Making communications markets work well for customers

Response to Discussion Paper

12 August 2019

Introduction

Ensuring that customers are treated fairly has become a key issue for regulators and policy-makers in the UK. Sky is committed to, and has proven track record in, delivering first class customer service, which includes treating customers fairly. Accordingly, we share the aspiration of equitable processes and outcomes for consumers.

Nevertheless, fairness is a broad concept and therefore open to wide interpretation. This gives rise to two potential regulatory risks.

First there is a significant risk that delivering 'fairness' is used as a justification for an ever-increasing array of interventions that, however well-intentioned, layer regulatory costs on businesses, which are inevitably passed on to consumers. Ultimately, interventions that are not carefully considered against the normal criteria of being evidence-based, proportionate, and targeted only at cases in which action is necessary, risk worsening outcomes for consumers by restricting competition and diverting firms' resources away from investment in products and processes to the benefit consumers.

Second, the amorphous nature of the concept of fairness potentially increases the regulatory uncertainty faced by firms, which is detrimental to investment, employment and innovation.

Given these risks, we welcome Ofcom's discussion document. It seeks, appropriately, to explain to stakeholders what Ofcom means when it proposes to act based on fairness concerns (as opposed to some other objective, such as economic efficiency). As a result, it reduces the uncertainty faced by Ofcom's stakeholders.

It is also particularly helpful that Ofcom reiterates its commitment to:

> "*continue to operate with a bias against intervention, seeking the least intrusive regulatory mechanisms to achieve our policy objectives, including those relating to fairness, and ensuring that these are evidence-based, proportionate, consistent, accountable and transparent.*"

Similarly, we welcome Ofcom's commitment (consistent with its duties under the Communications Act) to consider the consequences of intervening on fairness grounds before doing so. The examples of potential adverse consequences of intervention aimed at fairness-related objectives set out at paragraph 3.47 of the discussion document are important considerations.

We also welcome the following points in the discussion document:

- Ofcom's recognition that not all 'disengaged' customers are vulnerable.

- Ofcom's commitment to assess practices on a case-by-case basis.

- The recognition that there are benefits associated with differentiated pricing, and that it is not necessarily inconsistent with procedural fairness. (We discuss issues in relation to distributive fairness further below.)

- Ofcom's explanation of the questions it proposes to use to assess fairness issues, which appear to Sky to comprise a sensible and reasonable framework of analysis.

Our specific comments on the discussion document are as follows.

The benefits of differentiated pricing

As noted above, we welcome the fact that Ofcom recognises that differentiated pricing often delivers benefits to consumers. In fact, Sky takes the view that differentiated pricing should be presumed to be at worst neutral in its effects on consumers unless there is good evidence to support a view that it is harmful, either on economic efficiency or fairness grounds. As is often recognised, differentiated pricing is pervasive in modern market economies and generally accepted as fair.[1] Cases in which such pricing raises efficiency or equity concerns are exceptional, particularly where the firms that use differential pricing lack significant market power.

In the discussion of differential pricing in Ofcom's document, Ofcom notes that it "*may be beneficial where it leads to higher output or brings customers into the market who would not otherwise have been able to afford the service.*" This underplays the benefits of price differentiation in two ways:

- it fails to note that differentiated pricing may support the development and provision to consumers of entirely new products that would otherwise be unviable with uniform prices.[2] This is particularly the case in sectors where product development and provision has high fixed costs and low marginal costs of production – which are key characteristics of many sectors of the economy, including television and telecommunications. This critical dynamic benefit of differentiated pricing is often overlooked in discussion of this subject;[3]

- enabling more consumers to buy a product or service via differentiated pricing is not simply a matter of enabling those "*who would not otherwise have been able to afford the service*" to do so.[4] Differentiated pricing encourages more consumers to buy a service (by offering them a price less than their willingness to pay) even if they are able to afford higher prices.

It is also surprising that Ofcom's comments on differentiated pricing all come under the heading of *procedural* fairness. Price differentials have the potential to raise

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1 See, for example, 'The importance of differential pricing for good consumer outcomes in telecoms', Communications Chambers, May 2019. (http://static1.1.sqspcdn.com/static/f/1321365/28145679/1560928074137/Consumer+Outcomes+2.01.pdf?token=jy6Tzh%2FKMGkF5kE28dS95VCGQoI%3D)

2 As noted by Simon Bishop: "*Price discrimination is likely to be welfare enhancing in those industries which are characterised by high fixed costs but low marginal costs. When marginal costs are close to zero, any positive price provides the firm with a contribution to fixed costs. But if the firm charges all consumers a low price (i.e. below average cost), it will not be able to cover its fixed costs. Moreover there may be no uniform price that allows the firm to recover these costs. In such instances, price discrimination provides a mechanism whereby fixed costs can be recovered. In this case, if price discrimination were to be prohibited, the supply of the product would simply not be forthcoming, with concomitant adverse effects for consumers.*" Chapter 3 in *The Pros and Cons of Price Discrimination*, Konkurrensverket Swedish Competition Authority, 2005. (Available online at: http://www.konkurrensverket.se/globalassets/english/research/the-pros-and-cons-of-price-discrimination-9356kb.pdf.)

3 We recognise that in principle this benefit could be considered to fit within the category of 'higher output'. However, we consider that expanding the set of products and services available to consumers is sufficiently distinguishable and important as a benefit of differentiated pricing to be identified separately.

4 Emphasis added. This proposition is repeated at paragraph 3.12 of the discussion document.

issues of distributive fairness - for example, if, for some reason, higher prices for important necessities are all paid by poorer consumers with better off consumers paying lower prices. Indeed, we consider that this is potentially the most important reason why differential pricing might be considered problematic on fairness grounds.

The issue of 'behavioural biases'

We consider that the discussion of consumers' 'behavioural biases', and how companies interact with them, is the weakest part of the discussion document, and warrants further careful consideration by Ofcom. In places the discussion document gives the impression that Ofcom considers that it is inherently unfair for companies to identify and act upon 'biases' in the ways in which consumers make decisions.[5]

We doubt that this is what Ofcom intends. It is not always unfair for companies to behave in this way. And if this approach were followed, it would lead to unsustainable levels of regulatory intervention, given that it is rare that selling products and services to consumers does *not* involve firms recognising, responding to and shaping the ways that consumers make decisions, whether at the point of purchase or by influencing consumers' preferences more generally (for example, via investment in brands and persuading them of the merits of particular types of product).

To take one simple example, firms invest significant amounts in the design of their corporate logos. In doing so, whether explicitly or implicitly, they take advantage of a range of different behavioural 'biases', such as the fact that peoples' brains prefer pictures over words.[6] There is nothing unfair to consumers in firms investing in well-recognised logos that are a key part of their brand.

One problem underlying discussion of this issue is the pejorative use of the term 'bias'. The term derives from deviations in the way that consumers make decisions in reality, often subconsciously, from a highly stylised economic model of decision-making that was always based on unrealistic assumptions (such as consumers having perfect information, engaging in conscious rational optimising behaviour etc.) and the predictions of which are now known to be wrong. Although the term has become common currency, it is somewhat perverse to label deviations from a flawed model as 'biases' – with the implication that they are somehow abnormal or erroneous behaviour. In Sky's view, it is preferable in such discussions simply to refer to consumers' actual decision-making processes.

Firms have always sought to create and market products to consumers based on their knowledge of how consumers *actually* behave and make decisions. In the modern world there is a much deeper understanding of consumer behaviour and decision-making, often drawing on the output of research in the fields of, psychology, neuroscience and behavioural economics, among others. At the same time, vast increases in the ability to generate and analyse large datasets, as well as the ability to use technology to address particular groups of consumers (at the limit,

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5 For example, Ofcom states: "*Provided there is no procedural unfairness* ***and firms' practices do not exploit behavioural biases*** *... we will usually be less concerned about purely distributive fairness between non-vulnerable customers*". (Emphasis added.)

6 For a discussion of cognitive influences on design of brand logos, see Jonathan La Greca and Dr. Dan Young, 'Behavioural Science Brand Building', ResearchLive, 19 February 2019. (https://www.research-live.com/article/opinion/behavioural-science-brand-building-/id/5049912).

individual consumers), have led to ever greater sophistication in product development and marketing practices.

Sky considers that it is inappropriate to take a view that all activity of this type is inherently problematic. Nor, given its pervasiveness, could it ever be realistic to take a view that regulators should seek to target all activity by firms that seeks to take advantage of 'behavioural biases'. It is a basic principle of good regulation that rules should be implementable and defensible. An approach to 'behavioural biases' as broad as that which Ofcom's discussion document appears to adopt is neither of these.

We consider that what Ofcom actually intends here is that *particular forms* of firms taking advantage of the ways in which consumers make decisions are potentially problematic from the point of view of fairness of outcomes or processes. If this is the case, we consider that the discussion document would benefit from a clearer specification of those forms of marketing activity and/ or approach to service provision that Ofcom considers may be problematic.

Finally, in relation to price differentiation, Ofcom states:

> "*However, discrimination may be unfair. For example, where there is a lack of transparency, for example because providers hide some tariffs from customers,* ***or where behavioural biases are exploited***." (Emphasis added.)

We do not consider that it is reasonable or appropriate to take the view that differentiation may be unfair simply on the basis that it exploits 'behavioural biases'; it is not difficult to envisage circumstances in which firms 'exploit behavioural biases' in order to price differentiate, with the differences in prices paid by different groups of consumers being fair.

The framework in Figure 1

As noted above, we consider that the analytical framework set out in Figure 1 of the discussion document is sensible and reasonable. The one oddity, however, is the inclusion of the issue of offsetting benefits ("*such as market expansion through low price offers*") under the heading of "*who is being harmed?*". The issues of (i) who is being harmed and (ii) whether there are offsetting benefits are distinct. The latter should be a specific question to be addressed, and therefore appear in the first column of Figure 1 – for example posed as a question: "*What is the extent of the offsetting benefits?*"

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