BEHAVIOURAL BIASES OF CONSUMERS AND COMPETITION POLICY

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Abstract: *Conventional Principles of Competition Policy have to recognise that consumers are human beings and are thus not always guided by standards of rationality on which economic theories of market behaviour are based. Consumers would have their limitations when accessing, assessing and acting on information and such limitations can be exploited by the firms bringing distortions in the Competition Policy and its efficacy. Competition authorities would be required to include in their interpretation of the Law the principles of behavioural economics and consequent behaviour of the consumers. Simultaneously, advocacy provision would need to be accompanied by the development of case studies and relevant material towards making consumers conscious of their biases affecting their negotiating position in market.*

In the Discussion Note on "Competition Policy, Economic Growth and Corruption,"[1] a reference has been made to the observation of Prof. Laffont[2] spelling out boundary conditions as a prerequisite for ensuring perfect competition in Markets. Some such prerequisites identified by Prof. Laffont are: no public goods, no externalities, no information asymmetries, no natural monopolies, fully rational economic agents, etc.

Office of Fair Trading (OFT)[3] observes that traditional models of markets have assumed economic agents that can be classified as '*Homo Economicus*,' rather than as Homo sapiens. *Homo Economicus* has infinite capacity to take in and process information; is neutral to how things are presented; can anticipate and take the future into account; cares only about self-maximising; and treats gains the same as losses.

Proponents of behavioural economics assert that in many ways real economic actors differ from *Homo Economicus*. Homo sapiens can store only a limited amount of information; are taken in by how things are presented; tend to be poor in anticipating the future; care about other people and fairness; and care more about losses than gains. In short, Homo sapiens

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[1] Sardana, M.M.K. (2011), "Competition Policy, Economic Growth and Corruption", a Discussion Note DN1104, February, http://isid.org.in

[2] Laffont, J.J. (1998), "Competition, Information and Development," Annual World Bank Conference on Development Economics, 1998, Pp. 237–57.

[3] Bennet, Mathew, John Fingleton, Amelia Fletcher, Liz Hurley and David Ruck (2010), "What Dues Behavioural Economics mean for Competition Policy?" U.K. Office of Fair Trading, March.

exhibit systematic biases in the way they view both—the world and the markets. One should not conclude that in the reckoning of behavioural economists, the consumers make random choices in a chaotic manner. Rather the behavioural biases exhibited by consumers are systematic and are often bounded by rational decision-making.

The New Economics Foundation (NEF)[4] has identified seven key principles which affect the options of consumers, taking into account the psychological response of consumers in real life situations. These key principles are:-

1. Other people's behaviour matters: People do many things by observing others and copying; people are encouraged to continue to do things where they feel other people approve of their behaviour.
2. Habits are important: People do many things without consciously thinking about them. These habits are hard to change—even though people might want to change their behaviour, it is not easy for them.
3. People are motivated to 'do the right thing': There are cases where money is not the motivating factor as it undermines people's intrinsic motivation, for example, you would immediately stop inviting friends to dinner if they insisted on paying you.
4. People's self expectations influence how they behave: They want their actions to be in line with their values and commitments.
5. People are loss-averse and hang on to what they consider 'theirs'.
6. People are bad at computation when making decisions: They put undue weight on recent events and too little on far off ones; they cannot calculate probabilities well and worry too much about unlikely events; and they are strongly influenced by how the problem/information is presented to them.
7. People need to feel involved and effective to make a change: Just giving people the incentives and information is not necessarily enough.

Real world situations are determined by humans and also to be faced by them. Though, for the sake of convenience of developing economic theories, assumption may be made that humans would behave in a way to maximise gains for themselves; many among these species are driven by a value system which may dictate them to be altruistic and sacrificing. Individuals are always in learning and imbibing mode and are also 'habit-forming'. Further a large number goes the way others are going and gives preference to group choice rather than their own.

In the light of the above, the classical Competition Policy which presupposes among other things, that the absolute rationality with the consumers and suppliers has to accommodate the nuances of behaviour of the consumers and suppliers. Behaviour biases would take a place alongside other well known market failures such as market power, asymmetric

[4] The New Economic Foundation (NEF) (2005), "Behavioural Economics – Seven Principles for Policy Makers," 22 September 2005.

information and externalities, the implications of which are now well understood and incorporated in economic thinking[5.] Similarly while applying the principles of competition policy, the capacity and the positioning of consumer to access, assess and act on information would have to be determined. Application of principles of behaviour economics would re-emphasize the fact that markets cannot blindly be assumed to solve everything.[6]

The key to empowerment of consumer towards making appropriate choices in market would be enhancing his capacity towards: (a) Accessing Information, (b) Assessing the information, and (c) Acting on information and analysis. The capacity of the consumer to access, assess and to act would depend upon his ability to perform the due diligence at each stage which may or may not be within his temperament. Generally he would be governed by the seven principles stated in preceding paragraphs rather than arriving at the most rational choice. Even the firms, being professionally aware of biases of consumers, have reasons to exacerbate and exploit these biases at every stage of the decision-making process. OFT[7] has identified five frames through which prices are communicable to the consumer and thus the true price is left to be derived by the consumer in a complex manner. Besides, firms further complicate the matters by creating hidden costs beyond the competitive upfront price in the form of add-on services, tariff structures, etc., making actual price searching harder. In such a scenario, the consumer finds it fairly cumbersome to compare various offers and his decision-making is distorted. The firms also build up price barriers in levying higher switching costs and also adopt various modes keeping the consumer hooked even though he starts realising that he is not getting services commensurate to the costs paid by him.

In such a scenario, the overall objective of the competition policy gets squarely compromised. Playing on biases, the not so efficient firms continue to stay in the market by hooking a large consumer base by presenting low upfront prices and further making their exit difficult by imposing high cost on switching out options. On the other side, the firms which operate on efficient and equitable principles get outsmarted because they lose out to less efficient firms at the initial stages of luring the customers. In the ultimate, it may affect innovation adversely as the firms which would have the wherewithal to effect innovation are squeezed out.

[5] Bennet *et al*., *op. cit*.
[6] *Ibid*.
[7] *Ibid*.

Competition Authorities in European Union have integrated the Principles of Behavioural Economics in their recent interpretations on market Dominance and its abuse through the mechanisms of predatory Pricing, Tying/Bundling, Refusal to Deal, and Creation of Unfair Trading Conditions[8].

Competition Commission Act, 2002 in India has sufficient flexibility enabling the Competition Commission of India to interpret the relevant market of products, taking into consideration the overall economic scenario to cure the adverse effects on competition because of exploitation by firms of the biases of the consumers by passing appropriate directions in specific cases to set a tone. Through its role of administering the advocacy provisions of the Act, market studies and investigations need to be encouraged by the Commission enabling the consumers to have professional analysis of the information contained in the offer of the firms intending to play on the biases of the consumers.

Educating consumers may go a long way in restoring the balance, and, further interpretation by the Commission of the provisions of the Act in the scenario of actual situations in relevant market would take care of various concerns arising out of biases. It needs to be re-emphasised that even the problems arising from behavioural biases will be solved by the action of market participants themselves. The players on supply side themselves would create market conditions for their survival with matching upfront prices and tariff structures to expose the players who have hooked the consumers in the first instance by playing on their biases. The Commission can give their findings on the reasonableness of the costs of switching of services and impress on bringing more transparency in the price framing aspect.

[8] Petit, Nicolas and Norman Neyrinck (2010), "Behavioural Economics and Abuse of Dominance: A Proposed Alternative Reading of the Article 102 (TFEU – Case Law)," Global Competition Law Centre, Belgium.