Academic seminar to discuss the UKRN report on Price Comparison Websites

7th September 2016

Selective notes of the discussion compiled by Professor Catherine Waddams, from the Centre for Competition Policy and Norwich Business School at the University of East Anglia, who chaired the session.

Main messages

1. While the focus of the report is on the consumer experience, the incentives and responses of PCW providers will have a fundamental effect on what consumers are offered.

2. Substantive differences between PCWs in the service and products which they offer in different (regulated) sectors indicate that optimal policies may differ considerably between sectors and circumstances. Within each sector, interaction and consistency of policy with more traditional forms of agency (e.g. brokers) and in other markets are crucial for framing policy.

3. The ability and incentives for PCWs to segment the market will affect consumers differently; the existence of PCWs may result in higher prices for non-users than would otherwise have been the case. By shifting some search costs from users to the search engine, who then charges fees to providers, the PCWs reallocate these costs between consumers, including those who do not search.

4. Given the novelty and evolution of the PCW market and the continuing experimentation of websites with their consumers, the relevant market, the appropriate theory of harm and a framework for determining objectives and improvements are key to informing any intervention.

A list and summary of some relevant papers, as well as bios and contact details for the academic participants are included at the end of this note.

Attendees

David Deller, University of East Anglia; Amelia Fletcher, University of East Anglia; Morten Hviid, University of East Anglia; Kai-Uwe Kuhn, University of East Anglia; David Ronayne, University of Oxford; Catherine Waddams, University of East Anglia; Tobias Wenzel, University of Bath; Chris Wilson, University of Loughborough.

Dermot Nolan, UKRN and Ofgem; Claire Simpson, UKRN; Barbara Perata-Smith, UKRN; Neil Marshall, FCA; Elisa Pruvost, Ofcom; Caroline Ainslie, Ofgem, Will Hayter, CMA; Borbala.Szathmary, CMA; Raymond Iyayi, FCA; Eric Morrison, FCA; Charlie Gluckman, FCA; Sarah del Vecchio, FCA.

Neil introduced the main findings of the report, the second report of a UKRN project on consumer engagement and switching, which focused on online intermediaries and PCWs. This was primarily descriptive, identifying similarities and differences in the regulatory tools and practices of the FCA, Ofcom and Ofgem. The focus had been on understanding consumers' experiences and their engagement with PCWs. A central question was how to ensure that PCWs benefitted consumers. General consumer awareness of regulator accreditations of PCWs is low.

David Ronayne presented some findings from academic research, which were relevant to PCWs and the report. He focused on four topics: Prices, Fees and Comparison; Price Dispersion (central to the business model of PCWs) which remained high in internet and PCW-enabled sales; the role of Price-Ordered Results for homogeneous and heterogeneous goods, for rational and boundedly-rational consumers; and Business Models, Showrooming and Price Discrimination Clauses.

The floor was opened to general discussion.

PCWs and similar internet-based services are evolving rapidly, and practice often runs ahead of theory. A contrast was drawn within regulated sectors between the suppliers, who were often heavily regulated, and PCWs, where there was sometimes no regulation at all; and between the promotion by PCWs of themselves as benign public services, which was often accepted by the public and politicians with little focus on their commercial activities, incentives and cost recovery, and understanding the business models and incentives as portrayed in the emerging economic literature. Private consumer facing companies in the digital sphere are themselves experimenting with different consumer interactions, and had strong incentives to find mechanisms which generated consumer loyalty. Click through fees make repeat business valuable and this provides an incentive that limits the desirability of 'ripping off' a consumer at one particular transaction. Given the greater knowledge that commercial entities have, relative to regulators, there is a danger that intervention by regulators and competition authorities would stifle such experimentation and innovation. It is important to identify a benchmark for good or better outcomes and a reference framework to assess and interpret the evidence. Given uncertainty around the theory of harm relating to PCWs, an appropriate regulatory path may be one of monitoring, with the potential for ex-post enforcement.

In terms of benefiting consumers, many suppliers offer lower prices on PCWs than elsewhere, so that while PCWs may stimulate competition, with consequent benefits, those who don't use the PCW are more easily identified as price-insensitive and may pay more than if there were no PCWs. This is an externality on non-users that is passively 'exerted on them' by PCW users. If such non-use is driven by and related to characteristics that mark consumers as more vulnerable, then the broader social implications of this discrimination may be cause for concern.

Given the range of types of PCWs, from passive 'data scrapers' to retailers, identification of the functions relevant to particular markets is important. Does multi-homing suggest lack of consumer trust in individual PCWs, or is this a consequence of incomplete coverage or price discrimination between sites? How far have search costs been reduced, if consumers visit several PCWs?

Is there a role for a 'plain vanilla' publicly provided website to provide a consistent reliable service? There are examples of such websites for energy in other parts of Europe, but they are not heavily used; there is evidence of pro-competitive effects from a government-provided PCW for petrol. Providers are generally better at communicating with consumers than regulators, and invest heavily in marketing and understanding consumer response. By contrast, public bodies generally do not have funds for large scale marketing, and some publicly operated sites have poor functionality. The fixed nature of marketing and brand investment affects private PCWs' own incentives to operate across several different markets. PCWs' marketing may increase general awareness among consumers regarding the benefits of switching.

Some sectoral differences may depend on the nature of data required, both for producing comparisons and interpreting output. The relative cost of providing input data from the current supplier and the consumer is also likely to vary across sectors.

Other points: PCWs are a low cost route to market for new entrants, and their costs for new entrants have to be compared against alternative avoided marketing expenditure. Might PCWs enable excessive entry by service providers, or excessive switching? Does the empirical evidence of a variety of PCWs' models suggest that the 'best' model has not yet been identified? Further empirical evidence might be obtained from the experience of PCWs outside the EU, in particular in the US.

Some relevant academic papers

"Paying for prominence" by Armstrong and Zhou (Economic Journal)

http://onlinelibrary.wiley.com/doi/10.1111/j.1468-0297.2011.02469.x/abstract

> Summary: If a PCW can make a firm prominent in exchange for a fee then prices will be distorted upward and more expensive firms will tend to be prominent.

"Middlemen as guarantors of quality" by Biglaiser and Friedman (International Journal of Industrial Organization)

http://www.sciencedirect.com/science/article/pii/0167718794900051

> Summary: A PCW can exert a halo effect on the sellers it lists by putting its reputation on the line and therefore committing not to list "bad" (i.e. low-quality/dishonest) sellers.

“A Model of Biased Intermediation” by De Corniere and Taylor (Working paper)

http://users.ox.ac.uk/~inet0118/pdf/Taylor_14-06.pdf

> Summary: Suppose firms can pay a comparison service in exchange for prominent placement. Whether this benefits or harms consumers depends on the nature of competition between the firms (e.g. relative importance of price vs quality competition). The same kind of distinction is important in determining which kind of policies are likely to be effective.

“Price Coherence and Excessive Intermediation” by Edelman and Wright (QJE)

http://www.benedelman.org/publications/pricecoherence-2015-03-12.pdf

> Summary: Intermediaries tend to use MFN clauses to distort prices in a way that induces consumers to transact more through the consumers paying higher prices and inefficiently high utilisation of the intermediary.

“A Model of Add-on Pricing” by Ellison (QJE)

http://economics.mit.edu/files/7605

> Summary: Firms can profit by separately selling add-ons. The usual Chicago critique that would render such a strategy unprofitable does not apply because price cuts in the base good disproportionately attract “cheapskates” who will not buy the add-on. N.b Ellison shows that this logic only works if firms collude around add-on pricing, a PCW might be a potential mechanism to facilitate such collusion.

“Search, Obfuscartion, and Price Elasticities on the Internet” by Ellison and Ellison (Econometrica)

http://economics.mit.edu/files/7205

> Summary: An empirical paper that documents obfuscatory tactics used by sellers on a PCW to hinder consumer attempts at price-comparison. Shows that this leads to higher prices.

“Strategic Obfuscation and Consumer Protection Policy” by Gu and Wenzel (Journal of Industrial Economics)

http://dx.doi.org/10.1111/joie.12060

> Summary: Changes that reduce consumer search frictions may not leave consumers better-off because firms can react by changing, for example, their website design to make search more difficult again.

"Price Comparison Websites" by Ronayne (Working paper)

http://www2.warwick.ac.uk/fac/soc/economics/research/workingpapers/2015/twerp_1056b_ronayne.pdf

Summary: Price comparison sites increase competition between firms, but the fee that they charge drives prices upward. The latter effect dominates so that PCWs leave consumers paying higher prices.

"Ordered Search and Equilibrium Obfuscation" by Wilson (International Journal of Industrial Organization)

http://dx.doi.org/10.1016/j.ijindorg.2009.12.001

Summary: Some firms face a profitable incentive to deliberately make it harder for consumers to find their price in order to reduce market competition.

"Search Platforms: Showrooming and Price Parity Clauses," by Wang and Wright (Working paper)

http://www.cepr.org/sites/default/files/Wright,%20Julian%20paper_0.pdf

Summary: Careful analysis of MFN price-parity clauses in platform markets when consumers face costs of search.

"An Economic Policy Perspective on Online Platforms" by Martens, (Working paper)

https://ec.europa.eu/jrc/sites/jrcsh/files/JRC101501.pdf

Summary: Discusses platforms from a regulatory policy angle, including potential market failures in platforms, the extent of self-regulation and possible regulatory responses through existing competition policy, consumer protection and data protection instruments and selected policy issues.

Bios and contact details

David Deller joined the Centre for Competition Policy at the University of East Anglia in 2013 after completing a Ph.D. in Economics at the University of Essex. David's research comprises three core themes: (i) consumer behaviour in regulated markets, (ii) affordability and distributional issues in liberalised markets, and (iii) considering the institutions of the 'Regulatory State'. David has mainly explored these themes through the prism of the UK energy market.

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Morten Hviid is a Professor of Competition Law and the Director of the Centre for

Competition Policy, University of East Anglia. He has worked on a number of competition issues in digital markets, including across platform parity agreements.

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Kai-Uwe Kühn joined the School of Economics at the University of East Anglia as Professor of Economics in January 2016 from the University of Michigan, where he had held an Associate Professorship in Economics since October 1998. Previously, Kai-Uwe acted as Chief Economist for DG Competition of the European Commission between May 2011 and August 2013, where he oversaw several high-profile merger and antitrust cases. He is also a permanent Visiting Professor at the Düsseldorf Institute for Competition Economics (DICE) and a Research Fellow of the Center for Economic Policy Research (CEPR). In addition to his academic activities, Kai-Uwe has advised private companies and competition authorities on numerous competition cases. He has also previously acted as Co-editor of the Journal of Industrial Economics.

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Amelia Fletcher is a Professor of Competition Policy at the Centre for Competition Policy and a Non-Executive Director at the Financial Conduct Authority. She was previously Chief Economist at the Office of Fair Trading (2001-2013), where she also spent time leading the OFT's Mergers and Competition Policy teams. Before joining the OFT, Amelia was an economic consultant at Frontier Economics (1999-2001) and London Economics (1993-1999).

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David Ronayne is a Postdoctoral Prize Research Fellow at Nuffield College, University of Oxford. He received a Ph.D. in Economics from the University of Warwick. He works in applied theory, especially industrial organization, and experimental economics. His research focuses on policy-relevant issues facing the modern consumer and on the nature and implications of relative judgment.

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Catherine Waddams (formerly Price) is based at the Centre for Competition Policy and Norwich Business School at the University of East Anglia. She has studied privatization, regulation and the introduction of competition, especially in energy markets, and has recently focused on the distributional impact of regulatory reform, and consumer choice in newly opened markets. She is a Non-executive Director of the Water Services Regulation Authority (Ofwat) and a member of the UK Regulators Network expert panel and of the expert consumer panel of the Office of Road and Rail. From 2001 to 2009 she was a part-time member of the UK Competition Commission.

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Tobias Wenzel is senior lecturer at the University of Bath. Previously he was an assistant professor at the Düsseldorf Institute for Competition Economics (DICE) at the University of Düsseldorf. Tobias holds a Ph.D. from the University of Dortmund and a

Diploma in Economics from the University of Mannheim. Tobias conducts research in the area of Applied Microeconomics and Industrial Economics. His research has been published in journals such as Journal of the European Economic Association, Journal of Industrial Economics, International Journal of Industrial Organisation and Journal of Economic Behavior and Organisation.

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Dr. Chris Wilson is a Senior Lecturer in Economics at the School of Business and Economics at Loughborough University. His interests include consumer information, consumer switching, advertising, and pricing. Chris has published in journals such as the European Economic Review and the International Journal of Industrial Organization, and presented to a range of governmental departments.

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