

The Office of Telecommunications:
Helping consumers benefit from competition
in the telecommunications market



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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executive summary

- 1 The telephone is an integral part of modern life in the United Kingdom and 92 per cent of households have a fixed line telephone. Although the range of telecommunication services has increased in recent years, such as mobile telephones, consumers spent some £7 billion on residential fixed line services in 2002. BT Group plc (BT), the former monopoly supplier, received 70 per cent of this expenditure and is dominant in the market.
- 2 Under the Telecommunications Act 1984 the Director General of Telecommunications, who is the head of the Office of Telecommunications (Of tel), has a duty to promote the interests of consumers in respect of the prices charged for and the quality and choice of telecommunications services. Of tel aims to ensure that consumers get the best value for money and seeks to achieve this primarily by promoting competition. This is supported by regulatory action where, for example, competition is insufficiently established or would not result in basic affordable services for all. Of tel's regulatory action includes facilitating access to BT's network for its competitors, price controls to limit tariff increases, or reduce tariffs over time, and the requirement to provide geographically uniform prices for basic services¹.
- 3 We examined two aspects of Of tel's work that are intended to help consumers benefit from competition in the fixed line market:
 - **Raising consumers' awareness of the choices available to them and how to take up the benefits** (Part 1 of this Report). Many consumers are not taking up the potential benefits from competition in the fixed line telecommunications market. Consumers are ultimately responsible for deciding which telecommunication services to purchase, and from whom. Although suppliers take steps to inform consumers of their own offerings, the market is complex, and Of tel has a more general role in helping to ensure that consumers are aware of the choices available to them and the factors they should take into account in reaching a decision.
 - **Stopping and deterring anti-competitive behaviour** (Part 2). There is a risk that suppliers might take advantage of their position in the telecommunications market. Anti-competitive behaviour can be detrimental to consumers, in the form of higher prices and less choice, and to competing companies, who might be driven out of the market or suffer reduced income. Of tel therefore investigates all complaints of anti-competitive behaviour and other licence breaches, and where appropriate takes action, both informally and through legal enforcement measures.
- 4 Our methodology is at Appendix 1. When considering our specific recommendations, Of tel will need to advise the Office of Communications (Of com), which is due to take over Of tel's functions in December 2003, on any longer term action.

¹ National Audit Office report 'Pipes and Wires', April 2002 (HC723/2001-02): Figure 23.

Helping consumers take up the benefits of competition

5 Our main findings are:

- Consumers need to be well informed to benefit fully from competition. In any market, there is a risk that suppliers' actions alone cannot be relied upon to generate sufficient market awareness to meet the needs of consumers. This risk is significant in the telecommunications market where many consumers are not fully aware of alternative ways of buying telecommunication services. Although some consumers will have good reasons for not choosing the best deal in terms of price, others may be missing savings which they would enjoy if they were better informed.
- Suppliers and other consumer organisations have an interest in raising consumers' awareness of the issues to be considered in choosing a supplier. Oftel, however, has a particular interest in view of its policy of encouraging the development of effective competition, especially as it seeks to move away from direct regulation of consumer prices towards placing reliance on the effective operation of the market to protect the interests of all consumers. It recognises this by making 'well informed consumers' one of its main objectives.
- Since competition was introduced into telecommunications, the markets for gas and electricity have opened up to competition. Oftel's objective and approach have been less pro-active than Ofgem and *energywatch*, the regulator and consumer protection body for gas and electricity, which have frequently encouraged consumers to consider switching supplier. Oftel considers the markets to be substantially different in that in telecommunications there is a much wider range of services and tariffs than in the other utilities and it has more in common with service industries. It believes that differences in the nature of the market, rather than the regulator's approach, can explain differences in the rate of switching by consumers. For example, where consumers have access to a cable service (some 60 per cent of UK households) the level of switching is similar to that in the gas and electricity markets.
- A distinctive feature of the telecommunications market is that the majority of consumers are not well motivated to make changes and are not prepared to switch to an unknown supplier with an unfamiliar brand. Oftel's research has shown that in the residential fixed line market, only BT has a strong brand image and that customers may not trust alternative suppliers. The effort involved in switching may also dissuade consumers from exercising their choice.
- An important feature of an effectively competitive market is access to reliable and good quality information which consumers can use with confidence to make choices between competing offers. Many consumers are not aware of important features of the market, such as indirect access operators, though regular international callers, who are likely to benefit most from this service, do have greater awareness. It is not straightforward for Oftel to measure the adequacy of the information in the telecommunications market and whether existing levels are sufficient to prevent market failure. We found that although consumers can make savings, these are not uniform and are limited to certain areas. It is not easy to identify which consumers can benefit and to quantify the level of savings available. Oftel's starting point is to encourage suppliers and third parties to provide consumers with relevant information and to develop approaches to supplement this information on the basis of its research.





- Oftel has for many years undertaken extensive research into the behaviour of telecommunications consumers, supplemented by less frequent in-depth studies of consumer motivation and preferences. This research has been high quality. Oftel has recognised that this research by itself has not enabled it to make fully informed judgments on the extent to which it should supplement the information already available in the market. During 2002 it therefore sought to develop approaches to profile groups of consumers across the market and to identify and quantify the extent of any detriment that these consumers experience.
- Suppliers offer a wide range of tariffs and discount schemes and we found that it is difficult for consumers to calculate which tariff, from which supplier, would amount to the best deal or an improvement on their existing service. To make a fully informed decision, consumers would need a detailed breakdown of their call profile (the number, type, duration and timing of calls made) which none of the suppliers routinely provide. Suppliers would incur costs in providing such information which would not necessarily be justified by the benefits. Oftel has encouraged the development of price comparison services and endorsed www.phonebills.org.uk which provided a comparison of both direct and indirect access prices. While the participating companies accounted for the majority of revenue in the market, the number of firms represented was disappointing. It was discontinued at the end of 2002 in the light of the development of alternative price comparison sites. Oftel has developed an accreditation scheme to help build consumer confidence in such services. Oftel accredited the first company, *uSwitch.com*, in June 2003. The accredited schemes may, as with the 'phonebills' site, also experience difficulties in obtaining information from suppliers, although the *uSwitch.com* site includes over 20 companies.
- Oftel uses various methods of distributing information to consumers. During 2002 it began to use new, targeted outlets for distributing hard copies of its consumer guides, rather than relying on libraries and offices of Citizens Advice Bureaux and local trading standards services. Oftel also uses the media, especially local radio, as a way of obtaining free publicity for its consumer information. It has also improved its website.
- Oftel has sought to remove barriers to switching supplier. For example, its introduction of number portability enables consumers to keep their telephone number when changing supplier. Oftel is also working to lower the perceived risks of switching by playing a leading role in the setting up of the Telecommunications Ombudsman Service.
- We identified several areas of the market where there might be scope for targeting consumer information. The new approach to research that Oftel has developed has been accompanied by a re-focusing of its efforts, from late 2002, on more sophisticated targeting of information on different groups of consumers, based on its analysis of detriment and potential savings. It hopes that this approach, announced formally in April 2003, will also enable more rigorous evaluation of the impact of its initiatives.

- 6 In summary, Oftel has recognised that in working towards its objective of having 'well informed consumers' it needs to have a better understanding of the underlying drivers of consumer behaviour and to target its resources on improving consumer information. It, and in due course Ofcom, need to build on the useful initial steps that Oftel has already taken to use its 'leverage' as a regulator to encourage initiatives to improve information from within the industry and to provide supplementary sources of information where appropriate, while ensuring that it makes best use of its resources.

- 7 The Chief Executive of Ofcom has stated that Ofcom will be a 'reaching out' regulator that embraces consumer protection through the promotion of effective competition and choice. We consider that the following recommendations, most of which should be relevant to Ofcom as it begins to formulate its own strategy in detail, will be important in helping to achieve this. **Oftel and Ofcom should:**



- **Develop a fuller understanding of the needs and motivations underlying consumers' behaviour** by developing Oftel's existing programme of research work into a more systematic review of the drivers of consumer behaviour. This should build on the survey work we undertook in examining the subject. Oftel should feed the results of its research into its analysis of consumer detriment and its targeting of information. The research should include such factors as geographical location, age and ethnic group.
- **Complete and maintain Oftel's assessment of the extent of detriment suffered by consumers through a lack of information**, and hence identify the opportunities for consumers to make savings or to get more for their money and the types of consumer that can take advantage of these potential benefits. This work should enable it to assess better the need for regulatory intervention and to prioritise resources. Oftel or Ofcom could consider extending this work to include small and medium sized businesses, further sub-dividing residential consumer profiles to aid targeting, and measuring other forms of detriment beyond that arising from a lack of price transparency.
- **Provide, where appropriate, more practical guidance that reaches the consumers it is targeting**, as part of its consumer information strategy. For competition to be effective, Oftel and Ofcom need to actively encourage consumers to think about the way they buy their telecommunication services. In doing so it is important to target more precisely its consumer information initiatives to help ensure that the groups most likely to benefit from these initiatives are reached by way of the most effective communication channels. Oftel and Ofcom should also ensure that the results of its evaluation of the impact of its consumer information work are reflected in revisions to its strategy.
- **Consider how to make it easier for consumers to make choices in the fixed line market**, in particular by:
 - assessing whether the benefits to customers seeking to compare tariffs of having available their detailed call profile are proportionate to the costs of requiring or incentivising suppliers to provide the profile;
 - actively promoting changes to, or the interpretation of, EU legislation that would facilitate the inclusion by tariff and service comparison websites of a wide range of suppliers, and encouraging links between price and service quality sites that provide consumers with a 'one stop' service.

Stopping and deterring anti-competitive behaviour

8 Our main findings are:

- There are risks that the behaviour of telecommunications suppliers may work against competition in the market or be anti-competitive. Oftel is aware of these risks. It initiates its own investigations of potential anti-competitive behaviour and resolves disputes between companies, which may involve allegations of anti-competitive behaviour. In the two years to June 2002, Oftel conducted 187 investigations and found grounds for action in 62 cases (33 per cent), showing the value of such investigations in improving the competitiveness of the market.
- The proportion of investigations initiated by Oftel has fallen since the Committee of Public Accounts last reported in 1998. Oftel considers complaints to be the best indicator of anti-competitive behaviour. In Oftel's view this approach reflects its policy of responding directly to concerns from BT's competitors and of giving more importance to its statutory *duty* to resolve complaints referred to it than to using its statutory *powers* to undertake investigations on its own initiative. This is in line with its commitment to proportionate and targeted regulation. Oftel uses its awareness of market developments and trends in complaints to decide which investigations to initiate.
- Oftel took formal action in 19 of the 62 cases where it found grounds for regulatory action and made Directions and Determinations requiring a particular course of action. It did not make any Orders, which give rights to third parties to claim damages. Nor did Oftel use the stronger remedies available to it under the Competition Act 1998 as it had not found any behaviour that it judged sufficiently serious to justify such action. For the remaining cases, Oftel considered that the matter could be resolved voluntarily (for example, by the company concerned taking an agreed course of action).
- In deciding how to monitor a company's compliance with agreed enforcement action, Oftel makes decisions on a case by case basis depending on the type of action and the risk of non-compliance. Where Oftel considers that there is a risk that the problem will persist, it keeps the case under review and establishes monitoring criteria. Its Compliance Monitoring Unit, set up in April 2000 to strengthen monitoring arrangements, oversees all cases under review. Of the 62 cases where Oftel found grounds for regulatory action, 11 were reviewed in this way.
- Oftel set out in its 2001 Annual Report some types of behaviour it described as anti-competitive behaviour that had persisted from the previous year, but it has not provided an overall assessment of what it has achieved in investigating and stopping such behaviour.
- Oftel has accepted that it needs to speed up its investigations to meet the requirement of a new EU Directive, effective from July 2003, which requires all disputes under the Directive, except in exceptional circumstances, to be completed in four months. For investigations completed in the two year period July 2000 to June 2002, Oftel took, on average, just over six months to complete an investigation, an increase of four weeks (17 per cent) since we last reported on this matter. Significant delays occur during investigations because of re-assignment of cases (due to staff changes), insufficient case planning and management, and delays in receiving expert advice. Oftel took positive, and apparently effective, action to address these issues through changes to its management structure and systems. Performance information from the second half of 2002 shows that, despite opening more cases, the number of investigations taking more than four months fell from 56 per cent to 40 per cent.

- Oftel's internal assessment of the quality of its investigations, that 56 per cent of those completed in the two year period July 2000 to June 2002 were 'good' or 'very good' is supported, in broad terms, by the results of our survey of the companies involved. The companies that responded did not necessarily agree with the outcome of the investigation, and their views on the overall quality of investigations were very mixed, but two thirds of respondents considered that Oftel understood the main issues and that its investigations were thorough.

9 There is scope for Oftel to build on its improvements in stopping and deterring anti-competitive behaviour and to strengthen further its management in this area. Our specific recommendations, which should in due course be applicable also to Ofcom, are:



- **Keep under review the need for a more formal strategy for initiating investigations of potentially anti-competitive behaviour.** Ofcom, which will be a much larger organisation with more varied responsibilities, may have a greater need for a strategy. Oftel and Ofcom should, in addition to their existing activities, therefore consider initiating an internal overview, say every three months, by key staff engaged in identifying and investigating anti-competitive behaviour to identify new risks as telecommunications markets evolve. It is important that their approach provides a strong message to suppliers that anti-competitive behaviour will be quickly identified and rooted out.
- **Ensure that the latest changes in the handling of complaints and management of investigations enable it to complete investigations within four months.** Oftel should formally assess its progress in meeting the new target in August 2003 (once the Directive has taken effect) and again in April 2004 (12 months after the revised arrangements should have taken full effect).
- **Carry out each year a fuller overview of its work in identifying, deterring and stopping anti-competitive behaviour** to provide Oftel senior management with the assurance they need that Oftel is achieving its objectives. The assessment should identify trends in types of anti-competitive behaviour, set out how Oftel's investigations have progressed and how effective its enforcement action has been. It would help regulatory transparency if this assessment were published in its annual report.

