Switchme (comparing electricity providers) are a few examples of comparison websites that have emerged from the private sector.

Privately-provided comparison sites can generate revenue from both suppliers and consumers, although generating revenues from consumers is relatively uncommon (UK CMA, 2016). For example, Webjet generates revenue from consumers when they purchase flights, but there is an issue that consumers use these websites and then go on to purchase flights directly from airlines.

Comparison sites are commonly found in markets for ongoing services (e.g. utilities, telecommunications, insurance). Few comparison sites exist in professional services markets. Features of professional service markets mean that these often do not compete based on price (discussed in section 3.2.1.). This gives little incentive for firms in these markets to be listed on a comparison site, let alone pay a provider to be listed.

There have, however, been recent developments in comparison websites in professional services markets overseas. A legal services comparison site was launched in the UK in early 2016. The Law Superstore offers consumers information on quality, locality, complaint data, consumer feedback and, where available, price (fixed fee). Issues have been noted with the availability of price information in the UK legal services market, which has hindered the development of websites such as these (Legal Services Consumer Panel, 2016). Price comparison websites argued for increased price information and transparency in the UK Legal Services Market, in order to help consumers to make a complete evaluation of legal service providers (Legal Services Consumer Panel, 2016).

4.3.2.1. Free-to-consumer comparison sites

Many private comparison sites are free for consumers to use. They collect revenue from firms who choose to list their service on their sites (usually via advertising or lead generation), and so have the incentive to get as many consumers as possible using their service (Gamper, 2012). This model allows consumers to compare goods and services for free. They also appeal to businesses who want to have their offerings listed so they can reach consumers and potentially be visible to competitors (Gamper, 2012).

These sites usually generate revenue from the supplier through lead generation. Typically, these are based on a pay per click, pay per introduction, or pay per acquisition basis (UK CMA, 2016). Some comparison sites also generate additional revenue from hosting advertising or charging a fee for increasing the prominence of a product. Or, some may sell consumers data to other suppliers or third parties (UK CMA, 2016).

- **Demand-side effects**

Although these websites are provided free of charge to consumers, and pose no significant barriers to use, issues with this business model were identified by the UK Regulators Network (2016), during the ‘access’, ‘assess’, and ‘act’ stages of the consumer decision making process.

- **During the access stage –** consumers may not experience full coverage of providers in the market, the quality of information may not be sufficient (i.e. if the website compares on price alone then the overall value of the product or service may be hard for the consumer to compare), or the information may be outdated if not regularly updated.

- **Assessing information –** consumers may not be able to easily assess information as they may not be able to personalise their search, or the ranking criteria may be ineffective at supplying consumers with the information they require to make a thorough assessment. Further, there may be too much information presented on these comparison sites, which may lead to choice overload and the use of heuristics to make a decision. Lack of information accuracy on pricing is also cited as an issue.

- **Acting on information –** The data entered on comparison sites may not transfer correctly from the comparison site to the provider. This may mean that a consumer will end up with a policy unsuitable to their needs.

In order to mitigate these effects, in Australia, consumer advocacy websites such as Choice (choice.com.au) evaluate comparison sites based on their accuracy, impartiality and transparency. These can help consumers to choose between comparison websites when selecting plans in financial services (i.e. banking, health insurance etc.). Due to funding constraints, these websites are not updated often.

The UK’s energy regulator, Ofgem, implemented the ‘Confidence Code’ in 2014. This accredits independent domestic energy comparison sites, and requires members to follow certain principles in operating their service (e.g. independence and impartiality). The aim is to make consumers feel reassured, that the website is reliable, and should make the process of switching energy supplier easier (UKRN, 2014).

Codes of practice like the Confidence Code can be overly restrictive to suppliers in the market. The UK’s Competition and Markets Authority (2016) recommended that Ofgem’s ‘whole of market’ coverage requirement be removed to strengthen comparison websites incentives to engage consumers. It noted:

> We are aware of the concerns around trust that led to the Confidence Code requirement that Price Comparison Websites (PCWs) list all tariffs on the market rather than just those for which they earn a commission. We believe that such concerns around trust can be addressed… in two ways. First, there should be greater clarity around the role of PCWs – effectively acting as brokers offering their customers good deals and facilitating switches rather than repositories of all available tariffs – and our remedies require greater transparency from PCWs about market coverage. Second, Citizens Advice is now operating a non-transactional PCW that lists all tariffs through a web-based service, which we believe will meet the needs of those customers who wish to see the whole of the market (CMA, June 2016, p. 56-57).

- **Supply-side effects**

The Australian Competition and Consumer Commission (ACCC) (November 2014) also note that comparison websites have benefits for competition via the supply side of the market:

> - There is evidence that comparator websites can positively impact on competition in the markets for the products that they compare and/or sell by effectively reducing barriers to entry and making it easier for new entrants to enter the market.
> - Challenger brands (usually small and medium enterprises) are increasingly relying upon comparator websites as a cheaper and more wide-ranging marketing channel to promote their products (ACCC, 2014, p. 2).

Comparison websites can also mislead or deceive consumers. The ACC (2014) noted that a lack of transparency in terms of the material on the website and behind-the-scenes (commercial relationships) conduct is a key issue in this area, and stated their concerns:

> Concerns about material on the website broadly relate to representations as to the:
> - nature or extent of the comparison service, including market coverage
> - savings achieved by using the comparison service
> - comparison services being unbiased, impartial or independent
> - value ranking.
>
> Concerns about behind-the-scenes conduct broadly relate to:
> - undisclosed commercial relationships affecting recommendations to consumers
> - content and quality assurance of product information (ACCC, 2014, p.2).

The ACCC, as a result of their findings, published a set of guidelines in 2015 for providers of comparator websites to follow. In addition, they provide information to consumers about how comparator websites work, as well as actively monitoring comparison sites to ensure that no misconduct is occurring.

4.3.2.2. Pay-to-use comparison sites

Pay-to-use comparison sites earn their revenue from the consumer side of the market, and no longer depend on earning revenue from listing retailers (Gamper, 2012). This aims to change the incentives of the comparison site providers, making them more eager to work for the consumer and present impartial and unbiased rankings (Gamper, 2012). For example, Consumer New Zealand offers a pay-to-use comparison site covering a range of services.

Consumer organisations around the world also operate their own comparison sites. In the UK, the consumer organisation *Which* (which.co.uk) offers a comparison site containing independent expert review and comparison services. Only consumers who pay the upfront fee for this service are able to access the content (Gamper, 2012). Some consumers may be excluded due to inability to pay, particularly those from low income households **–** those who generally can benefit most from searching for better deals (Gamper, 2012). Others may be unwilling to pay because they have to pay an upfront fee and cannot reap the benefits immediately (present bias) or because the potential benefits may be uncertain, especially when there are free comparison sites available for the market they want to look at (albeit a two-sided model) (Gamper, 2012). .

Incentivising consumers to sign up to one-sided comparison sites is a key issue. Providers such as Webjet have found one way to mitigate this issue, where consumers do not have to pay to use the Webjet service. Instead, when the consumer chooses Webjet to choose an airline they are directed to the airline's own website and Webjet gets paid a fee by the airline for the customer's referral.

Key Finding

Comparison sites are least likely to be deceptive or misleading to consumers when they generate revenues from the consumer side of the market. However, these can be costly for government to administer and the uptake of a privately provided pay-to-use site is low when free comparison sites exist.

Comparison sites that rely on advertising revenues can be effective for consumers, provided they are transparent about their market coverage and the information they display, and do not act in a manner to mislead or deceive consumers about the best offers in the market.

4.3.3. Consumer to Consumer Websites

Consumer-to-consumer (C2C) websites have become prominent in routine services markets. Websites such as Yelp (restaurant reviews) and TripAdvisor (hotel/restaurant reviews) are platforms that have emerged that allow consumers to give feedback on these services.

The C2C model has been extended to professional services in the United States, where various web-based firms offer ratings services for private medical markets (d'Andria, 2013). These gather reviews from consumers and third parties on individual professionals and post them on their site. Some examples include: Judysbook.com, MyDocHub.com and AngiesList.com. These offer consumer-driven ratings that other consumers can freely (or, in the case of AngiesList, pay a subscription fee) read and use at their advantage. These reviews provide opinions on professionals' courtesy, waiting time, prices and service effectiveness. Some also provide information on how long a professional has been licensed, or a record of misconduct.

Empirical evidence has shown that such mechanisms can be market-enhancing for credence goods such as professional services, and can be a useful addition to traditional means such as advertising, certification and reputation for professions where there are no meaningful ways to infer quality (d'Andria, 2013). There is scope for websites such as these to be extended to other professional services; however, there is a tendency for consumers to only post reviews of services when they've had either an exceptionally good or negative experience, as is the case for travel websites such as TripAdvisor or restaurant review sites such as Yelp. Although Consumer-to-Consumer websites can be helpful in helping consumers infer information about the quality of a service, there is concern that these may be biased.

5. Switching Costs

Switching costs are the costs - in time, money, and effort - associated with switching providers (Burnham, Frels& Mahajan, 2003).

There is no definitive consensus on the classification of switching costs. Some authors distinguish between psychological and economic costs. Others categorise switching costs into learning, transaction, and artificial costs (Klemperer 1987; Nilssen 1992, cited in Blut et al., 2014). However, the most accepted, and arguably most complete, categorisation of switching costs is one used by Burnham, Frels, and Mahajan (2003). They distinguish between relational, financial and procedural switching costs.

Switching costs can be internal (self-imposed by the consumer) or external (imposed by a firm in the market). These costs depend on the service context and level of customer participation required (Schulte, 2015). As with search costs, consumer behaviour is also impacted by switching costs. Behavioural economics recognises that high switching costs can lead to status-quo bias and inertia, the tendency to remain with a previous decision, or not act at all. Consumers' behavioural biases may exacerbate switching costs, which affects customer commitment to a service provider, even in the case of low satisfaction with the service.

Considering whether switching costs arise from positive or negative constraints may be important in evaluating whether switching costs are negatively impacting consumers' propensity to switch. Positive switching costs are defined as "foregone benefits from the current relationship when switching to a new provider" whilst negative switching costs "represent actual losses associated with the switching process" (Blut et al., 2014).

5.1. Types of Switching Cost

Switching cost type	Description
Procedural switching costs	
Uncertainty costs	Perceptions of the likelihood of lower provider performance when switching
Pre-switching search and evaluation costs	Perceptions of the time and effort required in gathering and evaluating information before switching
Learning costs	Perceptions of the time and effort of learning a new service routine after switching
Setup costs	Perceptions of the time, effort, and expense of relaying needs and information to a new provider. As an extension to the definition provided by Burnham, Frels, & Mahajan, setup costs could also include the termination of the existing relationship with their old provider.
Psychological sunk costs	Perceptions of non-recoverable investments in time, money and effort in establishing and maintaining a relationship with a provider
Financial switching costs	
Financial loss costs	Perceptions of investments and costs already incurred in establishing and maintaining relationship. These can also be imposed by firms (i.e. break fees).
Lost performance costs	Perceptions of the benefits and privileges lost by switching
Relational switching costs	

Personal relationship loss costs	Perceptions of losses associated with breaking the bonds of identification that have been formed with the people with whom the customer interacts
Brand relationship loss costs	Perceptions of losses with breaking the bonds of identification that have been formed with the brand or company with which a customer has associated

5.1.1. Procedural Switching Costs

These include uncertainty, evaluation, learning, and setup costs (Burnham, Frels & Mahajan, 2003). This type of switching cost primarily involves the expenditure of time and effort (Burnham, Frels & Mahajan, 2003). Consumer perceptions of these time and effort costs are also important.

These have also been defined as ‘psychological costs’, referring to feelings and attitudes associated with switching suppliers – such as frustration, dissatisfaction, risk and uncertainty (Barroso & Picón, 2012). Barroso and Picón (2012) also state that these include the inconvenience and effort of learning about a new supplier and the anxiety caused by the inability of consumers to foresee the consequences of their choice. Considering the notion of psychological sunk costs is also helpful to begin understanding the behavioural limitations over and above existing procedural costs.

- **Uncertainty costs**

Uncertainty costs arise when a consumer adopts a new provider when they have insufficient information, the uncertainty stemming from the potential for a negative outcome (Guiltinan 1989; Jackson 1985; Klemperer 1995; Samuelson & Zeckhauser 1988, cited in Burnham, Frels & Mahajan, 2003).

These have also been termed ‘continuity’ costs, taking into account the psychological uncertainty or perceptions of risk surrounding the performance of an unknown or untested service provider (Guiltinan, 1989; Shmalensee, 1982, cited in Beatty, Jones & Mothersbaugh, 2002).

Uncertainty and risk are higher when quality is difficult to judge, or varies considerably across alternatives. In services, uncertainty costs are generally pronounced given their intangibility and heterogeneity (Zeithaml et al., 1985, cited in Beatty, Jones & Mothersbaugh, 2002).

- **Pre-switching search and evaluation costs**

Search costs also arise in the analysis required to make a switching decision. As discussed in section 2 of the report, these consist of the time and effort costs of collecting the information required to evaluate potential alternative providers (Burnham, Frels & Mahajan, 2003).

Search and evaluation costs have also been defined as (pre-switching) transaction costs: the time and effort it takes to make a decision and switch (Duijmelinck, Mosca & van de Ven, 2015). These costs could be substantial if consumers have to analyse information about a number of differentiated services. In this respect, consumers can experience choice overload (Duijmelinck, Mosca & van de Ven, 2015).

It is likely that both search and switching costs will be present in a consumer’s decision to switch (OFT, 2003). In order to change mobile phone supplier a customer may have to research alternatives and pay a cost to end their contract. However, search costs can also reduce the costs of switching suppliers, as the investment in researching other options reduces the uncertainty costs that can be associated with switching suppliers (OFT, 2003).

- **Learning costs**

Learning costs are the time and effort costs of learning the skills required to use a new service (Alba and Hutchinson 1987; Eliashberg and Robertson 1988; Guiltinan 1989; Wernerfelt 1985, cited in Burnham, Frels & Mahajan, 2003). Learning investments will often be specific to the provider, meaning that new investments need to be made to adapt to a new provider (Klemperer, 1995).

Learning costs are prominent in services, as consumers generally play an integral role in service routines and procedures (Bowen, 1986; Heskett et al., 1990, cited in Beatty, Jones & Mothersbaugh, 2002). For example, a customer using a bank for the first time may not fully understand the bank's procedures and their role in the process, and learning these requires cognitive time and effort.

- **Setup costs**

Setup costs are the time and effort costs associated with purchasing a service for the first time (Borges, Chebat & Davidow, 2011). These are connected to the process of beginning a relationship with a new provider (Burnham, Frels & Mahajan, 2003).

In services relationships, setup costs are experienced both by the firm and the consumer. As customisation is often high in services, the provider often needs to acquire information from the consumer in order to understand the consumer's specific needs and reduce the provider's own selling risks (Guiltinan, 1989, cited in Burnham, Frels & Mahajan, 2003). This service-firm learning results in costs borne by the consumer when purchasing from a new service provider for the first time (Guiltinan, 1989; Jackson, 1985; Porter, 1980, cited in Beatty, Jones & Mothersbaugh, 2002).

Examples of setup costs include:

- filling out forms when changing banks
- getting new X-Rays when changing doctors
- explaining a desired hairstyle when changing hairdressers.

The OFT (2003) termed these costs 'transaction costs,' and noted that while direct financial costs may not be involved, transferring information can be time-consuming and potentially disruptive for a consumer if there are problems during a changeover. For example, when switching banks, transferring salary payments and direct debits to a new bank account may increase the 'hassle-factor' of switching.

Setup costs could also include the termination of a relationship with a consumer's existing provider. The losing provider may impose additional costs (e.g. the consumer may have to ring up the existing provider and be subjected to a sales pitch before the provider allows them to leave). This can make setting up a relationship with a new provider more time-consuming, and therefore costly to the consumer.

- **Psychological sunk costs**

Psychological sunk costs, although not explicitly included in the definition of switching costs by Burnham, Frels, and Mahajan (2003), play an important role in switching behaviour.

In services markets, psychological sunk costs consist of consumers' perceptions of the non-recoverable investments – in terms of time, money, and effort – in establishing and maintaining a relationship with their current provider (Duijmelinck, Mosca & van de Ven, 2015, p.666).

Sunk costs may result in irrational behaviour, such as status quo bias (Duijmelinck, Mosca & van de Ven, 2015). For example, in insurance markets, consumers who have established a relationship with their provider may face high sunk costs. Duijmelinck, Mosca and van de Ven (2015) note that longer periods of enrolment in insurance reduce the likelihood of switching. Their insurance example also draws on the fact that often high-risk insurees may face high sunk costs, because of familiarity with their current insurance provider's procedures and they may have taken a lot of effort in getting prior insurance authorisation (Duijmelinck, Mosca & van de Ven, 2015). These behavioural factors will be discussed in more depth in section 6.2 and 6.3.

5.1.2. Financial Switching Costs

These consist of benefit-loss and financial loss costs, and involve the loss of financially quantifiable resources (Burnham, Frels & Mahajan, 2003).

In services, these mainly arise from the way that contracts are structured (including marketing programmes) (Burnham, Frels & Mahajan, 2003, cited in Productivity Commission, 2014). Financial switching costs can vary depending on the type of service relationship and can act as important drivers of choice (Burnham, Frels & Mahajan, 2003, cited in Schulte, 2015).

Firms can find it advantageous to impose financial switching costs, making customers more loyal and less price sensitive (OFT, 2003). Firms may do this through two channels:

- They can try to get customers to agree to contracts with a certain minimum term and 'early redemption penalties,' as is typically the case with mortgages. Mobile phone, electricity, and broadband providers also typically impose 'break fees' for customers ending their contracts.
- They can also create schemes that give incentives for repeat purchase, such as airlines' frequent flyer programmes and other loyalty schemes.

Pick and Eisend (2013), in their meta-analysis of switching costs, noted:

> Contracts imply that buyers have a contractual barrier to switch as long as the relationship continues. Hence, switching costs are increased. Furthermore, the buyer may also perceive a feeling of duty or obligation to keep the contract with the supplier – leading to a perception of high switching costs for contractual settings. Further, contracts directly prevent from switching. (Pick & Eisend, 2013, p. 191).

- **Benefit-loss costs**

Benefit-loss costs consist of the benefits lost if the relationship with the current service provider is ended (Duijmelinck, Mosca & van de Ven, 2015). These costs create economic benefits for the consumer, giving them incentives to stay with their original provider (Guiltinan, 1989, cited in Burnham, Frels & Mahajan, 2003). In switching to a new provider, consumers may lose points they have accumulated and discounts or benefits that are not given to new customers (Guiltinan, 1989, cited in Burnham, Frels & Mahajan, 2003).Given the highly personalised nature of services, these 'perks' may be created from strong relationships with service staff (Beatty, Jones & Mothersbaugh, 2002).

- **Financial loss costs**

These are the onetime financial outlays that are incurred in switching providers other than those used to purchase the new service itself (Heide and Weiss 1995; Jackson 1985; Klemperer 1995; Porter 1980, cited in Burnham, Frels & Mahajan, 2003). Making the switch to a new service provider often involves one-off expenditures such as deposits or initiation fees (Gultinan, 1989, cited in Burnham, Frels & Mahajan, 2003).

Contracts can also impose financial loss costs. These are imposed by firms, and can potentially create high switching costs for consumers. For example, if a consumer wishes to exit a contract early, they may have to pay a certain penalty or fee (Productivity Commission, 2014). These become sunk financial loss costs once the switch has occurred.

Burnham, Frels & Mahajan (2003) note that in addition to the onetime expenditures, switching providers may involve replacing transaction-specific assets (also termed as ‘coassets’) that the consumer has invested in (Kerin et al. 1992; Weiss and Heide 1993). For example, when switching internet service providers, investment in a new router may be required.

5.1.3. Relational Switching Costs

Relational switching costs consist of personal relationship and brand relationship loss costs. These involve psychological and emotional discomfort resulting from ending relationships with a provider (Burnham, Frels & Mahajan, 2003). Close links exist between relational and procedural switching costs, as both involve psychological elements as opposed to quantifiable losses (Barosso & Picón, 2012).

- **Personal relationship costs**

Personal relationship loss costs are losses associated with breaking bonds that have been formed with service staff (Guiltinan 1989; Klemperer 1995; Porter 1980, cited in Burnham, Frels & Mahajan, 2003). Consumers’ familiarity with their current provider’s employees or relationship with their service provider creates a level of comfort that is not immediately available with a new provider (Burnham, Frels & Mahajan, 2003).

Personal relationship loss costs are pronounced in credence services (OFT, 2003). In medical services, for example, the quality of the service received may not be observable post-purchase. A patient who asks their dentist for a diagnosis may not discover the quality of a diagnosis without consulting other experts for a second opinion (OFT, 2003). Therefore, such relationships are founded on trust. For this reason, a patient may be reluctant to switch to another dentist who they have not yet learned to trust. While a patient may place considerable trust in their dentist, and so be reluctant to change to an unknown dentist, this trust may be misplaced (OFT, 2003).

- **Brand relationship loss costs**

These are the losses associated with breaking the bonds of identification that have been formed with a particular service or company that a consumer has used in the past (Aaker, 1992; Porter 1980, cited in Burnham, Frels & Mahajan, 2003). Consumers can draw meaning from their purchases and form bonds that become part of their sense of identity (McCracken 1986, cited in Burnham, Frels & Mahajan, 2003). This brand based relational bond is lost in switching providers.

5.2. Behavioural Biases Can Exacerbate Switching Costs

Consumer perceptions of switching costs play a key role in determining their switching behaviour, as the existing categorisation identifies. In addition to existing switching costs, behavioural economics provides additional insight into how certain behavioural biases may impact consumer switching behaviour. These behavioural biases include loss aversion, reference dependence, and time discounting (Oxera, 2016). These can lead to status-quo bias and inertia: the decision to stay with a previous decision or not act at all.

- **Loss aversion**

Loss aversion refers to the fact that individuals have a preference for avoiding losses as opposed to acquiring gains. This is partially due to the ‘endowment effect’, where individuals ascribe more value to their own possessions because they own them. Consumers may be reluctant to give up what they have. This suggests that individuals often demand far more to give up something than they would be willing to pay to acquire it (Oxera, 2016).

Sunk costs, either in time, money or effort, can therefore decrease consumers’ tendency to switch (Blumer, 1985, cited in Matthews, 2009). If a consumer has previously committed to forming a relationship with their service provider and paid a sign-up fee for example, there will be reluctance to switch until both the financial and non-financial costs of their commitment have been psychologically amortized in the consumer's mind (Matthews, 2009). That is, until both financial and non-financial sunk costs have been 'paid back' to the consumer, even if gains could potentially be made by switching (i.e. they misjudge the costs and benefits of switching due to loss aversion).

Part of the reluctance to switch from one supplier to another may be due to the fear that experience with a new supplier is unknown and may be worse. Risk aversion may also influence customers to overestimate the (short-term) costs of switching, and underestimate the longer term benefits of switching (Xavier, 2011).

Key Finding

Loss aversion may cause customers to remain with their current service provider because of uncertainty about how much better another provider will be, a failure to acknowledge poor choices in the past or irrational consideration of sunk costs. Barriers to switching will reinforce this endowment factor, which makes it all the more important to ensure that switching is hassle free, fast, and cheap (Xavier, 2011).

- **Reference dependence**

A consumer's perceived gain or loss depends on where their outturn gain from switching is relative to their expectation. Reference dependence, along with loss aversion, can combine to lead to status quo bias; making a decision and not changing one's mind if there is a prospect of loss (Oxera, 2013).

- **Present bias**

Many consumers exhibit a psychological preference for receiving a benefit in the present over receiving it in the future (over and above discounting). Consumers discount the future to the present at a high rate, meaning they underestimate costs in switching providers the further away it is in time, leading consumers to choose options that are attractive in the short run (Matthews, 2009). For example, a consumer could enter into a broadband contract with a small upfront fee and not take into account that after six months the price of broadband will increase once the introductory offer ends. This can be attributed to the idea that consumers have a short-term focus, as well as their failure to anticipate the impact of future switching costs (Zauberman, 2003, cited in Matthews, 2009).

Present bias, like reference dependence and loss aversion, can also lead to status-quo bias. Oxera (2013) gives the example that a consumer may be unwilling to switch their existing mortgage provider, if consumers perceive that doing so would incur potential costs in the future (both tangible and hassle costs), but they may also procrastinate due to time inconsistency. A greater discussion of lock-in and inertia/status-quo bias is in section 5.4.

5.3. Service Context Affects Switching Costs

As with search costs, the nature of switching costs changes with the type of service being offered to the consumer. Schulte (2015) classifies services according to their nature, as well as the level of customisation required, in order to determine how switching costs may affect consumer behaviour.

5.3.1. The Nature of Services

The Nature of the Service Act, according to Lovelock (1983), p. 12, adapted from Schulte (2015), p. 59		
	Who or what is the direct recipient of the service?	
What is the nature of the service act?	**People**	**Things**
Tangible Actions	Services directed at people's bodies e.g. healthcare, haircuts, restaurants	Services directed at goods and other physical possessions e.g. gardening services, mechanics
Intangible Actions	Services directed at people's minds e.g. education, information services, cinemas, museums	Services directed at intangible assets e.g. banking, insurance, legal services, broadband, telecommunications

Switching costs are high for all service categories; however the nature of these costs differs between them. This may be important in understanding the case for intervention:

- Services that have a client-based process attached to them are directed at people. These services may have high relational costs associated with them, and although these may pose high switching costs, considering whether these are due to positive or negative sources of constraints is important.
- Services directed at intangible assets may face the highest negative switching costs and chances for lock-in through financial costs imposed by contractual obligations.
- Services directed at intangible assets may also face significant procedural costs, since it may be difficult for the customer to learn and understand the service in question.

5.3.2. Services and Customer Participation

Levels of Customer Participation, according to Bitner et al. (1997), p. 194, adapted from Schulte (2015), p. 62		
Low: Customer presence required during service delivery	**Moderate:** Customer inputs required for service creation	**High:** Customer co-creates the service product
Products are standardized	Client inputs customise a standard service	Active client participation guides the customised service
Service is provided regardless of any individual purchase	Provision of service requires customer purchase	Service cannot be created apart from the customer's purchase and active participation
Examples: airline travel, hotel stay, fast food restaurant	Examples: haircut, dental check-up, annual physical exam	Examples: marriage counselling, personal training, legal services

- Thibaut & Kelley (1959) argued *"customization creates switching costs and increases the attractiveness of the current exchange relationship in comparison to alternatives"* (cited in Dydland & Nilsen, 2015, p. 20).
- When high customer participation is required, the customer co-creates and customises the service (Schulte, 2015). Since individual investment in such a service is high, habits may be formed and this can likely generate high switching costs and subsequent lock-in and status-quo bias. If the customer were to switch providers, this will be perceived as more risky and the outcome more uncertain (Schulte, 2015).

5.4. Impacts of Switching Costs on Consumer Behaviour

5.4.1. Lock in, Status-Quo Bias, and Inertia

The primary effect of switching costs is to lock consumers in to a supplier (Matthews, 2009).

> In a market with switching costs, the rational consumer will not switch to the supplier offering the lowest price if the switching costs (in terms of monetary cost, effort, time, uncertainty, and other elements) outweigh the price differential between their current supplier and the new one. If this happens, the consumer is said to be locked-in to the current supplier (Lamiraud, 2013, p. 2).

The idea that switching costs cause consumer lock-in is not new. Many authors believe that in practice, switching costs create dependence and inertia, and the customer retains their relationship with their current supplier (Matthews, 2009).

Search and switching costs are the two primary rational explanations of inertia, or status-quo bias (Farrell and Klemperer, 2007, cited in Grubb, 2015). Generally, traditional economics and marketing literature refers to switching costs generating 'customer lock-in' and not inertia or status-quo bias. Behavioural economics, however, provides other reasons why consumers do not change provider, even when 'real' switching costs may be low, and extends the literature on inertia or status-quo bias to include further behavioural aspects.

Status-quo bias means that consumers tend to choose the same option they chose previously, even if prices and attributes have changed so that they would no longer make that choice even if making it for the first time (Grubb, 2015). This can either be due to the uncertainty of a decision, or due to underlying behavioural factors that act as a barrier to switching.

5.4.1.1. High Switching Costs and Lock-In

In services especially, switching costs can cause consumers to only exit a particular service relationship after a number of problems with their current provider have been encountered (Matthews, 2009). Although this may be a sign of tolerance by a consumer, it may also reflect the effect of switching costs that force customers to accept a certain level of difficulty before deciding to exit the relationship (Matthews, 2009). That is, they are 'locked-in' to their current provider.

- **Impact of procedural switching costs**

Procedural costs imply the expense of time and effort in establishing and maintaining a service relationship, leading to shared knowledge between the provider and consumer. This builds confidence and reduces perceived risk, particularly for services that are high in complexity, variability, and involvement (Berry 1995, cited in Schulte, 2015). Increasing length of patronage with a service provider creates a switching cost if a consumer becomes dissatisfied with the service.

Complexity has been identified as an antecedent for lock-in in consumer decision making (Koch, Eisend, and Petermann 2009, cited in Schulte, 2015). The time and effort required for switching as well as uncertainty about alternatives makes customers stay with service providers. Search costs, attractiveness of alternatives, and length of patronage explain some of the variance in the propensity of a customer to remain with their service provider (Patterson & Smith, 2003, in Schulte, 2015).

Learning costs in the service context decrease as experience with the service is gained, which in turn leads to an increase of cognitive switching costs. That is, repeated experience in consumption leads to habituation and a form of loyalty caused by switching costs (Murray and Häubl, 2007, cited in Schulte, 2015).

- **Impact of relational switching costs**

In the services sector, relationship-specific costs are important. Once a choice is made, relationship development can lock the consumer in and give the seller power in the future (Farrell & Shapiro, 1951, cited in Schulte, 2015).

Relational switching costs arguably create one of the largest barriers to consumer switching in services. Relationship length can be seen as a barrier to switching, reflecting a cost in terms of loss of information associated with a consumer's relationship with their service provider (Matthews, 2009). Many studies have found that in service relationships, there is a positive correlation between age and the tendency to form a relationship with the service provider (Patterson & Ward, 2000, cited in Schulte, 2015). However, Patterson and Ward (2000) also found that 30 per cent of consumers did not form relationships with their service providers at all (cited in Schulte, 2015). Consequently, differences between individuals will also determine how high relational switching costs will be for the consumer, and their ability to become locked-in by relationship mechanisms.

In service relationships, each person has their own set of criteria for relationship development and evaluation (Patterson & Ward, 2000, cited in Schulte, 2015). Therefore, the ability for consumers to become 'locked-in' to a service provider depends on psychological perception and cognitive capacity, as well as attitudes to change (Schulte, 2015).

- **Impact of financial switching costs**

Financial costs can easily lock the consumer in to the relationship, if the upfront financial costs to exit the relationship are large. These include lost benefits costs from the ongoing relationship with the provider and sunk investment costs (Schulte, 2015).

5.4.1.2. An Explanation of Status Quo Bias, Inertia and Lock-In

The concept of status-quo bias and inertia extends the literature on customer lock-in to include behavioural aspects. Many authors now recognise that consumer behaviour is strongly influenced by status-quo bias, or inertia: the tendency to stay with a previous decision or not act at all. Although the switching cost literature recognises that switching costs may be psychological, taking insights from behavioural economics offers an extension to this idea (see section 5.3). For example, loss aversion may create attachment to a previously chosen product similar to an endowment effect (Ericson & Forster, 2011, cited in Grubb, 2015). Consumers may also become psychologically attached to brands (Grubb, 2015).

The Behavioural Insights Team, in its 2016 report examining behavioural insights in regulated markets , highlights that:

> One of the strongest forces in consumer behaviour is inertia; in many cases, consumers will maintain a default or perceived default, even where there may be benefits from switching (Samuelson & Zeckhauser, 1988; Wilson, Price & Others, 2005). This tendency to stick with a previous decision, or simply not acting, is termed **status quo bias** by psychologists (Samuelson & Zeckhauser, 1988). (Behavioural Insights, 2016, p. 13).

Status-quo bias is driven by the finding that consumers place different values on services they may already have compared with those they do not have. This observed behaviour could be explained by different underlying behavioural biases, for example, loss aversion (it is a feature of underlying preferences), or limited consumer capacity or information (it is a feature of uncertainty about the impact of change) (Oxera, 2012).

If consumers do not want to think about the choice or engage with a product or service, they will apply the minimum effort to searching and switching, and maintain the status-quo if they can (Behavioural Insights, 2016). Consumers therefore have a tendency to select default options even when the effort of making a different decision is low (UKRN, 2014). One implication of this is that consumers on automatically-renewable contracts are more likely to let their contracts roll over even when they can exit these contracts easily (UKRN, 2014).

Status-quo bias is pronounced in the case of utilities, for example in energy or financial services, even when the potential savings to be made by switching are significant (Behavioural Insights, 2016). In these markets, the explanation that consumer satisfaction causes the majority of low switching rates does not seem likely, especially in energy markets (Behavioural Insights, 2016). In determining whether status-quo bias was a result of customer satisfaction, the UK Competition and Markets Authority examined complaints data, finding that complaints had increased drastically from 2007 to 2013, but still low rates of switching were prevalent (CMA, 2015, cited in Behavioural Insights, 2016).

This indicates that consumers can experience status-quo bias even when they are dissatisfied with a service. Status-quo bias "*has been associated with a tendency to exaggerate the disadvantages of leaving one's current situation and to understate the potential gains of switching, in an environment of uncertainty and complex decision-making"* (Lamiraud, 2013, p. 7). A discussion of customer retention and satisfaction is in the next section.

Oxera (March 2016) provides an example of status-quo bias in retail energy markets. Although consumers do not own a physical object, they purchase services from a retailer and associate a value with a particular retailer's brand. Although values attached to brands vary between consumers, they are expected to be higher for established brands (incumbent retailers) and suppliers that invest more in advertising and brand-building activities. Experience with their current provider leads some customers to place additional trust in their provider and to perceive a risk of loss when considering changing their supplier. Consumers switching provider therefore 'lose' the services, brand value and trust attached to that company. Some may therefore prefer to maintain the status-quo than switch for uncertain future benefits. So, status-quo bias, as a result of high perceived switching costs, can help initial market players retain their customer base.

Key Finding

Although status-quo bias can be caused by high 'real' switching costs, it can also be caused by low switching costs that are exacerbated by the 'hassle factor' of switching. Underlying behavioural biases can cause consumers to remain with their current provider because they misperceive that switching is too costly.

Status-quo bias may be more likely when the service required is ongoing, and not a routine or one-off purchase, where there is no specified period of service, or there are no contracts e.g. in banking.

Automatic renewals may also cause low consumer switching, for example where a mobile contract may be for a set term but automatically rolls over after that term has ended.

5.4.2. Status-Quo Bias, Customer Retention and Satisfaction

The literature recognises that switching costs can be an important tool for firms wishing to retain their customers in order to improve profitability (Matthews, 2009).

Individuals may continue relationships either because they genuinely want to or they have no other option (Bendapudi & Berry, 1997, cited in Matthews, 2009). Switching costs can act as one of the contributors to constraint-based relationship maintenance, as they can keep the customer in the relationship. Switching costs are therefore one variable that affects service loyalty, with 'affective commitment' describing commitment based on liking and 'continuance commitment' when based on dependence on negative switching costs (Allen and Meyer, 1990, cited in Matthews, 2009).

One way that customer retention can be achieved is to create switching costs so that the costs (financial, time and psychological) of changing to a different provider stop consumers from switching (Matthews, 2009). In service sectors with high switching costs, few customers that have a bad experience will switch to another supplier, providing evidence of customer inertia generated, and the customer retention achieved (Matthews, 2009). Identifying whether switching barriers are due to positive sources of constraints is important, as well as potential firm incentives for creating them. This is further discussed in the next section.

5.4.2.1. Positive and Negative Switching Costs - Identifying Firm Influences and Incentives

- **Procedural costs**

These costs can either be exogenous (outside the firm's control) or endogenous (imposed by firms). When these are exogenous, some argue that customers should perceive these costs as neutral and accept them as a natural part of the purchase process (Bhattacharya, 2013). When these procedural costs are endogenous, however, they impose negative constraints. For example, some service providers in utilities markets make the process of switching unduly complex, by making their customers ring them up to end their contract. This creates an additional procedural barrier outside of the existing real and perceived time and effort costs required by consumers to switch (OFT, 2003).

- **Financial costs**

These are in the firm's direct control, and generally consumers perceive these as a negative barrier to switching (Bhattacharya, 2013). A consumer may incur financial losses if a contract is broken or lose benefits such as rewards points that may have taken time and effort to accumulate. Even if a consumer has found a better service provider they may be forced to remain due to the financial repercussions of switching. As the consumer's choice is constrained, they will perceive financial costs as coercive or punitive and will view these negatively.

When financial losses from switching are greater than gains, the customer may continue to participate in the relationship, but not willingly (Bhattacharya, 2013). If customers experience financial switching costs, they may want to exit these relationships as soon as it is feasible to do so, and if they cannot they may try to retaliate against the firm (i.e. by spreading negative word of mouth). Firms that impose financial switching costs in this way do so to attain greater short-term profitability and return rates. Customers may lack true motivation and loyalty to repurchase the service at the end of their contract term/once they have redeemed rewards points, or if competitors temporarily lower their prices. The profitability from financial switching costs may therefore not be sustainable for firms in the long run.

If all firms in a particular services market impose certain financial switching costs this may be a viable long-term strategy. Since consumers experience status-quo bias, they may end up getting used to the service and by the end of the contract term (when it may be financially feasible for the consumer to change providers); they may be used to the service (i.e. locked-in due to behavioural factors) and never end up changing or the alternatives may not be any better.

- **Relational costs**

These are generally viewed positively by consumers (Bhattacharya, 2013). If customers believe they are handled with care and attention and are familiar with their service provider, they will most likely not want to exit the relationship. In addition, if customers perceive the brand to have a strong image and have positive associations with the company they will likely feel an emotional attachment to the brand and also will not want to exit the relationship. In these cases, customers have positive reasons to stay in the relationship. These relationships are characterised by customers who willingly stay, giving rise to positive emotions, affective commitment and true loyalty.

The marketing literature notes that true customer loyalty, as a result of relational switching costs, is more sustainable for firms and results in a consistent pattern of purchase over time and a favourable attitude to the brand (Bhattacharya, 2013). The marketing literatures identifies that firms who wish to sustain a long-term competitive advantage will generally focus on building a loyal base of customers, and invest more in relational switching costs.

Key Finding

High switching costs cause customer lock-in and status-quo bias. Analysing whether this may be due to positive or negative sources of constraints is important. Generally, relational switching costs arise from positive sources of constraints, while financial and procedural elements arise from negative sources. Low switching rates and status quo bias can be explained in some cases by true customer loyalty, and intervention will likely not be warranted in these areas. However, when firms impose high financial costs or make the procedure of switching unduly complex for example, intervention may be necessary.

6. Effects of Switching Costs on Competition and Consumer Welfare: A Fine Balance

A body of literature exists around markets with locked-in customers and the impacts they have on competition (Farrell and Shapiro 1989; Farrell 1987; Gallini and Karp 1989, cited in Schulte, 2015). This focuses on how a firm, particularly in a service market, can enjoy a 'quasi monopoly' once a consumer makes a decision to use them (Schulte, 2015). Firms have the potential to exploit such a monopoly by lowering service quality or raising prices without consumers switching – they become 'captive customers' (Schulte, 2015). All services markets – whether routine, ongoing, or professional, may have some degree of lock-in provided, and this is especially pronounced in the case of professional services.

Switching costs do not necessarily produce anti-competitive effects. They can provide firms with a certainty of revenue for locked-in customers, encouraging firms to charge lower prices than if no switching costs existed. Additionally, when firms cannot price discriminate between old and new customers, the effects of switching costs on prices critically depends on the degree of market share asymmetry (e.g. if there are dominant firms in the market, or if all firms have relatively symmetric market shares). If market share is, or becomes, sufficiently symmetric, price competition becomes fiercer, and some switching costs can have a procompetitive effect (Barreiro-Viñán et al., 2016).

Davis (2016) proposed a framework to consider how to balance the benefits and costs of search and switching costs. In this framework, Davis included the following considerations:

1. the reasons a competition agency believes that on average prices will fall and not increase if barriers to search and switching are removed
2. a quantitative evaluation of the net benefits to intervention should ideally be taken; this would take into account the effects of discounts offered to acquire new customers, in anticipation of customers who are switched to standard retention products or higher priced services at the end of the discount period
3. whether current market outcomes have advantages (or disadvantages) due to increased (decreased) investment and innovation relevant to an appropriate counterfactual (e.g. having removed search and switching costs by a realistic amount)
4. whether search and/or switching costs help or hinder market entry (Davis, 2016).

Components of these questions are discussed in more detail in the following sections.

6.1. Competition Outcomes: Lower or Higher Pricing?

Switching costs can impact on the structure of firms' prices (OFT, 2003). The existence of switching costs enables firms to price above cost to consumers who are locked in, because the consumer would incur a high switching cost in order to change supplier. This makes these customers valuable to firms.

Firms may also adopt low prices to attract new consumers, and then charge higher prices once they are locked in. This 'bargain then rip-off pricing' is a characteristic of many markets with switching costs (OFT, 2003). However, this may not always be the case:

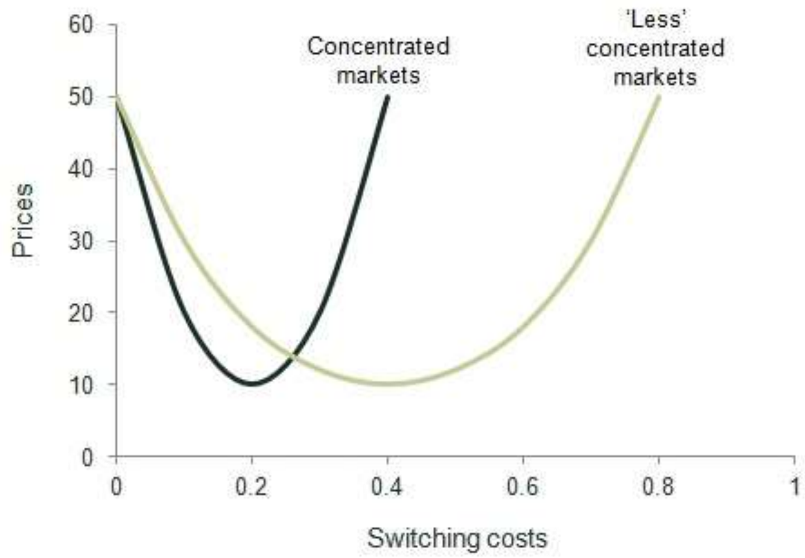
- When firms **have the ability to price discriminate** between old and new customers (for example, through low introductory offers to new customers) then prices to new customers will tend to be lower, while prices to existing customers tend to be higher than in markets without switching costs. For example, electricity retailers, broadband providers, and telecommunications providers are able to price discriminate.

- If firms **cannot price discriminate but are constrained to charge a single price** to all customers, then when setting prices they have to balance the incentive to adopt low prices to attract new customers (as they will be valuable in the future) with the incentive to price higher to extract rewards from their existing customers. That is, they have to balance the trade-off between 'harvesting' from their existing customers or 'investing' in new customers. The consequence of this is that a firm's price depends on their market share and the stage of growth the market is currently in (OFT, 2003). A firm that has a high market share will generally have a strong incentive to 'harvest' from their existing customers as opposed to 'invest' by adopting low prices to attract new customers. If a market is rapidly growing, then future profits may appear large with respect to the present, so the incentive to 'invest' may outweigh the incentive to 'harvest', even for large firms. Some examples of such firms include dentists, mechanics, and hairdressers.

If firms are unable to price discriminate, the literature on the topic suggests that the balance between the 'harvesting' and 'investing' effects will depend on the characteristics of the market (Oxera, June 2014). Oxera (June 2014) noted that studies have found that switching costs and prices can be U-shaped, illustrated by the figure below.

When switching costs are sufficiently low, an increase in switching costs can lead to lower prices – that is, the 'investment' effect dominates the 'harvesting' effect. In this case, firms may be more certain about the revenue they will receive as switching costs increase because consumers will become locked in to their offering. Conversely, at higher levels of switching costs, the 'harvesting' effect dominates and an increase in such costs would lead to higher prices. Finding the optimal amount of switching costs – which ensure that businesses have a certain amount of revenue, and are not driving up prices to harvest their customers – can be difficult.

Stylised relationship between switching costs and prices:



Source: Oxera (June 2014).

The OFT (2003) also noted that although switching costs **do have implications for the overall structure of prices**, they will **not necessarily raise the average price level over time**. If firms anticipate that new customers purchasing their service will contribute $X in profits in follow-on sales, then it makes sense to offer that customer a discount on the initial service purchase of up to $X to incentivise them to purchase it. In cases such as that, the *ex-post* rip-off equals the *ex-ante* bargain and therefore the average price level over time would be unaffected. However, these results only arise under very specific conditions. Uncertainty or liquidity constraints faced by firms can mean that perfect 'refunding in advance' cannot occur. As a result, average price levels may be raised (OFT, 2003).

Key Finding

In certain situations, raising switching costs can lead to lower prices. When firms cannot price discriminate, and are constrained to charge a single price to all customers, then they have two competing pricing incentives:

- invest: price low to attract new customers; or
- harvest: price higher to lock-in existing customers.

Oxera (June 2014) cites that importantly, studies on the impact of switching costs on prices find that the relationship between prices and switching costs is U-shaped. The precise shape of the U depends on market structure. In less concentrated markets, the U is broader – that is, the investment effect dominates for higher levels of switching costs, and is more likely to lead to lower prices than in more concentrated markets. The balance between costs and benefits of proposed remedies to reduce switching costs will differ by country when market conditions are varied (Oxera, 2014).

The implication of this for New Zealand is that although interventions overseas to reduce switching costs may have beneficial pricing outcomes, in some cases such interventions may be unwarranted, and an analysis of the market could be undertaken to determine whether there would be positive or negative impacts of switching costs on pricing.

6.2. Effect of Switching Costs on Market Dynamics and Entry

Switching costs create implications for market dynamics (OFT, 2003). It may be beneficial for firms to create switching costs depending on what stage a particular market is in. In start-up markets, competition is intensified when firms compete for consumers to exploit in the future. Low prices will be used to compete for these customers. In more mature markets, however, competition is less intense as most customers will already be locked-in to a supplier. Market entry also becomes more difficult when high switching exist in these mature markets. Moderate switching costs, however, can be conducive to market entry because they make existing firms less likely to react aggressively to new entry. As a result, where switching costs can raise the profitability of markets, there is potential that the existence of switching costs can encourage entry.

Key Finding

Switching costs, under particular conditions, can make markets more profitable and give firms the incentive to raise barriers to entry (OFT, 2003). It can thus be profitable for firms to create them through, for example:

- imposing exclusivity contracts on consumers; or
- creating pricing schemes that give incentive for repeat purchase (i.e. discounts on the next service purchase, or rewards to loyal customers).

These practices can have negative effects when practiced by a dominant firm, or when there are 'feedback mechanisms' such as network effects, which means that a higher market share in itself makes the firm more attractive to new customers (for example, in telecommunications where customers have to be on the same network in order to get free calls to their friends/family members). By raising barriers to entry, switching costs can dampen the competitive process when adopted by firms with market power.

6.3. Implications of Switching Costs for Competition Policy

Although switching costs do affect the dynamics of market competition, the OFT (2003) noted that they do not *necessarily* make markets less competitive.

- Switching costs can intensify competition in growing markets, where firms have the incentive to attract new customers, so adopt lower pricing and more aggressive marketing strategies (e.g. they may be more present on online platforms).
- In more mature markets, switching costs can also increase competition and drive prices down, as seen in the previous section. Competition may lessen as more consumers are locked-in, this could be in part compensated by aggressive *ex-ante* competition.
- Switching costs can also provide incentives for innovation because they can act like a patent in making sure that the rewards from innovation are not dissipated by imitators, since firms can retain their customers through switching costs.

6.3.1. Competition Issues Posed by the Existence of Switching Costs

Competition problems do arise in markets with switching costs, and have implications on the assessment of competition policy in these markets.

Switching costs have implications for the incentives to coordinate, and the subsequent feasibility of tacit coordination:

- If switching costs make competition less intense in mature markets, then they can reduce coordination incentives because the incremental gain from coordination may be small.
- However, switching costs may increase the sustainability of coordination. Competitors may be able to observe how large a rival firm's price cuts need to be in order for consumers to switch suppliers.
- For similar reasons, switching costs may undermine the severity of retaliation for deviation from a collusive agreement, as punishment is made difficult and costly for the punishers.

Therefore, the impact of switching costs on price will depend on the stage and structure of the market. It can take time to facilitate price coordination, as the study of the Perth Retail gasoline market found (see section 4.1.). The ability of authorities to keep pricing data can help identify whether coordination is occurring in a particular market, as noted in section 4.1.

The OFT (2003) also highlighted that switching costs may have particular importance in abuse of dominance cases. When investigating pricing abuses, the OFT advises that authorities should be cautious because of the impact that switching costs have on price structures:

- Pricing below cost may not be predatory once follow-on sales are taken into account and seemingly high prices to locked-in customers may no longer appear too high when intense competition before the customers were committed is taken into account.
- A dominant firm may create switching costs that have the effect of removing competitors from the market, through 'loyalty rebates' or exclusionary contracts. In such cases, it is the responsibility of the dominant firm to show that the pro-competitive benefits outweigh any exclusionary effects.

Key Finding

Switching costs can involve deliberate action by a firm to make switching more difficult. When this is the case, these will likely hinder competition.

In New Zealand, such actions may not often be in breach of the law; that is:

- they may be engaged in by firms with various levels of market power (not just a dominant firm) and so are not necessarily captured by section 36
- while the terms contained in a consumer contract may fall afoul of unfair contract terms provisions, conduct may not necessarily be contained in a contract (e.g. making a contract difficult to terminate) or if in a contract, the terms may be sufficiently clear and prominent so as not to be misleading but still make switching less likely (e.g. long notice period or automatic roll overs).

6.4. Impact of Switching Costs on Consumer Welfare

Switching costs do not necessarily negatively impact on consumer welfare. The Netherlands Bureau for Economic Policy Analysis (NPB) developed a diagnostic checklist in 2005 to assess whether switching costs are likely to significantly impact consumer welfare, and to aid in considering whether intervention is required (Pomp, Rangel & Shestalova, 2005). In this checklist, they identified three questions:

1. Are switching costs large?
2. How fierce is competition for market share?
3. How large is the loss in consumer welfare?

In their checklist, they noted that switching costs can also have beneficial effects for consumers and that when estimating the loss in consumer welfare, potential benefits also need to be investigated (Pomp, Rangel & Shestalova, 2005). In particular situations, switching costs may not necessarily lead to a decrease in consumer welfare.

Contracts that involve financial switching costs (e.g. break fees) may in some cases be specifically designed to offer consumers protection against changes in prices for ongoing services. Some examples include life insurance, mortgages, and energy contracts with fixed prices. If consumers could freely end these contracts if a competitor offered a lower price, firms would only be willing to offer these contracts at higher prices, if at all.

Switching costs may also alleviate the 'hold-up' problem, which arises if firms are unsure whether they will reap the future returns from their investments. For example, health insurance firms may cut back on their investment in prevention if customers frequently switch between health insurance funds.

If consumers respond to incomplete information, lowering switching costs may lead firms to focus on certain characteristics to the detriment of other characteristics. This is especially relevant where professionals have an intrinsic motivation for providing quality. For example, in professional services markets (e.g. doctors, dentists, lawyers, accountants) such providers are motivated to provide quality, so focussing on the price of these services may mean that consumers do not consider other measures. However, it must be noted again that such services have occupational licensing regimes and codes of conduct, so such issues may not be of concern.

It is important to recognise these benefits when considering the rationale for intervention in a market, and where the service is ongoing these benefits may be important to consider. These benefits will likely not be applicable when services are frequently purchased or homogenous.

Key Finding

Switching costs may not necessarily lead to a decrease in consumer welfare in particular situations:

- Contracts that involve financial switching costs may in some cases be designed to offer consumers protection against changes in prices (e.g. fixed-term mortgages).
- Switching costs can give firms a certainty of revenue from their investments (e.g. health insurance firms may cut back on investment in prevention if customers can frequently switch).
- Lowering switching costs may lead firms to focus on certain characteristics to the detriment of other characteristics if consumers respond to incomplete information.

These benefits are important to recognise, and can be applicable to ongoing services. However, these will likely not be applicable when services are frequently purchased or homogenous.

7. Overseas Efforts to Reduce Switching Costs in the Services Sector

7.1. Reducing Financial Switching Costs

7.1.1. Contracts

- **Automatically renewable contracts**

Some regulatory bodies in the UK have banned auto-renewable contracts (UKRN, 2014). Both Ofcom and Ofgem have banned contracts that automatically roll over at the end of their fixed term into new fixed terms: consumers are frequently required to pay a penalty to exit these contracts. Such bans can help overcome status-quo bias by requiring consumers to consciously enter another contract.

Ofcom introduced these measures in 2011 for landline and broadband contracts having conducted analysis that identified a causal link between automatically renewable contracts and reduced levels of consumer switching. In energy, Ofgem mandated that suppliers must default customers to a contract of no fixed length offering the lowest price if the customer takes no switching action before the end of their fixed-term contract (UKRN, 2014). However, such intervention may have costs attached to it: firms may not be able to offer consumers lower prices as a result of their contract being prevented from being rolled over and some consumers may benefit from automatic roll over (i.e. it will be hassle free).

In utilities/essential services markets, it is common practice for contracts to be rolled over when their term ends. This may have benefits for consumers, but can also act as a barrier to switching providers. The UK's Department of Business, Innovation, and Skills (2016) is investigating whether further prompts at the point of roll-over could facilitate better consumer engagement.

The CMA (March 2016) published a set of guidelines as to how to set fair terms for automatically renewed contracts under the UK's 2015 Consumer Rights Act. They note that it is important that consumers are made clear at the outset of the contract how it will be renewed and that a reminder is sent a reasonable time before it is due to be renewed. This notice should include clear information about the terms of the proposed renewal of the contract and the steps that customers need to take to exit the contract if they wish to (CMA, March 2016). They also state that customers must be given a right to cancel a contract once it has been renewed without having to pay a cancellation fee, and any requirement to provide cancellation notice is reasonable (that is, it will not tie the consumer into the contract unfairly) (CMA, March 2016).

- **Fixed-price/fixed-term or 'lock in' contracts**

A number of businesses offer contracts that include a fixed rate over a particular term or 'lock-in', which generally include a penalty for leaving early. While overseas regulators recognise that this practice may enable providers to offer better deals, consumers need to be aware of the exit charges that they agree to in such a contract (Department of Business, Innovation & Skills, 2016).

In order to ensure that business conduct is fair in fixed-term contracts; the UK has implemented notice and penalty-free cancellation periods (UKRN, 2014). Ofgem has rules to ensure that consumers are given enough warning when their fixed-term contracts come to an end. Suppliers must notify customers between 42-49 days before the contract expires. Between this notification period and the end of the fixed-term contract, suppliers are banned from charging a termination fee should the customer decide to switch.

- **Price variation during fixed-term contracts**

Some fixed-term contracts include price variation clauses, where a provider can vary the price they charge to consumers over the term of the contract. Regulators overseas have recognised that this may sometimes be problematic.

The UK's 2015 Consumer Rights Act allows variation clauses, so long as firms are transparent in explaining what, when, and how a contract may change. This aims to give customers the ability to make an informed decision about whether to enter a contract. If price variation is to occur, the firm must give reasonable notice and a right to freely cancel the contract so that a customer can go elsewhere if they are unhappy with the change, without being made worse off (CMA, March 2016). The CMA (March 2016) recognised that allowing the price of a service to be increased without informing the customer will likely be an unfair contract term.

Ofcom in the UK has introduced measures that mean if a provider makes a contractual change that is to the customer's material detriment, for example a price increase, the customer can exit the contract without penalty. Ofcom implemented this measure in January 2014 for landline, broadband, and mobile contracts after finding many consumers who were caught unaware by price increases in what they believed were fixed-price contacts.

In Australia, some fixed-term energy contracts allow for 'unilateral price variation'. This allows energy retailers to raise the price of energy in these contracts in the middle of the contract. Although Australian retailers claim that such terms are necessary because their costs can go up during the contract's duration, many consumer advocacy groups believe that allowing for unilateral price variation is an unfair contract term. There is concern that ending unilateral variation would lead to higher prices for consumers. Consumer advocacy groups (such as Choice) have been active in making retailers make the wording around unilateral price variation more clear, as well as communicating any price changes proactively rather than consumers finding out on their next bill. Although better communication does make consumers realise that they may need to consider switching, exiting a fixed-term contract generally means they'll have to pay an exit fee.

- **Exit fees**

Under the UK's new Consumer Rights Act (2015), service providers are allowed to seek to recover losses that they have 'reasonably incurred.' A firm can set non-refundable cancellation charges that reflect a genuine estimate of what they will directly lose as a result of a customer ending their contract (CMA, March 2016). Under these guidelines however, keeping a payment that covers a firm's cost and loss of profit will generally be regarded as an unfair contract term, as this can mean that firms get compensated for the same loss twice (CMA, March 2016).

In the banking sector, the Australian Government has banned exit fees on home loans taken out after 30 June 2011, however all loans taken out before that date may still have exit fees attached to them. For consumers on fixed rate loans, the payment of a break fee may be required to compensate the lending firm for potential losses from providing the consumer with the fixed rate, which will likely be fair.

- **Other contract issues**

These may not necessarily be direct financial switching costs, but more related to the procedure of switching. Some contracts can be easy to sign up to online, but cannot be cancelled online. Regulators have begun to recognise that consumers may benefit from being able to cancel contracts by the same means they entered them, and is an area that the UK's Department of Business, Innovation and Skills is investigating in their Call for Evidence, opened in 2016. They are also investigating how other contract terms may affect consumers, and whether there is further scope for intervention. They are due to release their findings on these and other issues in 2017.

Key Finding

Generally, as long as clear information about a contract is provided upfront (for example, the terms of contract renewal, any exit charges etc.), these sorts of contracts will most likely not pose issues to consumers, and may allow them to be offered a lower up-front price in exchange for firms having a certainty of revenue. However, if fixed-term contracts allow for 'price variation' it could be beneficial for consumers to be able to exit these contracts freely if they experience significant material detriment.

7.1.2. Reactive save activity

Reactive save activity occurs when a losing provider is able to accurately identify, as a result of the information they receive through the switching process, those customers intending to switch and to make them a counter offer not to switch (UKRN, 2014). This increases financial, and to some extent, relational switching costs.

Regulators in the UK have implemented a ban on reactive save activity (UKRN, 2014). The UK's telecommunications regulator Ofcom had two concerns relating to the activity, which led to a ban on reactive saves in telecommunications:

- The first was that reactive sales activity could damage competition as it favoured incumbents over new entrants and providers looking to grow their customer base. The losing provider had a systematic opportunity to make a discriminated counter offer, and entrants to the market seeking to attract these customers would likely face high marketing and sales costs. Ofcom considered that this created barriers to entry and expansion and undermined the competitive process, ultimately harming consumers' long-term interests (UKRN, 2014).
- They were also concerned that reactive save activity might reduce the incentives for incumbents to provide good value to their existing customers, as well as reduce the incentive to price competitively to its entire customer base.

Ofcom's concerns about save activity only exist during the switching process, when a customer is trying to complete a switch of providers. If the customer initiates contact with their losing provider to discuss options, then this is not of concern. Intervention appears to be justified if reactive save activity is likely to cause firms to have little incentive to offer lower prices to their existing customers unless they have to i.e. when a consumer is trying to switch. However, in the Australian health insurance market, where the process of switching has been made easier, the losing insurance providers were trying to 'win back' customers. The Australian Private Health Insurance Administration Council (PHIAC) (2015) noted that attempts to 'win back' consumers should be seen as fostering competition, and procompetitive.

Key Finding

Reactive save activity can allow firms to offer lower prices to existing customers who are in the process of completing a switch to another provider. This can cause firms to have little incentive to price competitively to their customer base and provide good value to their existing customers, if they are able to win them back. Such activity can damage competition as it favours incumbent firms over new entrants to the market. Generally, this will be anticompetitive unless it is the consumer considering switching that directly contacts the supplier to see if they will be offered a better deal.

7.1.3. Fees to Access Data from Professional Service Providers

In many cases when switching service providers, the consumer may have to pay their current provider a fee to access their data in order to transfer it to their new provider:

- In Australia, medical records are the property of the doctor, hospital, or practice that created the documents. Patients incur a fee to obtain a copy of their record or to have a copy provided to another healthcare organisation. Though Australian law limits this to the 'reasonable expense' incurred by the practice in accessing, copying and providing those records to the patient (per Australian Privacy Principle 12.78–12.81), in practice it has been found that there is a lot of variation between providers and charges. While some copies are provided free of charge (e.g. by Public Hospitals in Western Australia), there are also cases of very high fees (Australian Productivity Commission, 2016).
- In the UK, generally these fees are also incurred at reasonable expense from the service provider (i.e. when switching accountants and lawyers). However, in medical services, patients are entitled to their records for free when switching GPs.

Key Finding

Regulators overseas are considering how best to open data up across professional services sectors, with the Australian Productivity Commission (2016) investigating how best to provide consumers with this data, and at what, if any, cost. Although regulation in New Zealand means that consumers can access their medical records for free, similar issues that have been found in fees for accessing medical records in the UK could be experienced in other sectors in New Zealand (e.g. accountancy).

7.2. Reducing Procedural and Relational Switching Costs

7.2.1. Comparison Websites and Switching

In addition to making consumer search easier, comparison websites have the potential to also switch consumers to better deals. The UKRN (2016) mentions that in addition to offering a single purchase, there are potential developments of intermediaries taking on an ongoing relationship with the consumer, monitoring the market and either notifying the consumer of better deals in the market when they occur, or (with pre-arranged consent), actively switching them.

In the UK, price comparison sites in energy markets offer collective switching arrangements (UKRN, 2016). These group customers together to increase the volume to a supplier and can negotiate a better price (UKRN, 2016). Although this is popular in energy, it is not a popular practice in other sectors, as collective switching tends to work better when services are homogenous. It can be more difficult when more diverse services are required, such as in broadband or insurance. The UKRN (2016) notes, however, that this model could be tailored to other markets in the future. Comparison sites are discussed in more detail in section 4.

7.2.2. Switching Principles & Process-Based Remedies

Governments overseas have recognised that overarching principles can help to develop process-based remedies in order to reduce switching costs.

In 2015, the UK Government set six switching principles, aimed at setting out an overarching set of aspirations and standards across energy, telecoms, and current account switching, while recognising that they may also apply to wider products (Department of Business, Innovation & Skills, 2016): *"Switching should be quick; free; led by the gaining provider; consumers should have access to their* *data; price comparison sites should be transparent; and, there should be an effective process when a switch goes wrong."* (Department of Business, Innovation & Skills, 2016, p. 13).

The UK Government has recognised that in sectors where consumers have a choice of suppliers, industry should work towards a switching service that reflects the principles. This will help improve consumer perceptions of the switching process and their engagement in these markets, ensuring they get the best deal and improving competition. The Department of Business, Innovation and Skills (2016) recognises that this proposal aims to create a common expectation of an appropriate switching timeframe, making this aspect of the switching process easier to understand for consumers.

'Gaining provider' initiated switching helps to reduce both the procedural and relational costs associated with switching providers. Since a consumer does not have to actively go to their old provider to get their information or records, they avoid some of the procedural and relational costs associated with having to verbally break bonds with their supplier, which can be seen as a large barrier to switching by many consumers. The adoption of such a principle has the potential to be valuable in reducing switching costs across professional services markets, for example if a consumer found a dentist offering a better prices, or a service better in line with their needs, then the transfer of relevant dental records could be undertaken by the gaining provider in order to enable an easy transition for the consumer. Although this is done by some medical professionals in some countries, there has been no widely used policy of regulation to mandate firms to do this.

7.2.2.1. Switching processes and services

One intervention that has been prominently used is making the process of switching easier for consumers in order to lower both procedural and relational switching costs (UKRN, 2014).

Consumers considering a change of provider are often worried that something will go wrong, such as loss of supply and double billing. As a result, switching processes have been introduced across a range of services in the UK including in personal current accounts, broadband, and energy (Department of Business, Innovation & Skills, 2016). Some examples of how switching processes have been made easier are discussed below.

- **Telecommunications industry:**

In the UK, Ofcom, in 2013, identified that multiple processes and service bundling meant that consumers were unable to switch. As a result, Ofcom required providers to adopt a single process, led by the gaining provider, to make consumer switches easier. Under such a process, the consumer who decides to change provider does not have to inform their current provider; instead this is managed by the new provider. This reduces customer switching costs by ensuring that difficulties, such as the existing provider trying to persuade the consumer to stay, or to delay or disrupt the switching process. This has been more favoured by consumers, with 60% finding the 'gaining provider led' process 'very easy' compared to 32% using 'losing provider led' processes (UKRN, 2014). A similar switching process has been adopted in New Zealand.

- **Current accounts:**

In the UK's retail banking sector, the Current Account Switch Service (CASS) was launched in 2013 as one means to reduce friction in switching for Personal Current Accounts. This aims to facilitate all aspects of switching, and the process (including transferring direct debit details) within seven days (Behavioural Insights, 2016). This is also a gaining provider led process, and has reduced the month long switch times down to seven days. The UKRN (2014) noted that a 14% increase in current account switching was found compared to the previous year, and 99% of switches have been completed within seven days.

Although the process of switching can be made easier, this does not mean that consumers will be automatically informed that regulatory changes to facilitate greater switching have been made. In the UK, along with the switching service being implemented, a consumer education process also accompanied the introduction of the new service, with more than 75% of all current account holders aware of the service. Encouraging switching is discussed further in section 8.3.

- **Energy markets:**

The UK's energy regulator Ofgem, energy suppliers, and other industry partners worked with the UK Government to develop a new switching process. This has enabled domestic energy customers to switch suppliers within 21 days, half the time it previously took. By the end of 2018, the UK Government aims to have worked with Ofgem to enable reliable next-day switching. This reduces present bias and feelings of uncertainty that consumers may have about the switching process.

- **Switching health insurance providers:**

In Australia, the Australian Private Health Insurance Administration Council (PHIAC) investigated how the current regulatory regime on waiting periods and portability rules for health insurance products were promoting switching in 2015. This followed the implementation of new rules that were intended to enable greater switching.

The PHIAC noted that the administrative process of switching, created by regulation did not represent a barrier to consumers seeking to change insurers. Some consumers, however, were becoming disenchanted if the process was not handled efficiently, particularly if this involved delays that resulted in the consumer making payments to their old insurer even if this was refunded later (PHIAC, 2015). There was also no standardised industry-wide system of processing transfer certificates, making it difficult for the switching process to work, and causing delays. They concluded:

> Switching is likely to increase in the years ahead as a result of the increased presence of insurance brokers, and the increased propensity of consumers to review their policy choices in the light of higher premiums and the reduction in the private health insurance tax rebate... As a result, there is a risk that the transfer process may become more difficult for insurers to administer. If this is the case, the opinion was expressed that there may be a need to completely re-think the transfer process and legislative timeframes in order to maintain the integrity of portability in the industry in the years ahead. This may create an environment where a centralised electronic system will need to be developed in order for the market to operate in a way that facilitates consumer mobility. In fact, as at May 2015, the industry is moving in this direction. (PHIAC, 2015, p. 19).

- **Switching Doctors:**

The UK has made the process of switching doctors easy by ensuring that consumers do not have to tell their current GP or new GP surgery why they want to change. The consumer does have to fill in a registration form with their new provider, and a request will be made to the current GP for medical records to be transferred to the new GP surgery. This has been easily implemented in part due to patient's health data being digitised and similar patient notes taken among doctors, whereas in jurisdictions like Australia, this is still being implemented (Australian Productivity Commission, 2016, Appendix D).

Key Finding:

In general, regulators can make the process of switching professional service providers easy. However, there may not always be a case for intervention. The question as to whether consumers will switch doctors, or any other professional services provider, often lies in how much information is available to consumers in order to first search for a new provider. Since large information asymmetries generally exist between the service provider and customer in these contexts, search costs are very high (before even accounting for potential behavioural biases that may come into effect). Regulators can indirectly lower switching costs if first consumers' search costs are reduced (i.e. consumers can access their personal usage/consumption data and provide it to other service providers, as discussed in section 3 of this report).

7.2.2.2. Number Portability

Another intervention that has been used to reduce procedural set-up costs is to make consumers' customer numbers portable (UKRN, 2014). Switching can be made easier by making services that are linked to a number or code personal to the customer portable to other providers (UKRN, 2014).

- **Mobile number portability:**

Mobile number portability has been implemented in many countries, which enables consumers to keep their number when switching provider. In the UK, mobile number portability is 'losing' or 'donor provider led'. A customer must contact their existing provider to get a code that they pass on to their new provider to complete the transition. In New Zealand, it is a 'gaining provider' led process, reducing procedural and relational switching costs.

- **Bank account number portability:**

Portability has been suggested for retail banking in relation to current accounts. It is argued that the potentially beneficial effect that this would have on competition may not be in line with the costs associated with initiating such a scheme. The New Zealand Productivity Commission (2014) and other regulatory bodies overseas have noted that this may be the case; however, a full cost-benefit analysis has not been done on this.

- **Health insurance number portability:**

In Australia, health insurance number portability has been suggested to further reduce switching costs in the health insurance sector. The implementation of such a scheme would require the creation of a national register and may involve high set-up costs, similar to the difficulty of trying to implement bank account number portability (PHIAC, 2015).

Key Finding

Reducing procedural and relational switching costs may not necessarily require intervention by regulators, as these can be firm-led (i.e. some firms will see the benefit in 'gaining-provider led' switching processes without the need for intervention). When considering whether intervention is required, it is necessary to consider particular barriers enforced by a firm (generally an incumbent) that make innovations in improving the switching process difficult.

7.3. Encouraging Switching – Soft Intervention Measures

In order to reduce consumers' perceptions of switching costs, especially the time and effort required making the switch, regulators are beginning to recognise that providing information about *how to switch* is important. This is likely to be crucial in facilitating greater consumer switching.

Although the switching process can be made easier with ongoing services, through enabling better contract terms and lower exit fees, as well as portability of consumer information, regulators have recognised this cannot work without consumers knowing how to switch. Once regulators, or even the particular industry itself, makes switching costs low, consumers must then be activated into searching and switching to better deals.

There is scope for soft intervention measures to be investigated in the professional services market. As recognised in earlier sections, switching processes can be made simpler, with the computer age bringing greater information availability and giving service providers the ability to keep digital records. In jurisdictions such as the UK and New Zealand, for example, changing doctors generally involves the filling out of one form. It is not necessarily the process of switching that causes the greatest switching barriers. In professional services markets, relational switching costs generally pose the largest barrier to switching. Sometimes consumers will not have a desire to switch, as they already have an established relationship with their doctor. If they do wish to switch, overseas regulators have recognised the need to make the process as streamlined as possible, to lower procedural costs.

7.3.1. Consumer awareness campaigns

Many regulator websites often contain information designed to help consumers switch providers (UKRN, 2014).

- In the UK, this type of information is provided by Ofgem, Ofcom and the Money Advice Service (an independent body set up by government and funded by a levy on financial services firms to help people manage their money) (UKRN, 2014).
- In Australia, the Securities and Investment Commission provides information about how consumers can switch mortgages, to try and make the process as easy to understand as possible on their moneysmart.gov.au website. There are also numerous websites, both publicly and privately funded, that offer information and calculators that compare consumers' current home loans with potential home loans are available, and can help facilitate consumer understanding of highly complex home loan structures, which is beneficial to consumers.
- In Canada, the Canadian Radio-Televisions and Communications Commission has information about how consumers can change their current providers easily on their website (crtc.gc.ca), and has similar switching-based processes as those in the UK.

Sometimes regulators go further by designing campaigns to encourage consumers to engage and also make an informed decision (UKRN, 2014). For example, Ofgem in the UK launched a *'Be an Energy Shopper'* campaign in response to consumer demand for unbiased advice about how to compare tariffs in gas and electricity markets (UKRN, 2014). They provided an easy guide on goenergyshopping.co.uk to show how changes to the energy market can help consumers compare tariffs and get better deals on their gas and electricity bills (UKRN, 2014). Consumers are directed to this website through digital media and PR campaigns, that aim to raise awareness about the possibility of switching, inform consumers about the benefits of switching as well as supporting people in using information to make accurate comparisons (UKRN, 2014).

The '*What's My Number?'* campaign in New Zealand was similarly used to engage consumers, and consumer awareness of the *Powerswitch* website did increase (for more information, see section 4 of the report).

Another way governments and regulators also promote better information is by setting industry performance targets around consumers' awareness of switching processes (UKRN, 2014). In the UK, the Treasury and the Payments Council agreed upon performance criteria for consumer awareness and confidence in the new current account switching service. Such targets included that 75% of consumers were aware of the service by June 2015 and 75% would be confident in using the service (measured by agreeing that the process would be quick, easy, low effort, error free and that they would be in control of the process). In order to meet these targets, the Payments Council who led the current account switching service initiative invested in a multi-million pound advertising campaign that accompanied its launch (UKRN, 2014).

7.3.2. Knowledge about Switching Professional Service Providers

In the online age, simply typing in "how to switch doctor/dentist/accountant/lawyer/etc." yields a number of webpages giving consumers the process of how to go about switching these providers, and what information might be required from their previous service provider.

Often, the professional service provider the consumer is wishing to switch to can contact the old service provider to organise the switch ('gaining-provider' led switching), without regulators necessarily needing to mandate this. However, regulators note that consumers may not be aware of this process. Additionally, as mentioned in section 7.1.3, a fee may be incurred in accessing records from previous service providers, or from 'gaining provider' led switching. Consumers are less likely to switch if financial costs are high even if they are made aware of an easier process.

The UK's National Health Service's 'Choices' website offers information about how consumers switch their GP. The website assures consumers that they only have to fill out one form to sign up to a new GP, and their new provider will then request the patient's medical records to be transferred from their current GP to the new surgery.

7.3.3. Overcoming Behavioural Biases to Encourage Switching

Many of the remedies discussed throughout this section help to overcome behavioural biases by reducing procedural, relational, and financial switching costs, which in turn can reduce status quo bias. The OFT (2010) recognised that the power of consumer learning may be enough to overcome behavioural biases. However, although this may work in markets where consumers make frequent purchases (or can benefit by learning from others via word of mouth) when purchases are infrequent or of large value, then learning may not provide the constraint required. Similarly, there will be circumstances where biases are hardwired (e.g. limits to computation that can't be overcome) or where consumers cannot learn from others. Regulators and consumer advocacy groups have a role to play here, with many across jurisdictions (including the UK, Canada and Australia) informing consumers about potential behavioural biases and simplifying information for them.

Key Finding

The behavioural literature does note that it may not be necessary to try to 'correct' consumers' behavioural biases. As long as consumers learn that they may have that bias, they will make allowances for these in their behaviour, which will limit the extent to which firms can exploit behavioural biases. The OFT concludes that: *"The implication is that educating consumers about their biases, even if this does not change them, may be sufficient to remove much of the associated consumer detriment."* (OFT, 2010, p. 33).

7.3.4. The Use of Third Parties in Facilitating Consumer Learning

It is not just regulators who can educate consumers about the switching process and potential barriers to switching. Third parties, including consumer and campaign groups, all have a role to play in facilitating consumer learning, as do websites, social networks, and discussion forums. Consumer groups in Australia, the UK, and Canada are prominent across various markets in their respective services sectors.

Although prices of services are becoming more prominently displayed online, both facilitating searching and switching by improving comparability, firms can still seek alternative ways of shrouding price information. Making consumers aware of this possibility can help them to be more informed. Consumer advocacy groups in Australia and the UK actively do this, to ensure that consumers remain fully informed about how firms within services markets may operate. This is especially important as consumer advocacy groups often recognise that regulators may have trouble controlling these effects.

Key Finding

Soft intervention measures in the form of consumer awareness campaigns and other measures to enhance consumer knowledge of switching can encourage switching behaviour, in addition to, or instead of, direct intervention in a market.

Soft intervention measures in New Zealand's electricity markets through the *What's My Number* and *Consumer Powerswitch* advertising campaigns have been found to enhance consumer awareness around switching and has prompted more consumers to switch providers.

Designing targets for consumer awareness of switching processes is important. Industry targets can ensure that customers have greater knowledge about switching processes.

8. Conclusions and Recommendations

Search and switching costs create barriers to competition when they stop consumers from searching the market or completing a switching process.

8.1. Search Costs

Behavioural biases can affect a consumer's search and evaluation process. In designing remedies to reduce search costs, regulators do not necessarily need to ensure that more information is provided, but that better, or even less information, is presented and framed in a structured and easily comprehensible format.

Consumers can be sensitive to the way that information is framed and have differing limits to their ability to make decisions. This has implications for their preferences, decisions, and behaviour. In turn, the way in which firms on the supply side present their offerings to consumers can affect market outcomes. Firms may have an incentive to exploit or exacerbate consumer biases (Oxera, 2013). This is especially pronounced in the case of ongoing services, where different price frames and complexity can hinder the search process.

The display of price and quality information in New Zealand differs according to the particular services market. Whether intervention is required to ensure the display of such information could be determined on a market-by-market basis.

- Price information is already displayed in markets for routine services. In routine services, this can be used in addition to descriptions of the service in order for the consumer to make a purchase decision. Since there are usually a range of providers in these markets, consumers can easily make one-off purchases, and continue to purchase from the same provider if they are satisfied with their experience, or move to another provider if dissatisfied.

- In ongoing services, although product pricing is transparent, the product and service differentiation (and different bundling of products and services) can make comparison difficult for consumers. For instance, it can be hard for consumers to compare providers due to providers adopting different pricing frames (e.g. some banks quoting account fees over different time periods, insurance premiums having various add-ons to a base level of services etc.). The quality of these services can also be difficult to infer due to service intangibility, meaning consumers may have further trouble making comparisons between providers.

- In professional services, price information is rarely displayed. Display of price information is unlikely to become a market feature as firms do not have the incentive to publish this - instead engaging in aspects of non-price competition. Some professional service organisations either deter, or lobby to prohibit, advertising based on price. There is scope for greater information availability in professional services markets (e.g. dentists, accountants, lawyers) in New Zealand. Although there are concerns that making pricing information available will lead to a decrease in the quality of such services, this will generally not be the case as occupational licensing already applies quality standards to a number of professions.

In order to reduce search costs, regulators often look to implementing transparency policies to introduce greater information to the market. Transparency policies can produce pro-competitive effects, and incentivise firms to improve their products and services. In some circumstances, however, more transparency can have unintended consequences by facilitating tacit coordination. Consumers may also focus unduly on the publicised information to the detriment of non-publicised information (e.g. prices against quality factors) (Oxera, June 2014).

The risk of these unintended consequences may depend on:

- The structure of the market - if providers already publish pricing information regarding their services, the risk of coordination as a result of further proposed transparency provisions may significantly increase if pricing (and potentially quality) information regarding their services is already in the market. This depends on whether sellers and purchasers have access to the information, and whether purchasers use that information effectively.
- The weighting of other product features – for example, prices, contractual conditions, and quality features, thus reducing any risk of consumers unduly focusing on only one of these when choosing their provider.

Where price coordination may be of concern, regulators could consider monitoring pricing data from sectors where price transparency policies have been implemented. As Byrne and de Roos (2017) note, the ability of regulators to digitally keep records of pricing data can help to detect whether a price transparency policy facilitates coordination. The knowledge that it will be monitored may be sufficient to incentivise firms not to coordinate.

In addition to price information, regulators have begun to recognise that data on quality is also required for consumers to make informed purchases. There are challenges in measuring and presenting information on quality in a meaningful way, not just for consumers, but also as a good practice tool to improve standards in services markets (Legal Services Consumer Panel, 2016). The UK's Legal Services Consumer Panel recommends that regulators decide the scope, focus and extent of their investigations into quality, including how they might credibly go about gathering and publishing this information.

Complaints data can be used as a proxy for quality, however this needs to be accessible and contextualised in a way that consumers can understand (e.g. the use of percentages, data is placed in the context of positive reviews, and disclosure about how customer complaints were dealt with). Again, the contextualisation and accessibility of this data will differ according to the specific market. Making the information visible would also be an important factor. Firms will have no incentive to show complaints data unless regulation requires it to be published.

Although regulation to standardise the way firms present their prices to consumers to make comparison easier (overcoming framing effects) may improve static efficiency, it is also to take into account dynamic efficiency when considering policy options to ensure that firms' ability to innovate is not hindered by overly regulated and restrictive price frames and structures.

Providing consumers with their individual consumption and transaction data is an initiative that proposes to significantly lower both search and switching costs in many services markets. However, common standards need to be developed to ensure that information is provided in a machine-readable format that can be analysed by another supplier. This will help to ensure that comparison sites can work optimally for consumers by providing them with plans that suit their needs. The midata reforms in the UK allow consumers to access and provide their data to rival competitors, but have had implementation issues around deriving common standards for use, as well as slow consumer uptake. Regulators in New Zealand could investigate how such an initiative could work across services markets in New Zealand, and how they might support industry in deriving common data formatting standards.

Comparison sites are an innovation that has emerged that can help to significantly lower consumer search costs. These are least likely to be deceptive or misleading to consumers when they are provided by government or consumers have to pay to use them. However, these can be costly for government to administer, as evidenced by the analysis of the Consumer Switching Fund, and the uptake of a privately provided 'pay-to-use' site is low when free comparison sites – that mainly rely on advertising - exist. These free sites can be effective for consumers, provided they are transparent about their market coverage and the information they display, and do not mislead or deceive consumers about the best offers in the market.

8.2. Switching Costs

High switching costs, whether real or perceived, can cause customer lock-in and status-quo bias. Analysing whether these costs arise as a result of positive or negative factors is important. If a consumer has a good relationship with their provider (i.e. faces a relational switching cost) then this will be a positive source of constraint on switching behaviour, while financial and procedural elements arise from negative sources. Low switching rates and status-quo bias can be explained in some cases by true customer loyalty (e.g. customers may not be price sensitive or are happy with services provided), and intervention will likely not be warranted in these areas. However, when firms impose high financial costs or make the procedure of switching unduly complex for example, intervention may be warranted.

Behavioural biases can also lead to status-quo bias. Loss aversion may cause customers to remain with their current service provider because of misplaced loyalty, a failure to acknowledge poor choices in the past or irrational consideration of sunk costs. Barriers to switching will reinforce this endowment factor, which makes it all the more important to ensure that switching is hassle free, fast, and cheap (Xavier, 2011).

Although status-quo bias can be caused by high 'real' switching costs, it can also be caused by the perceived 'hassle factor' of switching (i.e. underlying behavioural biases can cause consumers to remain with their current provider because they misperceive that switching is too costly):

- When the service required is ongoing, but there is no specified period of service or there are no contracts, status-quo bias may be more likely (e.g. in banking).
- Automatic renewals may likely cause low consumer switching (e.g. mobile contracts may be for a set term but automatically roll over).

When switching costs are present in a market, these can have effects on firms' pricing:

- If firms can price discriminate between new and existing customers, then they may price low to attract new consumers ('invest') and high to existing consumers who are locked-in ('harvest').
- When firms cannot price discriminate, the price they charge may depend on the structure of the market.
    - In less concentrated markets, the investment effect dominates for higher levels of switching costs, and will lead to lower prices.
    - In concentrated markets, the harvesting effect tends to dominate when switching costs are higher, and will lead to higher prices.

When considering proposed remedies to reduce switching costs, the balance between the costs and benefits of switching costs on pricing will differ when market conditions are varied (Oxera, 2014). The implication of this for New Zealand is that although interventions to reduce switching costs overseas may have beneficial pricing outcomes, in some cases such interventions may be unwarranted or particularly costly. An analysis of the market should be undertaken to determine the potential impact of switching costs on prices before contemplating remedies.

Switching costs can cause issues to competition as their existence can make markets more profitable, giving firms the incentives to raise barriers to entry (OFT, 2003). It can be profitable for firms to create switching costs through, for example:

- Imposing exclusivity contracts on consumers; or
- Creating pricing schemes that give incentive for repeat purchase (i.e. discounts on the next service purchase, or rewards to loyal customers).

These practices can have negative effects when practiced by a dominant firm, or when there are 'feedback mechanisms' such as network effects. This means that a higher market share in itself makes the firm more attractive to new customers (for example, in telecommunications where customers have to be on the same network in order to get free calls to their friends/family members). By raising barriers to entry, switching costs can dampen the competitive process when adopted by firms with market power.

Switching costs can involve deliberate action by a firm to make switching more difficult. When this is the case, these will likely hinder competition. In New Zealand, it may not be often that such actions are not in line with the law, that is:

- They may be engaged in by firms with all levels of market power (not just a dominant firm) and so not captured by section 36;
- In the case of a consumer contract, it may fall foul of unfair contract terms, but conduct may not be something contained in a contract (e.g. cumbersome to terminate). Information contained in a contract may also be sufficiently clear and prominent so as not to be misleading but still makes switching less likely (e.g. long notice period or automatic roll overs).

Generally, as long as clear information about a contract is provided upfront (for example, the terms of contract renewal, any exit charges etc.), these sorts of contracts will most likely not pose issues to consumers, and may allow them to be offered a lower up-front price in exchange for firms having a certainty of revenue. However, if fixed-term contracts allow for 'price variation' it could be beneficial for consumers to be able to exit these contracts freely if they experience significant material detriment. Overseas regulators have also begun to address methods of cancelling contracts. Regulators in the UK have recognised that consumers may benefit from being able to cancel contracts by the same means they entered them. Developments in this area could be followed and further investigated to see whether regulating these methods may be appropriate in New Zealand.

Reactive save activity can allow firms to offer lower prices to existing customers who are in the process of completing a switch to another provider. This can cause firms to have little incentive to price competitively to their entire customer base if they are allowed to win them back. Such activity can damage competition as it favours incumbent firms over new entrants to the market. Entrants are likely to face high marketing and sales costs, creating barriers to entry and expansion that undermine the competitive process. This is likely to harm competition unless it is the consumer considering switching that directly contacts the supplier to see if they will be offered a better deal.

Opening up data up across professional services sectors to enable easier switching is being investigated by regulators. The Australian Productivity Commission (2016) is currently investigating how best to provide consumers with this data, and at what, if any, cost. Although government regulation in New Zealand means that consumers can access their medical records for free, similar issues that have been found in around fees for accessing medical records in other countries, which could be experienced in other sectors (e.g. accountants).

Regulators overseas continue to implement and improve process-based remedies in utilities and banking markets by minimising the time and effort required for consumers to switch. In professional services markets, these have not been adopted as widely, although there appears to be scope for these remedies. By adopting processes led by the gaining provider in some professional services markets, regulators could potentially reduce both procedural and relational switching costs. This in turn could increase switching rates, provided the financial cost of moving consumers' data across providers does not create a barrier to switching.

Reducing procedural and relational switching costs may not necessarily require intervention by regulators, as these can be firm led. For example, some firms will see the benefit in 'gaining-provider led' switching processes without the need for intervention. When considering whether intervention is required, particular barriers enforced by a firm (generally an incumbent) may make innovations in improving the switching process difficult.

Soft intervention measures can enhance consumer awareness of switching and can encourage switching behaviour, in addition to, or instead of, directly intervening in the market. Advertising campaigns have been used by regulators overseas to make consumers aware of interventions that may directly lower switching costs, and these have caused switching rates to increase. While many of the methods above already address behavioural biases, regulators overseas recognise that some behavioural biases may not necessarily need to be corrected or directly addressed. As long as consumers are made aware of particular biases they may experience, they may make allowances for these in their behaviour, which can limit the extent to which firms can exploit these biases.

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