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Behavioural economics and customer complaints in communication markets

Report commissioned by the Australian Communications and Media Authority as part of the *Reconnecting the Customer* public inquiry

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EXECUTIVE SUMMARY

This executive summary has been taken from the report *Behavioural economics and customer complaints in communications markets,* prepared by Dr Patrick Xavier.

The full report is available at **engage.acma.gov.au/reconnecting**.

This report examines the extent to which insights stemming from behavioural economics can contribute towards explaining the drivers of consumer dissatisfaction that are manifesting in consumer complaints. The report also highlights how these insights can assist in identifying operational policy and regulatory measures to facilitate best/good practice customer service and complaints-handling within the (tele)communications sector.

There is now already substantial (recent) literature on behavioural economics and insights from behavioural economics but relatively little on how governments/regulators have been drawing on these insights to improve consumer protection, especially in telecommunication markets. Accordingly, a major aim of this report is to conduct a 'stocktake' of initiatives in this regard. It identifies efforts made in Europe by the European Commission (EC), the Body of European Regulators of Electronic Communications (BEREC), the UK Office of Fair Trading (OFT), the UK Better Regulation Executive (BRE) and National Consumer Council (NCC), the UK Office of Communications (Ofcom), the UK telecommunications regulator, the United States government, and the Organisation for Economic Co-operation and Development (OECD).

Some of the insights about actual consumer behaviour and consumer biases identified by behavioural economics are particularly relevant to the telecommunications market. They may help to explain why some consumers may be making or not making decisions to switch service provider and to enter particular types of contracts that are contributing to the detriment/ dissatisfaction that leads them to lodge complaints. Issues the perspective of behavioural economics explore, include:

- **Choice overload** - consumers have to compare too many products and features leading to confusion, random choice, or even failure to make any choice.
- **Heuristics** – consumers often take short cuts (e.g., by following rules of thumb such as what others say/do) when the decision environment is complex relative to their mental and computational capabilities.
- **Endowment** – consumers value something more once they have owned it than before they own it and may be reluctant to give up what they have. They may stay with the present service provider e.g., the incumbent, because of misplaced loyalty and/or a failure to acknowledge poor choices in the past.
- **Defaults** – a *default inertia* may operate in favour of an 'opt-in' default since making a decision to 'opt-out' takes more effort than to 'opt-in' e.g. an 'opt-in' default would automatically extend a mobile phone or broadband contract unless the customer expressly 'opts-out'.
- **Hyperbolic discounting** – consumers and service providers may tend to be short-sighted when making decisions overvaluing immediate costs or benefits against future costs or benefits.

- **Framing biases** – consumer choice is influenced by the 'frame' in which information is presented; presentation of the same information in a different 'frame', can lead to a different decision.
- **Risk/Loss aversion –** the preference for avoiding loss is widely considered to be greater than the preference for gain. Part of the reluctance to 'switch' from one supplier to another may be due to the fear that experience with a new supplier is unknown and may be worse.

The above concepts are explored in greater detail throughout the body of the report in terms of their implications for customer complaints and complaints handling in the telecommunications sector. The report flags a number of areas requiring particular consideration by government/regulators and industry in their efforts to improve customer service and complaints-handling.

Implications of behavioural economics for policy and regulation
Behavioural economics helps in explicating why people sometimes fail to act in their own best interests and the myriad, and often complex, processes underpinning decision-making. It urges that behavioural outcomes of policy initiatives be considered. Behavioural economics does not necessarily counsel heavy-handed 'paternalistic' consumer protection regulation. In fact, many of the benefits from incorporating the insights of behavioural economics might be realisable without strong paternalism. A sensible approach would be to seek to install relatively less intrusive measures that inform and 'nudge' more informed, empowered, consumers towards better decisions (e.g., through the use of greater transparency and information disclosure and default options that recognise behavioural tendencies), without unduly raising service provider compliance costs or costs on other customers.

Regulation of information disclosure
A basic problem in many markets is 'information asymmetry' – service providers have more information than consumers who have inadequate information upon which to make good 'efficient' decisions. Even in competitive markets, suppliers will possess market power if consumers are not well informed about products, supply alternatives, and feel unable/unwilling to switch between these alternatives. But behavioural economics adds another consideration to the information asymmetry problem. Even if consumers do have enough information, they might still make 'sub-optimal' decisions because of behavioural tendencies. To begin with there is the risk of 'information overload' that could result in confused consumers and worse decision-making. This was already recognised in conventional economic analysis but a "behavioural" perspective places more emphasis on this limitation. It emphasises that to empower consumers in making the pro-competition framework more effective, *better* (not necessarily more and indeed, perhaps less) information disclosure is required in a structured, easily comprehensible, format. Thus, disclosure should be simple and recognise e.g., that consumers frequently do not go beyond the advertised 'headline' price or, indeed, read the entire contract, particularly the qualifications and limitations in fine print. Behavioural economics underlines the importance of making use of 'smarter information' – thinking carefully about its framing, the context in which information is read, and the ability of consumers to understand it.

In regard to the focus of this report, a basic question is whether service providers are relatively careless about customer complaints because they believe that customers are relatively unconcerned about customer service in choosing a service provider (and that their competitors' customer service is worse anyway?) and that once contracted, customers are ‘locked-in’ by high switching costs, and other factors pointed to by behavioural economics e.g., the ‘endowment’ factor. If service providers believe consumers do not search for, or, in any event, do not seem very concerned about choosing a service provider that delivers good customer service, there is less incentive for them to go to the trouble and expense of providing good service. In fact, there may be a disincentive for them to do so. If consumers make purchasing decisions relatively unconcerned about the quality of customer service, or on the expectation that the service provider will provide an “average” standard of customer service (no worse than that of other service providers), a telecommunications service provider that invests in superior customer service is not rewarded with an improved market share. Indeed, because it needs to charge a higher price to cover the higher cost of better quality service, it either loses market share or it retains market share but with a lower profit margin. In the longer term, it will seem to make economic sense to simply let customer service decline. In the converse situation, a firm with below average customer service retains market share and does so with better margins, and has little incentive to improve customer service. [1]

In this context, there may be a case for regulatory involvement by way of requiring adequate, appropriately presented, information disclosure in a manner that consumers are more likely to take note of and that would increase incentives for improved customer service performance. For instance, the publication of customer service performance metrics could help in this regard, as discussed below.

In regard to measures concerning transparency and information disclosure, a number of suggestions are identifiable from the insights of behavioural economics:

- the information should be aligned with service provider incentives where possible, such that providers support the objectives of the measure
- the behavioural outcomes sought should be clear to the policy maker
- the information provided should be ‘framed’/presented in a manner that is simple and of value to providers and consumers and should provide sufficient incentive for providers and consumers to change their behaviour beneficially
- the information requirements should fit with the wider pro-competition regulatory system and also with existing regulations concerning information requirements
- government publication of more regulatory information should serve to provide an incentive to drive best/good practice customer service behaviour by service providers, including through concerns about ‘reputational impact’.

Special attention to information needs of vulnerable customers would likely benefit other consumers as well. Poor product choice resulting from inadequate/misleading information and complex products and services tend to have a disproportionately adverse impact on vulnerable disadvantaged consumers. Therefore the design of information disclosure should have the vulnerable in mind, especially because disclosure that does this will benefit other consumers as well since most, if not all, consumers want simplified better presented information.

Facilitate switching to strengthen incentives for service providers to improve customer service. The ability and willingness of consumers to switch service provider is critically

[1] The discussion on this issue draws on arguments in Akerlof, G (1970), The Market for “Lemons”: Quality Uncertainty and the market Mechanism” *Quarterly Journal of Economics*. Vol. 84. August, pp. 488-500. Available at http://ideas.repec.org/a/tpr/qjecon/v84y1970i3p488-500.html

important in harnessing competitive pressure to help improve customer service. If switching is difficult, costly, discouraged or impeded, customers would be ‘locked in’ and this would limit the incentive/pressure on service providers to provide best practice/improved customer service in order to dissuade customers from migrating to another supplier. Regulators could consider requiring that service providers ensure a simple, cheap and quick transfer of consumers who choose to switch provider, including e.g., limits on the “lock in” period in contracts and reduction of ‘early exit penalties’. There may be objections to measures to reduce switching costs[2] just as there were concerns raised regarding number portability (that proved to be largely unfounded). There may well be some costs, but these costs will have to be balanced against the benefits of the measures for consumers and more generally for effective competition (including the dynamic efficiency effects of investment and innovation that this competition brings).

Consider use of ‘cooling-off’ periods during which customers can break contracts without penalty (as in the case of failure to deliver promised/advertised broadband speeds).

Consider use of ‘opt-in’ defaults where the consumer has to express a desire for data roaming service, or to extend a contract that would otherwise terminate, rather than an ‘opt-out’ default that would extend the contract if the customer takes no action. [3]

Enhanced TCP Code provisions. The regulator could seek to enhance the Telecommunications Consumer Protection (TCP) Code, but in this regard the evidence from experience is that industry has not demonstrated a commitment to comply with the Code. Thus, if this approach is to be used, the Code will have to be significantly strengthened, signatories widened and compliance ensured by robust enforcement. And stronger incentives would have to be installed for service providers to comply with the Code. Those who sign up to the Code and commit to its provisions could be ‘accredited’ publicly in a manner that would commercially advantage them in the market. Such commercial advantage is more likely if consumer decisions are influenced by the Code. There would be more prospect of this if a succinct summary of the Code is freely available in stores etc., with links provided to web sites that could provide more details regarding the Code. Publicity that praises service providers delivering good customer service performance /Code compliance could also increase the incentives/rewards involved.

Mandate a Customer Service Charter. As in the case of the TCP Code, the question here is whether industry will demonstrate a commitment to comply with such a Charter. A Charter would help to focus consumer attention on their rights. This could be assisted e.g., through a succinct summary of the Charter made freely available in stores etc. For service providers, a Charter would focus attention on agreed customer service standards. But for the approach to

[2] The Australian Government has said that it will ban exit fees on home loans taken out from the middle of 2011. But Westpac Banking Corporation has criticized the move arguing that it would make it harder for small lenders to compete. See Glenda Korporal (2011) “Kelly slams home loan exit fee ban” *The Weekend Australian*. March 5-6, 2011.

[3] A change from ‘opt-out’ to ‘opt-in’ may not be without its critics. For instance, in regard to such a change in relating to contracts for the provision of financial advice, concerns have been expressed by the Australian Financial Services Council (which represents mainly large retail funds and financial adviser networks), that this would result in a massive churn of clients rather than support long-term relationships between clients and advisers. In the Council’s view: “An opt-out proposal puts the onus on the adviser to deliver value and clients can stop at any time if they don’t think they are getting value for money.” And according to media reports the Federal Government may be having second thoughts. Jennifer Hewett (2010), “Canberra may axe super proposals”. *Weekend Australian Newspaper*. 29 January 2010.

be effective, it will need to be supported by an enforcement framework with sufficient penalties for non-compliance. Compensation payments to customers for breaching the Charter is likely to be effective in this regard and, moreover, is also likely to draw and sustain consumer interest in the Charter.

Mandate standards for advertising, marketing or promotions, including restrictions on use of terminology; 'headline' broadband speeds. This approach would help in addressing an underlying cause of consumer complaints i.e., not clearly understanding a product or service, and thereby result in less complaints. There would be increased compliance costs for providers, but these costs have arisen from poor customer service and need to be considered/ balanced against the benefit derived from reduced consumer complaints and detriment.

Mitigate risk of 'bill shock' by mandating expenditure management tools. 'Bill shock' complaints could be reduced through a requirement that expenditure management tools be provided to consumers e.g., an SMS/e-mail alert when a customer nominated expenditure/usage has been reached, 'opting-out' of voice or data roaming or premium mobile services (PMS).

Install a performance reporting framework which includes customer service metrics. A performance reporting framework that includes customer service metrics will focus more attention on customer service. It could assist consumers to include this aspect in the decision-making process if the information is presented in a way that is useful for consumers. Research conducted by behavioural economists suggests that information based on public reporting on service performance may not significantly influence consumer behaviour. However, about 17% of customers surveyed in a study for the ACMA said this was a factor they took into account when choosing a product or service.[4] This is a significant proportion. If these customers do make choices and are able and willing to switch on the basis of customer service, there could be pressure exerted on service providers to provide improved service. Moreover, better, more transparent and quickly accessible information about customer service performance could expand the number of customers who might take it into account in choosing a provider.

A customer service performance reporting framework seems likely to provide incentive for service providers to improve customer service and complaints-handling practices by creating "benchmark competition" incentives. The costs of compliance should be considered, of course, since this could be high. Moreover, choice of the performance metrics to be monitored and rewarded is crucially important and the information collated should be measurable, comparable and meaningful. It would be sensible if the metrics to be used are selected by the regulator in consultation with service providers and also consumer organisations. And it would be important to pilot/'road test' the use of such performance metrics.

Incentives for improvement in customer service would be stronger if results were made public so that they have reputational impacts on the service providers. This would result in a needed strengthening of the reward for good customer service and, conversely, penalty for poor service, including escalating fines for repeat offences and 'name and shame' impacts.

[4] 'Community Research into telecommunications customer service experiences and associated behaviours', ACMA Report May 2011

And the incentive would be stronger still if the rewards to senior management (including the CEO) and staff are aligned with performance in this regard.

The approaches discussed above are non-exclusive. That is, the use of a number or all of the options discussed above could contribute to improving customer service and complaints-handling performance.

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