

Assessing consumer detriment

By

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Never in the field of competition policy and indeed wider economic policy has the standing of the ‘consumer’ been higher. Almost every policy pronouncement and decision is couched in terms of the impact that this has had on ‘the consumer’. This focus on the consumer has driven policy makers to demand that decisions and policies either enhance consumer ‘welfare’ or minimise consumer ‘detriment’. However, the ever-increasing focus on consumer welfare and/or detriment has highlighted the relative scarcity of study on the subject.

This scarcity of analysis has led to some confusion about exactly what a consumer is. In competition analysis, the end consumer, or final consumer, is very often one step removed from the competitive process. This is particularly true in intermediate goods markets. There tend to be two options in such cases; firstly, to treat the customer as if they were the consumer and secondly, to make some vague statements about consumer impact and largely ignore the final consumer in the analysis.

The most detailed analytical work on consumer detriment has tended to come from an established model of economics. Or rather, consumer welfare as a concept sits neatly within the normal microeconomics taught to undergraduates. However, the consumer welfare function that comes from this area is a limited one and lacks much in the way of refinement. In short, it focuses on the price charged to consumers and the loss that they may suffer should that price rise. While price is certainly an important factor for many consumers, a simple focus on price presents the following problems:

1. Consumers may face non-price related detriment, such as access, quality, information, reduced choice, less innovation, etc;
2. Price may not be the primary factor in determining consumption decisions in all markets;
3. A single consumer may suffer different forms of detriment in different markets.

What is particularly interesting about this approach to consumer welfare is that it is fairly well embedded in most regulators’ understanding of consumer welfare. It is interesting to note that the recent OFT paper on ‘The Development of Targets for Consumer Savings Arising from Competition Policy’ by Stephen Davies and Adrian Majumdar talks of the Simple Arithmetic Answer, when looking at identifying consumer savings from competition cases. The SAA, as they coin it, simply measures the gain to consumers from an intervention. However, the authors raise a number of important questions regarding the SAA. For example, what happens when consumer welfare is dependent on the existence of a particular competitor? The authors point to the situation where a firm may need to make what may appear to be otherwise excessive returns to enable them to invest enough to innovate. This question raises the important relationship between short term and long-term consumer welfare. In essence, are price reductions in the short term capable of limiting innovation in the long term?

Davies and Majumdar argue that a possible intermediate standard is possible, the Hillsdown standard, which states that “a merger should still be allowed when there is a price increase, so long as the marginal cost reduction exceeds the price increase ($P0P1 < C0C1$ in the diagram). Crudely speaking, this allows profits to be offset against a loss in consumer surplus, but only that part of profits due to enhanced efficiency.”

There is a further complication in the assessment of welfare in cases where some consumers gain and others do not. In short, if a policy exists that benefits 90 per cent of consumers, but disadvantages 10 per cent, is it a good policy? Such a question focuses us on what might be termed detriment depth. If consumers lose a penny on the price of a good, but a few lose pounds, then there are different degrees of detriment in play. Such problems can occur in utility markets where those most able to pay can get discounts on payment mechanisms such as direct debits, while those (often disadvantaged members of society) that pay in the more expensive forms (cheques, meters) pay a higher unit charge. Such problems correspond with the National Consumer Council’s ‘The Poor Pay More’ campaign.

The problem of differential detriments is, to some extent, dealt with by the ‘compensation principle’. The principle has taken a number of forms. Nicholas Kaldor argued in 1939¹ that the repeal of the Corn Laws was generally beneficial for society because it had so benefited consumers that they **could have** afforded to compensate the farmers for their loss and still be in a better position than before the regime had changed. Kaldor argued that the policy was good even if consumers chose not to compensate farmers. In short, a policy is efficient if it results in benefits for those who gain of such a scale that they ‘potentially’ can compensate fully all those who have lost out and still remain better off. This approach is rather similar to a balance sheet approach to policy making – tot up the benefits on one side, tot up the losses on the other – then balance them out.

While Kaldor adopted a balance sheet approach, the work of Hicks² took the approach on a stage. In his approach, a change can be argued to have improved societal well-being if, and only if, both the beneficiaries of a change *could* fully compensate the losers and remain better off themselves, and the losers could not have compensated the beneficiaries sufficiently to get them to forego their benefits without themselves being worse off than in their original position. The compensation principle thus has a forward and backward induction process and rather neatly forms the basis for much of the cost-benefit analysis that has followed it. While Hicks and Kaldor developed a balance sheet approach, Posner simply argued that justice was best served by efficiency and that the pursuit of the size of the cake should always outweigh the division of that cake.

In the context of the assessment of consumer welfare, Posner’s appears to be little more than the philosophical version of the rather economic reductionism of the SAA. The Kaldor-Hicks approach is certainly useful in the context of general policies with

¹ Nicholas Mercurio and Steven G Medema Economics and the Law: from Posner to Post-Modernism. 1997. Princeton University Press, p19.

² Nicholas Mercurio and Steven G Medema Economics and the Law: from Posner to Post-Modernism. 1997. Princeton University Press, p50.

wide impacts; it is less clear that it is useful for localised impacts. The term 'localised' is used in this context in a geographic sense (where impacts are felt only in specific places), in a temporal sense (where impacts may occur over time) and in an egalitarian sense (where people are affected adversely within a demographic or class group). In retail markets, the geographic impact can be seen in the location of supermarkets and the competition between them (for example the discussion of isochrones in the 2000 complex monopoly inquiry, and fascia in the Safeway merger case). Temporal impacts come back to the problem identified earlier where innovation may be undermined in a market to the short-term benefit (very low prices) but the long-term detriment (retarded innovation) of the consumer. The third category, egalitarian impacts, can be found in the case made for those with restricted mobility (for example) and the decline of village shops in rural areas. The third area of contention, broadly termed distributional equity has been described by Tobin³ as a 'specific egalitarianism'. Specific egalitarianism produces a result that is less unequal than the result that would arise from a distribution on a simple ability to pay basis. Such an effort may well work against allocative efficiency to ensure a greater degree of distributional equity.

Competition policy has developed tools that enable it to look at localised competition impacts in a geographic sense, but have more difficulty in dealing with threats to innovation and targeted problems of egalitarian distribution. Competition authorities have tended to leave the latter areas to either industrial policy or social policy. However, in a number of recent inquiries and retail market developments, the issues of buyer power and their impact on both innovation and social equity have risen in importance.

The dividing lines between that which is consumer welfare and that which has wider welfare implications is a far from clear one. There is no bright line test to separate out consumer welfare from citizen welfare. While stating this is simple, providing a means of separating the two for analytical and policy purposes is far from straightforward. In assessing the consumer/citizen split, one of the questions that is worth asking is whether retail markets differ to other markets and whether this has an impact on the range of policy tools available to deal with problems. It could be argued that retail markets exhibit the range of behaviours that Albert O Hirschman identified in his seminal work 'Exit, Voice and Loyalty'. Hirschman argued that in modern markets consumers expressed their disquiet with a company through Exit – that is they could simply refuse to buy a product. Similarly workers could show their disquiet by leaving the company. As exit is a significant event, be it loss of customers or workers, Hirschman argued that consumers and workers could be given a Voice to communicate their frustrations and views. The provision of such a Voice could limit the possibility of Exit, something that may have long-term implications for the firm and indeed wider impacts for the community within which the firm operated. This relationship between Voice and Exit is an interesting one in retail markets. In regulated industries it is relatively easy to see the desire of policy makers to limit/replace Exit through the provision of Voice. Indeed in the water industry the consumer watchdog was called Water Voice.

³ Tobin J. 1970. 'On limiting the domain of inequality'. *Journal of Law and Economics*. Vol 13 (October), pp 263-77. Quoted and discussed in Blank, RM. 2000. 'When Can Public Policy Makers Rely on Private Markets? The Effective Provision of Social Services.' *The Economic Journal* (March). Blackwell Publishers, Oxford.

It can be argued that firms in most fast moving consumer goods markets find that exit and voice are largely one and the same things. A decline in sales tells a firm that its product is no longer as relevant to consumers. However, the fmcg sector has seen a number of efforts to give consumers a voice to try to limit exit by using feedback to redesign products or change formats.

Such a mechanism is increasingly important in the battle for mind-space as much as shelf space. Consumers are faced with ever-increasing numbers of choices and look for editors to enable them to make their choices as efficiently and effectively as possible. But to be effective consumers must be able to learn from their choices. As Tversky and Kahneman argue "... effective learning takes place only under certain conditions; it requires accurate and immediate feedback about the relation between the situational conditions and the appropriate response. The necessary feedback is often lacking for the decisions faced by managers, entrepreneurs, and politicians because (i) outcomes are commonly delayed and not easily attributable to a particular action; (ii) variability in the environment degrades the reliability of the feedback, especially where outcomes of low probability are involved; (iii) there is often no information about what the outcome would have been if another decision had been taken; and (iv) most important decisions are unique and therefore provide little opportunity for learning ...⁴."

Furthermore it is interesting to note that "...in discussing choice anomalies that could be attributed to 'framing' effects, Tversky and Kahneman make a distinction between what they term '**transparent**' and '**opaque**' versions of choice problems. Briefly stated, when a problem is presented in transparent form, choice behaviour does not violate basic tenets of rationality. When choice problems are formulated in an opaque manner, however, people may well violate basic principles ... because of the effect of 'framing' and so on.⁵"

It is interesting to compare a market such as the pensions market, which has poor or delayed feedback mechanisms and opaque information, with fmcg markets where feedback is rapid and information is generally transparent.

This issue of transparency is centrally important in markets and in wider social policy. In retail markets transparency is important for the individual choosing their food products and more generally for local planning decisions. If we use the principle of transparency as a means of limiting exit and providing voice we can present the following typology for consumer-citizen issues:

⁴ Tversky, Amos and Kahneman, D. 'Rational Choice and the Framing of Decisions,' in Hogarth, Richard M and Reder, M.W (eds). Rational Choice: The Contrast Between Economics and Psychology. University of Chicago Press. London. 1987. pp90-91.

⁵ Hogarth, Robin M and Reder, M.W. 'Introduction: Perspectives from Economics and Psychology,' in Hogarth, Richard M and Reder, M.W (eds). Rational Choice: The Contrast Between Economics and Psychology. 1987. University of Chicago Press. London. p7.

	Individual transparency mechanism	Collective transparency mechanism
Consumer oriented mechanism	Choice	Information
Citizen oriented mechanism	Voice	Representation

Source: Martin Lodge. 2000. Regulatory Accountability: Towards a Single Citizen-Consumer Model? Paper for the Political Studies Association 50th Annual Conference.

If one takes this typology and applies it to retail market competition issues, one can see that the consumer-oriented mechanism of choice and information is a key and popular tool for competition regulators. The framing issues of planning and wider societal impacts are left to the citizen-oriented mechanism. For these citizenship issues, regulators tend to rely on the effectiveness of voice and representation. However, the trend in the UK for increasingly centralised and unaccountable decision-making through the creation of the regulatory state raises serious questions about whether the citizen-oriented mechanism delivers the level of accountability in the citizen dimension of the retail market. If the wider issues of planning and social welfare are not delivered in a manner consistent with a citizen-oriented mechanism, then it is likely that such issues will become more important in the consumer-oriented mechanism of choice and information.

Existing work on consumer detriment

There is relatively little work on the issue of consumer detriment. The work of the OFT⁶ is one of the very few pieces that addresses it directly and their later work on developing a methodology for consumer impacts⁷ takes the work forward. Both reports take a relatively straightforward economists' view of the issue, the former more than the latter.

The 2000 OFT report identified three main ways in which consumer detriment may occur:

- **price detriment:** consumers may not buy the product or service at the cheapest price available to them;
- **appropriateness detriment:** consumers may not buy the most appropriate product, given their tastes and preferences; and
- **quality detriment:** consumers may purchase a product or service which is not of the quality they assumed *ex ante*.

⁶ OFT. Consumer Detriment. 2000. HMSO.

⁷ Stephen Davies and Adrian Majumdar. 2004. The development of targets for consumer savings arising from competition policy.

This approach can be accused of being a rather purist approach and makes detriment an individual rather than collective issue. It also leads to a focus on markets with *imperfect information*. This is not necessarily quite as it seems – after all it is not simply a matter of providing more information – it is more the idea that markets only function perfectly with perfect information. Imperfections in information can come from soluble issues (for example where the providers of information are misleading or confusing) and insolubles (bounded rationality and warranted product complexity - like car engines). As we have argued above, there are real issues about how information is presented to consumers. The work of Tversky and Kahneman highlights the importance of information transparency, in its broadest sense, to decision making.

The OFT argues that information problems tend to centre on three main loci:

- **Complexity or 'newness'**: the product or service is intrinsically complex or new;
- **Information transfer is difficult**: there are no obvious and easy ways for information to be transferred to consumers by the better informed;
- **Information transfer is hampered**: differences in understanding are not dealt with and consumers make decisions in ignorance.

As consumers tend to be individuals (with limited buying power), immobile (they tend to buy locally) and ignorant (they are not as educated about products as suppliers), they are prone to make 'mistakes'. Of course the internet has had some impact on mobility since the OFT wrote their report. As a rough indicator, the OFT argued that the degree to which all three applies is a first function of detriment. In the sense that detriment centres on consumer 'mistakes', the key factors that point to a likelihood that consumers will make 'mistakes' include;

- Uniqueness of purchase:
- Infrequency of purchase:
- Speed of change of market:
- Search costs:
- Change in choices

Measuring consumer detriment

The 2000 OFT report suggested that the measurement of detriment must rest on three information approaches:

- **actual beliefs** (A), which describe the information the consumer has when making a purchase;
- **rational beliefs** (R), which describe the information the consumer would have after having completed a rational search process; and
- the **true distribution** (T), which describes the best possible information about the world.

The OFT thus defined consumer detriment as:

- the divergence between **actual beliefs** and **rational beliefs**;
- the divergence between **rational beliefs** and **true distribution**; and
- the degree of avoidability.

In other words, in looking at any particular market situation where it is believed that a consumer detriment may exist, one must assess whether it is:

- ‘an (R-A) problem’, where consumers do not appear to be receiving or acting upon information when it would be rational to do so; or
- ‘a (T-R) problem’, where consumers experience a rational informational shortfall.

To quote:

“If an (R-A) problem is found, it is necessary to establish why this information gap exists. If the market is changing rapidly and A just takes some time to catch up with R (there may be some historical experience of this), then consumer detriment is likely only to be transitory. However, if there is evidence of systematic exploitation of systematic biases in the way consumers evaluate information or of misinformation and false claims which cause a difference between A and R, then intervention may be required.

In case of a (T-R) problem, there may be very good reasons for the information deficiency (as in the market for medicines), and no detriment necessarily occurs. In other cases, this information shortfall may be the result of higher-than-necessary search costs (because some information problems cannot be overcome by appropriate market solutions) or of suppliers [suppliers here can include manufacturers, retailers or intermediaries] manipulating either R (by making information artificially complex or expensive) or T (by behaving in other non-competitive ways), such that some of this shortfall is avoidable (by preventing this manipulation).”

Having focused almost all of their work on information gaps, the OFT then add in avoidability and cost effectiveness of remedies. They argue that there are a number of reasons why differences occur between rational and actual beliefs:

- a consumer may be given **misleading advice** by suppliers. This may involve factually incorrect information (which is illegal) or may involve suppliers failing to correct mistaken beliefs held by the consumer. There may be an important distinction here between the intention to give bad advice and an ignorant salesperson, who simply makes a ‘mistake’;
- suppliers may employ **high pressure sales tactics** which could include the provision of misleading information (as above), may change the consumer’s discount factor (‘you cannot wait another day for such a good offer’), or may simply induce consumers to make a purchase that they otherwise would have not made (‘an offer you cannot refuse’); or
- the **product market may change** (a new product may be introduced) such that rational beliefs may change, while actual beliefs take some time to catch up. This

may happen if new information is available but has not yet filtered through to a large proportion of consumers.

The approach of the 2000 OFT paper focused almost entirely on the relationship between consumer information and rational behaviour. It appeared to rest on an unstated belief that consumers would act more rationally in ordinary circumstances. They thus argued that there is a detriment problem when consumers:

- do not appear to be receiving or acting upon information when it would be rational to do so ('an (R-A) problem'); or
- experience a rational informational shortfall ('a (T-R) problem')

Policy makers then have to ask:

- to what degree is this problem avoidable (the avoidability test)?
- to what extent is this problem soluble in a cost effective manner?

The OFT report recommends a series of indicators be used to identify markets where a detriment may occur. These pointers are:

- **Price dispersion:** to what extent are prices widely dispersed?
- **Focal points of competition:** are there key indicators or places within which competition is focused?
- **Secondary purchases:** is this the only product needed - or is it a secondary product to a primary purchase?
- **Commissions:** do they exist and why?
- **Complex products:** how complex are they and should they be?
- **Infrequent or credence purchases:** how often is the consumer in the market and what is the relationship to the good?

While the latter indicators are useful pointers to potential problem markets, they are in many ways unrelated to the original indicators of detriment the OFT focused on. The disjuncture between the information-based analysis and structural-based indicators raises questions about the utility of the approach. Even if information were a problem, it is clear from the experience of the financial services industry that simply providing information does not 'solve' problem markets.

The 2000 OFT report addressed directly the issue of consumer detriment but did so from an almost entirely informational standpoint. As such it only dealt with one form of detriment and from the viewpoint that such a failure was largely the fault of the ignorant consumer. What was interesting in this regard was the rather limited nature of what the 2000 report thought of as information. The range of stimuli that consumers absorb in making decisions are broadly termed information sources. Such sources can take the form of advertising, pack labelling and even where the product is on a shelf, or whether it is part of a promotion or not. The OFT report focused on what might be termed the classical economists' view of information – the specific pieces of information that a consumer needs to make a rational choice. Such a view has been summed up by Gary Becker; "all human behaviour can be viewed as

involving participants who maximise their utility from a stable set of preferences and accumulate an optimum amount of information and other inputs in a variety of markets⁸.”

That classical model is of the atomistic consumer choosing their products and services in isolation from one another and on the basis of ‘normal’ stimuli. However, few anthropologists, for example, would recognise an atomised individual. They are more used to dealing with peer groups and family groups and see decisions in the light of these sorts of interactions. Such scholars would point to the clear existence of peer groups, which are particularly strong and visible among teenagers for example. Such groups have significant influence over what is and what is not purchased by members of that group and aspirants. Some of these influences on consumers have made it into more mainstream economics but to differing degrees.

However, as a considerable amount of work by scholars such as Tversky and Kahneman and Richard Thaler show, consumers will not always act in a classically rational manner. They fail to do so for two main clusters of reasons – one can loosely be termed ‘bounds to rationality’ and the second group can be termed ‘specific mental accounting issues’.

The general bounds to rationality that Thaler⁹ in particular has identified are threefold. Firstly, there is the relatively well-accepted bounded rationality, bounded willpower and bounded self-interest. The idea of bounded rationality has been with us since the work of Herbert Simon in the 1950s and essentially argues that individuals have limited computational abilities with which to deal with all the information placed in front of them. In other words, we can’t remember everything and can’t calculate every possible option before us. Indeed, as the report of Claus Moser on numeracy in the UK indicates, bounded rationality is a fairly fundamental and deep-seated problem.

The idea of bounded willpower is an interesting one in both food markets and financial services markets. This bound means that consumers often take decisions in the short term that damage their long-term interests. Thus we get debates about whether we should force people to save as individuals often spend rather than save, opting for short-term gain over long term wealth. Perhaps individuals are more prone to take the Keynesian view that in the long term we are all dead. The operation of this bounding on behaviour is behind savings schemes, stamp schemes and Christmas hamper schemes.

The idea of bounded self-interest is perhaps the most surprising, but perhaps most comforting. This bound argues that individuals, in certain circumstances, care, or act as if they care, about others. This is illustrated in a standard economic experiment where two individuals are given a set sum, say £100 and one is told that s/he has the untrammelled right to divide that sum between the two parties. Rational behaviour would tell you that the person would give one penny to the stranger and keep the rest

⁸ Gary S. Becker. 1976. *The Economic Approach to Human Behaviour*.

⁹ Christine Jolls, Cass R. Sunstein, and Richard Thaler. 1999. *A Behavioural Approach to Law and Economics*. University of Chicago Law School. Working Paper.

for themselves. Of course, in reality the person making the decision almost always opts for a ‘fairer’ division of the money. While this experiment might be rather neat (and it falls down with MBA and economics students), it does illustrate a rather interesting issue in retail markets. Consumers have a concept of ‘fairness’ in their dealings with retailers and manufacturers. They have certain expectations, which have shifted over time. However, they have a fairly nuanced understanding of what is ‘right’ and ‘wrong’ in their market interactions.

The specific mental accounting problems are many and varied. Perhaps the most developed form of the approach comes in Prospect Theory which argues that firstly, the structure of a problem may affect the choices that are made. That is, the same problem presented in different ways may influence the decisions of participants. Secondly, outcomes received with certainty are overweighted compared to outcomes that are uncertain; and thirdly, gains get treated differently to losses. Losses generate a risk seeking response while gains produce a risk averse response.

There are a number of further complications to consumer behaviour and the following issues must be borne in mind:

- **The endowment effect:** any product that is part of the already existing endowment of the individual will be more highly regarded than a product that is not. Individuals thus tend to rate what they already own more than a product that they do not.
- **The sunk cost effect:** individual sunk costs affect decision making
- **The theory of momentum:** individuals will complete a task once work has begun, irrespective of the continuing validity of the decision.
- **Search costs are relative:** any difference in price between goods is seen in relation to the total price of the goods, including transaction costs.
- **Psychic costs of regret are large:** present decisions can often be limited on the basis of the individual not being able to trust themselves to make the right decision in the future.
- **People segregate gains:** individuals prefer to treat multiple gains as a series of individual gains. For example, getting two Christmas presents wrapped separately is preferable to getting two presents in one wrapping;
 - **integrate losses:** individuals like to place all their losses in one basket.
 - **let big gains cancel small losses:** if the overall balance of gains and losses is toward the gain, then the losses should be pooled with the gains to cancel them out;
 - **segregate ‘silver linings’:** when large losses out-weigh small gains, the gains may be separated out as a ‘silver lining’ to the cloud of the large loss. The picture becomes less clear when dealing with smaller gains and losses – here integration may be the preferred option.

In short, the idea of the rational consumer has taken a fair bit of dismantling over the last couple of decades. However, the central tenet of the work of Tversky and Kahneman still holds; namely that individuals will tend to act rationally when they are

presented with clear, transparent information, but will behave less rationally when faced with opaque information. Information is broadly conceived in this context.

The degree of binding on the rationality of individuals will vary market by market and tend to be highest in financial services markets. Indeed it can be argued that there are not so much bounds to rationality as barriers!

The key question in retail markets is the degree to which people can make reasonably rational decisions that reflect their real choices. It is also instructive to analyse who it is that provides the core information to those consumers in the first place. Whether it is the producer or the retailer that provides the initial information upon which consumers make their decisions. In this context it is interesting to look at the role of the retailer as the choice editor for the consumer. It is now reasonably normal to contemplate the retailer as the gatekeeper for the consumer and the manufacturer, but in the context of consumer behaviour the role of the retailer as choice editor is perhaps more interesting to look at closely.

When faced with complex decisions, consumers often refer to choice editors. If one looks at the retail financial services market, one can see mortgage brokers, insurance brokers, Independent Financial Advisors, and many other quite explicit choice editors. Indeed, in the last few years there has been a proliferation of online choice editors on the marketplace, where consumers can simply input their details on to a single sheet and the choice editor will simply search the internet – or a subset of the internet – for the best available product.

In the recent past the role of these choice editors has been the subject of a number of competition inquiries. The role of IFAs has been a constant source of debate in financial services markets and the role of travel and estate agents has rarely been out of the purview of regulators. Indeed the more recent development in these markets has been to try and find ways for consumers to avoid the role of choice editors.

The more recent work for the OFT was designed to identify a means of calculating consumer benefits from competition interventions. As such it is a form of consumer welfare methodology. The particularly interesting element of the report for this exercise is the discussion on the relationship between innovation and competition. The authors point out that recent literature has tended to focus less on the number of competitors (it is interesting here to compare the Competition Commission Supermarket inquiries) and more on the process of rivalry between firms. Much of the innovation literature has focused on ‘patent races’ where firms compete aggressively to patent a particular development that gives them a particular advantage and blocks off rivals. In this scenario competition as a race for monopoly rent (via the patent) stimulates innovation. Conversely the ‘escape from competition’ desire to innovate argues that firms will seek to innovate as a way of staying ahead of competitors. What is interesting in this particular approach is the view from Aghion, Harris, Howitt and Vickers (2001) that innovation is “faster for more competitive regimes, but that ‘a lot of imitation’ is always bad for growth”.

This would suggest that the current consumer goods market, with relatively few players who compete by innovating through incremental changes, is probably good

at triggering fast innovation but has little chance of seeing growth due to the high level of private label imitation.

Conversely, (Para 4.32) “A more unequivocal message emerges from Bessen and Maskin’s (2000) model, which examines the roles of patent protection and imitation in markets where innovation is both sequential and *complementary*. Precisely because subsequent innovations are often complementary (i.e. building on each other), certain types of imitation can actually expand the market for the initial innovation. Although imitation reduces the initial innovator’s current profit, it raises the probability of further innovation and so enhances the likelihood of the original innovator making another profitable discovery later on. As such, this increases the expected profitability of the initial innovation. They argue that this prediction – that greater imitation *enhances* the incentive to innovate – is supported by evidence from the US computer industry.”

In short there appears to be relatively little concrete evidence one way or the other regarding the overall welfare effects of competition on innovation and imitation on innovation.

While the literature on the relationship between innovation, imitation and competition may not be conclusive, it does allow for a series of potential questions. Firstly, does imitation deter incremental innovation but spur innovatory leaps capable of more robust protection? Secondly, is this a positive or negative development? Thirdly, is the role of the retailer as gatekeeper and competitor unique? If so, does this change the nature of the imitation in the marketplace? For example, when AMD launched a new dual powered chip, it stole a march on Intel who had to play catch up. In retail markets the competitor has to be informed of innovations in advance and so can launch a competing product at the same time as the innovating product is launched. There is no catch up to play.

If we assume that the desire to innovate is at least in part driven by the desire for enhanced margins due to an improved product, then what impact does a zero ‘catch-up’ period play? It is not entirely illogical to argue that a limit to the ability to earn in essence monopoly rent discourages those incentivised by that monopoly rent.

A further question arises in a globalised or regionalized economy with differences in levels of protection for incremental innovation. If, for example, retailers in the UK offer a zero catch-up period and limit rent from innovation, but this does not occur in France and Germany, it could be argued that UK consumers free ride on the returns offered in France or Germany without paying the innovation premium.

Conclusions

From a review of the literature the following broad conclusions can be drawn:

- Established models of consumer detriment tend to rely on an outmoded model of consumer behaviour and rationality;
- Advances in the understanding of consumer behaviour point to a more complex model of behaviour and thus potentially broader approaches to detriment than price;
- Detriment can be plotted on both a horizontal (width of impact) and a vertical (depth of impact) axis – some detriment problems can affect a large number of consumers a little and some can affect a small number a lot;
- The established model of detriment has developed alongside a model of intervention that focuses on establishing the conditions for a consumer rationality that does not exist in real world markets;
- The abrogation or removal of citizen accountability mechanisms has created a vacuum in accountability in the externalities created by retail markets that is increasingly encroaching on competition regulation;
- There is little conclusive evidence on the link between innovation and competition. It is clear that imitation limits market growth. It is reasonable to suggest that varied rules on imitation lead to free riding problems within the EU.

Applications to competition issues in the retail market

We were asked to consider a number of key problems in the current retail market. These included the position of private labels and the zero catch-up time offered by retailers as competitors; buyer power of supermarkets; vertical supply chains; planning laws restricting the siting of supermarkets; negative environmental and societal externalities generated by supermarkets; the position of the convenience store sector; limited direct brand-to-brand competition between supermarkets outside of must stock items; reductions in the incentive to innovate; and the spread of supermarkets into other non-food areas.

These issues can be broadly categorized as follows:

1. Demographic/Market driven developments
 - a. The spread of supermarkets into non-food areas; the move into convenience stores
2. Wider impacts of such trends
 - a. Food deserts, food miles, environmental footprints
3. The emergence of entry and expansion restrictions
 - a. Buyer power, vertical supply chains, planning laws
4. Behavioural/market power problems
 - a. Zero catch up time/retailer as competitor and gatekeeper, limited direct brand-to-brand competition

Given the typology of consumer and citizen issues outlined above, it could be argued that category 1 and 2 problems are more classically citizen problems. It is difficult to argue that the widening reach of supermarkets on stock or category is not driven by a rational response to consumer demand. If there are competition concerns then they arise as a result of a rational market response by firms, rather than as an effort on their part to restrict the market in some way. It is difficult to argue that Tesco finds a local corner shop or Dixons a competitive threat, but more that it sees them as a margin-enhancing opportunity. In this sense the supermarket move is a positive response to consumer demand. As such it is difficult to fit such a move into consumer detriment models.

Similarly the impact of shopping patterns on the environment and wider societal distribution is difficult to reconcile with an established model of detriment. It is possible that such an effort could be undertaken. In this regard the more likely candidate would be societal impacts, if we work on the assumption that we can adapt a model of consumer detriment to take a more explicit account of a model of distributive justice that specifically aims to deal with problems of deep detriment felt by small groups of consumers. However, it has to be noted that such groups fall into the classic regulatory pit of the ‘final 10 per cent’ problem. This problem is identified as occurring when society solves 90 per cent of its problem with relative ease and then spends huge resources trying to solve the last 10 per cent of the problem.

The final two categories of problem are more prone to being dealt with in an economic regulation environment. However, it could be argued that category 3 more readily fits into the citizen detriment problem category rather than consumer detriment. This would tend to point to the solution lying more in the political realm than the competition/regulatory realm. This is in large part because these factors are partly a response to governmental restrictions or market developments that are primarily designed to enhance efficiency. While buyer power has been placed in this category because it is more of a structural factor with behavioural impacts rather than a behavioural issue with structural impact. Category 4 problems would appear to be the more directly related to consumer detriment. The role of retailers as gatekeeper competitors, or gatekeeper-poachers, is clearly a behavioural development in the sector which, while most directly having an impact on branded goods companies, has an indirect, but important impact on consumers through a distortion of innovatory incentive structures. Similarly the attempt to limit direct competition through differential stocking policies has a direct impact on the ability of consumers to comparison shop and thus maximize their utility.

Recommendations

It is a pat answer in almost every report that more research is needed. This is partly because this is always the case and partly special pleading by researchers. In the area of consumer detriment there is a need to develop a new model of consumer detriment that centres on the following factors:

Problems

1. **Choice:** consumer welfare is highest in competitive markets;

2. **Transparency:** consumers will choose more rationally in transparent markets;
3. **Innovation:** consumers gain directly from innovation and indirectly from policies that encourage innovation;
4. **Fairness:** enhancements to the welfare of ‘most’ consumers must include provisions to compensate those that lose.

Solutions:

1. **Choice:** recognising the importance of choice editors and that more choice is not necessarily the right answer;
2. **Transparency:** recognizing the limitations of information-based approaches;
3. **Innovation:** try to balance short term with long term consumer welfare;
4. **Fairness:** ensuring that those few who suffer deep detriment as a result of a general benefit to many are compensated in some form.

Thus while established consumer welfare/detriment assessments focus on price, a more nuanced consumer detriment would use price as the *primus inter pares* of factors, but would also consider rewards for innovation, transparent market operation, and fairness. The trick must now be to adapt this methodology to specific cases of potential harm or gain for consumers.

Such an approach would form the first stage of an assessment. The second stage should focus on the mechanism for dealing with the problems identified. In essence this would move the consumer detriment problem into potential citizen detriment issues. Or rather it would provide a mechanism for explicitly identifying where such a division might occur.