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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Global Forum on Competition

**HIGH SWITCHING COSTS: A BARRIER TO COMPETITION AND A DETRIMENT
TO CONSUMERS**

Note by Ms. Jill Johnstone

-- Session VI --

This note is submitted by Ms. Jill Johnstone, Director of Policy, UK National Consumer Council under session VI of the Global Forum on Competition to be held on 21-22 February 2008 (available in pdf format only).

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switched on to switching?

a survey of consumer behaviour and attitudes, 2000–2005

by Alena Kozakova

About the National Consumer Council

The National Consumer Council (NCC) makes a practical difference to the lives of consumers around the UK.

With changes in provision of services by government and companies, there is apparently more choice, and more talk about meeting consumers' needs. Yet the rhetoric does not always match people's experience: markets can operate in ways that act against consumer interests; and consumers who are disadvantaged or vulnerable can be ignored.

The NCC uses its insight into consumer needs to advocate change. We conduct rigorous research and policy analysis to investigate key consumer issues, and use this to influence organisations and people that make change happen. We don't just respond to policy discussions, but shape future debate through our groundbreaking thinking.

An open and collaborative organisation, we seek to work with public service providers, businesses and regulators. We hold regular policy forums, which provide us with a unique opportunity to exchange views and test our thinking.

Our relationship with the Department of Trade and Industry – our main funder – gives us a strong connection within government. But we are ready to challenge any organisation, public or private, that does not give consumers a fair deal.

We have linked organisations in Scotland and Wales, and a close relationship with colleagues in Northern Ireland. We play a leading role within European and worldwide consumer groups, ensuring that cross-border consumer issues are tackled and the consumer voice is heard within global institutions.

Please check our website at www.ncc.org.uk for our latest news.

We can often make our publications available in Braille or large print, on audio tape or computer disk. Please contact us for details.

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About the research

The NCC's survey into consumer switching updates a survey carried out for the Department of Trade and Industry in 2000 by FDS International Ltd – *Switching suppliers*. In March/April 2005, FDS undertook a similar survey for the NCC, conducting 1000 Computer Assisted Telephone Interviews with households in Britain. Sample sizes were around 400–500 for each product field.

The 2005 research examined the same six markets: gas, electricity, fixed telephony, home (building) insurance, current accounts and mortgages. It also examined switching levels for mobile telephony and savings accounts.

The research provides an insight into how patterns of consumer switching have changed over the past five years and how consumers' views of switching has evolved.

Notes: Home insurance covers building insurance. However, 93 per cent of these customers also have home and contents insurance with the same supplier. In all graphs, figures have been rounded to nearest percentage.

Definition of social grades

The grades detailed below are the social class definitions used by the Institute of Practitioners in Advertising, and are standard on all surveys carried out by MORI.

A	Upper middle class	Higher managerial, administrative or professional
B	Middle class	Intermediate managerial, administrative or professional
C1	Lower middle class	Supervisor or clerical and junior managerial, administrative or professional
C2	Skilled working class	Skilled manual workers
D	Working class	Semi-skilled and unskilled manual workers
E	Those at the lowest levels of subsistence	State pensioners, etc, with no other earnings

Summary and recommendations

When markets function properly, consumers can identify which product is best for them and switch if they want to get a better deal. This, in turn, encourages companies to compete vigorously to retain current customers and attract new ones. It ensures that companies cut costs and innovate in order to offer products that meet consumers' needs at low prices. Switching has a particular importance in newly liberalised industries, where it helps to stimulate competition. However, markets do not always function properly, and consumers may be unable to switch providers or benefit from switching. In these cases, prices will remain high and product innovation and quality low.

Key findings

A positive picture

Our research findings paint a broadly positive picture. In most markets, switching levels increased between 2000 and 2005. As our Active Consumer Index shows (see figure 1), overall switching levels reached 152 per cent of the 2000 levels. We conclude that many consumers seem to have understood that they can often increase their welfare by changing suppliers. Suppliers also seem to have understood that their customers have become more demanding, and if they don't offer them a good deal, they will lose them. However, regulators still

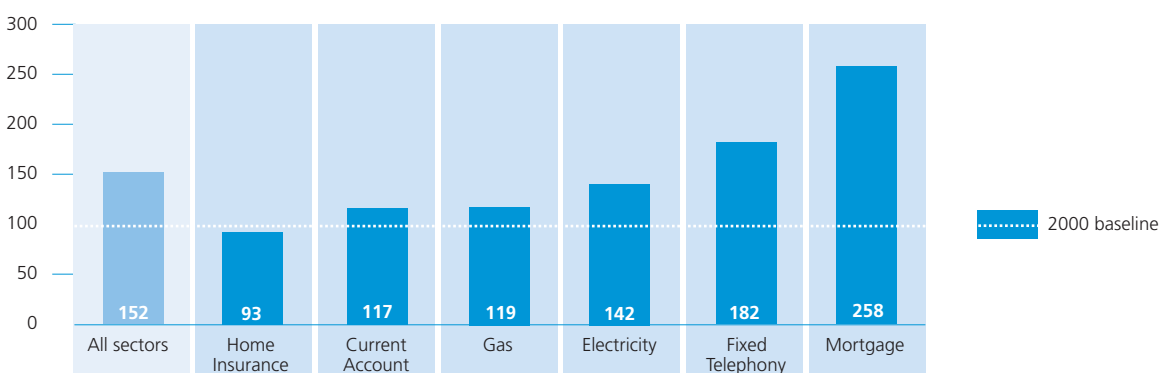
have work to do to facilitate switching, prevent abusive business practices and convince many consumers of the potential benefits of switching.

Switching trends

- Since 2000, switching levels have increased in all markets except insurance.
- A large number of consumers in the energy, fixed telephony and mortgage markets have understood the potential benefits of switching, as levels have risen considerably in these sectors.
- However, in some areas, such as banking and fixed telephony, switching levels are still very low.

- The number of consumers considering switching has decreased in most markets, except for fixed telephony and current accounts, where they remain unchanged.
- In many markets, demographic groups differ in the degree to which they switch. The younger and wealthier usually switch more than older or poorer consumers.
- A large proportion of consumers still seem to be unaware of the benefits of (or, worse, the possibility of) switching, or think the financial benefit of switching is outweighed by the time and effort it takes to do so.

Figure 1: The Active Consumer Index, comparing switching levels in 2000 and 2005 (levels for 2000 are set at a baseline of 100)



Consumer behaviour

- Consumers claim that switching and comparing packages is easy. Those who switched believe that they made the right choice. However, consumers still find it relatively hard to switch in certain markets – in particular in banking.
- Consumers have a set of priorities that influence their switching behaviour. Financial benefit is only one of them and may not always be the most important.

Barriers to switching

Our research suggests that there are still some barriers to switching. The NCC believes the most important deterrants include these top five lock-in practices:

- 1. Lengthy and cumbersome switching procedures** can make it inconvenient for consumers to switch and outweigh any potential benefits.
- 2. Early exit charges**, imposed by an existing provider, can reduce the benefits of switching (as is often the case in the mortgage market).
- 3. Confusing products and non-transparent pricing** can make it difficult or time-consuming to compare deals (this often occurs with mobile telephony and financial products).
- 4. Technical incompatibility of equipment** can make it uneconomical for consumers to switch (for example, if they cannot use a blocked mobile phone with their new provider).

5. Long-term deals can lock consumers into lengthy relationships with their providers (as may occur with home insurance and mobile telephony) and increase the risk of them being overcharged.

Considerations

We acknowledge that switching data must be analysed with care and alongside other factors influencing the market. There is no optimal level of switching and consumers do not automatically benefit as a result of switching, as has been demonstrated by Catherine Waddam Price's and Chris Wilson's recent study of energy markets¹.

Likewise, consumers who have not switched will not necessarily be worse off. The incumbent provider may happen to offer the best deal for their particular circumstances. Sometimes a mere threat of switching may bring about a reduction in a consumer's bill.

In addition, high switching levels do not automatically signify that a market is competitive. First, if pricing is unclear and products complex, price differentials and subsequently switching can occur over a long period of time, without the market becoming more competitive. Second, if companies co-ordinate their behaviour to keep prices high, the market will not be competitive, regardless of switching levels. Third, high switching levels can conceal certain undesirable activities, such as mis-selling and market churning.

Conversely, low switching levels do not automatically indicate that markets are not competitive. Indeed, once price differentials have been exhausted through intensive switching, and prices have been driven down to a competitive level, only limited switching can occur. However, in such circumstances, the market is most likely to be competitive.

Finally, certain groups of consumers – in particular vulnerable consumers – may be completely left out of the switching process, because from a suppliers' point of view, it is not profitable to compete for them.

NCC recommendations

- Regulators should continue to promote the benefits of switching and act to remove switching barriers. Our list of the top five lock-in practices highlights the most important of those barriers. They should also take action against rogue practices, such as mis-selling and pressurising, and be vigilant about potential market churning.
- Regulators should pay particular attention to those groups of consumers who might be excluded from the competitive process and devise remedies which would ensure that these consumers can also benefit.
- Banks should ensure that barriers to switching bank accounts are removed. Should banks fail to remove these barriers within two years, the government should legislate in order to confer new regulatory powers to the Financial Services Authority.

Switching trends, 2000–2005

In 2000, the Department of Trade and Industry's *Switching suppliers*² found that while switching was under way in some markets, in others only a limited number of consumers were switching providers to get a fair deal. In an attempt to gauge whether consumers have been more active in the past five years, the NCC's 2005 research provided comparable data in gas, electricity, fixed telephony, home insurance, current accounts and mortgages. We also collected data in two new markets: mobile telephony and savings accounts. Our findings reveal that, in general, consumers are increasingly choosing to switch providers. But there are still areas where there is cause for concern.

Changes in switching behaviour

Since 2000, switching levels have increased in all but one of the surveyed markets (see figure 2). The most significant increases took place in the mortgage market (an impressive increase of 158 per cent), fixed telephony (an increase of 82 per cent) and electricity (an increase of 42 per cent). Switching in the gas and current accounts markets has increased by a smaller amount (19 per cent and 17 per cent respectively). Home insurance was the only market in which the number of consumers switching has decreased (by 7 per cent).

However, not all markets set off from the same starting point. In 2000, switching was well under way in the gas, electricity and the home insurance markets. But it was slower to take off in other markets, such as fixed telephony, current accounts and mortgages. From this perspective, the 82 per cent increase in switching in fixed telephony has not been sufficient for the market to catch up with more dynamic sectors, such as mortgages. The current accounts market still registers only limited switching (only 7 per cent in 2005, up from 6 per cent in

2000), and it has experienced no major change in consumer attitudes over the last five years.

Both of the new markets surveyed – savings accounts and mobile telephony – experienced only limited switching. Seven per cent and 17 per cent of consumers, respectively, have switched provider.

Figure 2: Percentage of consumers who switched or considered switching in 2000 and in 2005

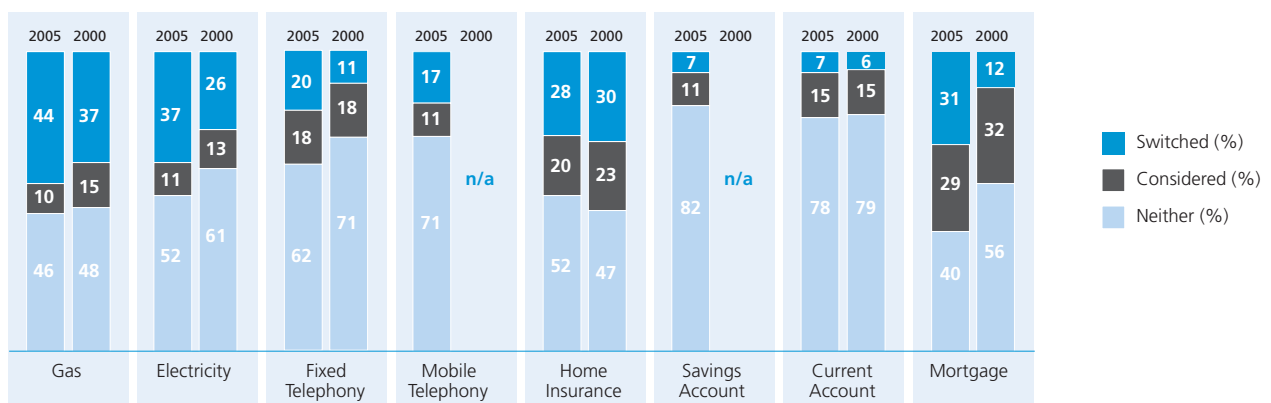


Table 1: Percentage of consumers switching or considering switching (by demographic sub-group)

	AB	C1	C2	DE	16-34	35-54	55+
Gas	45	46	43	42	44	44	43
Electricity	40	44	38	40	33	41	36
Fixed telephony	25	18	20	17	24	20	17
Mobile telephony	19	18	19	15	33	15	7
Home insurance	41	32	22	20	35	31	32
Savings accounts	6	8	9	5	10	8	6
Current accounts	6	10	5	6	10	9	4
Mortgage	39	29	29	22	40	31	16

Demographic patterns

In many markets, switching is not distributed evenly between different demographic sub-groups (see table 1). In the home insurance and mortgage markets, for instance, the richest consumers are twice as likely to switch suppliers as the poorest consumers.

Moreover, in most markets, switching levels decline as consumers grow older. In the mobile phone market, for instance, consumers between 16 and 34 are

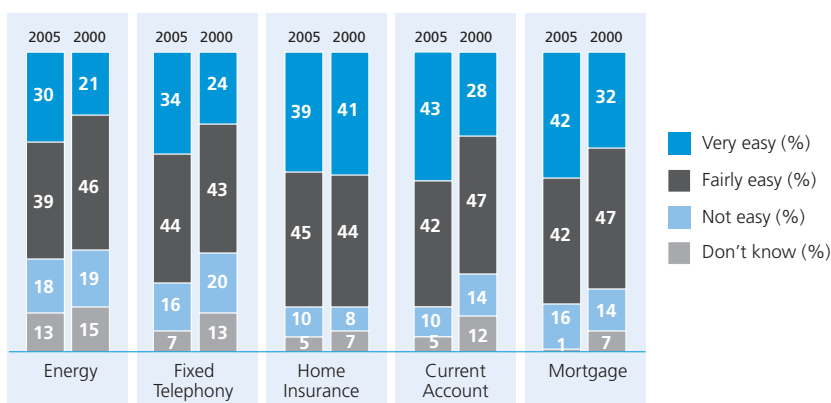
almost five times more likely to switch their supplier than consumers aged 55 and above. In the current accounts and mortgage markets, consumers between 16 and 34 are two and a half times more likely to switch than consumers above 55. Similarly, in the home insurance market, the richest consumers (socio-demographic group AB) are twice as likely to switch their provider as the poorest consumers (socio-demographic group DE).

Finding out what companies offer

As in the 2000 research, most consumers claim that it is easy to find out what companies have to offer (see figure 3). There has been an increase in consumer confidence, most notably in the current accounts market, where the number of consumers saying it is very easy to find out what companies offer has risen by 54 per cent. Similarly, in the energy and fixed telephony markets, more than 40 per cent more consumers believe that finding out what companies offer is very easy.

The only exception to the rule is the home insurance market. In this market, the overall assessment of how easy it is to find what companies offer remains practically unchanged, with five per cent fewer people believing that it is very easy.

Figure 3: How easy do consumers think it is to find out what companies offer?



Expected financial savings

Since 2000, there has been little change in consumers' expectations as far as financial savings are concerned. Most consumers still believe that they can achieve only minor savings through switching (see figure 4). In the energy, fixed telephony and current accounts markets, only a fraction of consumers believe that they could achieve substantial savings through switching.

The mortgage market continues to be the exception to the rule. Here,

a large proportion of consumers believe that they can make major savings through switching supplier: 41 per cent of consumers believe that they can make major savings (an increase of 21 per cent since 2000).

Finally, in the home insurance market, the situation is quite the reverse. A significantly lower number of consumers (a decrease of 35 per cent) believe that they could achieve major savings through switching.

Consumers' experience of switching

There have been few changes in the consumer experience of switching over the last five years (see figure 5). The overwhelming majority of consumers still find switching either very easy or fairly easy. There were also few changes in the trends across markets. In fixed telephony, there was an increase of 16 per cent in the number of consumers who said that switching was very easy. In home insurance, five per cent fewer consumers found switching very easy. Switching in the current accounts market continues to be the most problematic. Indeed, there has been a sharp increase of 64 per cent in the numbers of consumers who perceive switching in this market to be difficult.

The majority of consumers (at least 70 per cent across all surveyed markets) who switched their provider would switch again. However, when we consider all consumers – including non-switchers – the picture is less clear (see figure 6). When asked whether they would switch if it were free and simple to do so, large numbers of consumers said they wouldn't. If we take into account that a large proportion of the switching consumers responded positively, we can conclude that a large majority of the non-switching consumers feel no need to switch and are less likely to switch in the future.

This may point to a large group of consumers who are unaware of the benefits of switching or who simply do not believe that there are advantages to be gained. Alternatively, given that most consumers generally expect only minor savings from switching, many consumers may decide that

Figure 4: What level of savings do consumers believe can be achieved by switching?

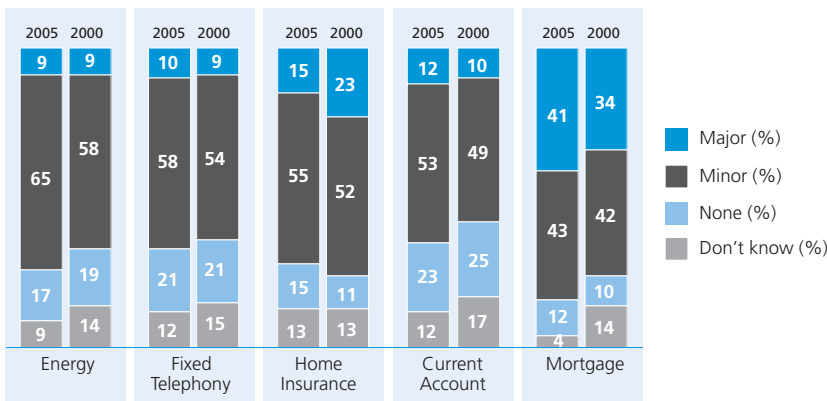
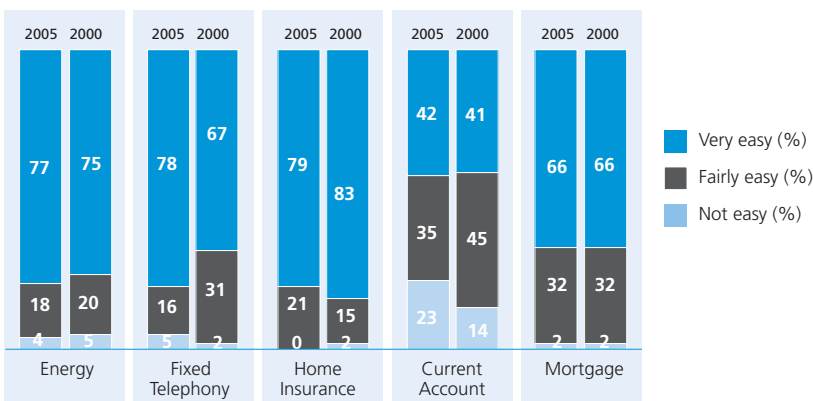


Figure 5: How easy have consumers found it to switch?



the time and effort it takes to switch cancels out the expected financial benefit.

The current accounts market is, again, the least dynamic market. Here, only 37 per cent of consumers say that they would switch if it were free and simple – a 16 per cent increase on figures from the 2000 research. The mortgage market is the most dynamic market, with 61 per cent saying they would switch – an increase of 24 per cent since 2000. Finally, the home insurance market is the only market in which the number of consumers saying they would switch dropped (by 6 per cent).

Commentary

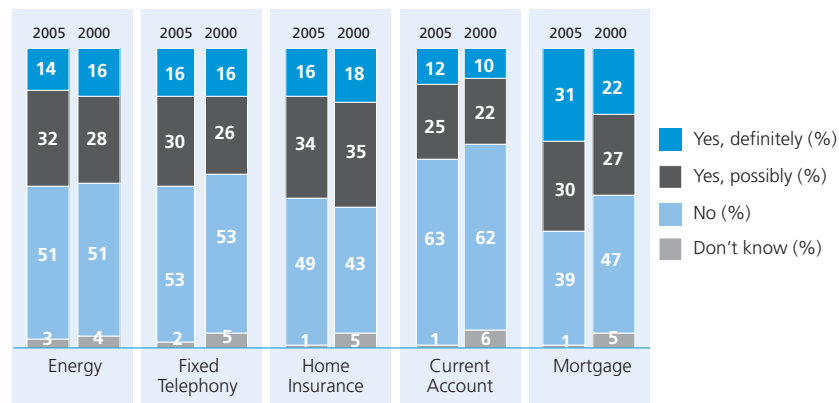
The results of our survey show an encouraging trend. In all but one market switching levels have risen since 2000. Moreover, consumers find it easy to find what companies offer, and they consider the switching process to be straightforward.

However, the switching results were not consistent across socio-demographic groups, and in certain markets (such as mortgage or mobile telephony) there are clear variations. We believe that providers may use this knowledge to price discriminate against those consumers who are less likely to switch, while offering better deals to those they are more likely to lose.

Gas and electricity

The energy markets are the most active: gas retained its position as the market with the highest levels of switching, and electricity has become the second most active

Figure 6: Would consumers switch if it were free and simple to do so?



market. These results are certainly encouraging. However, given how little time consumers spend researching alternative offers before switching (see Time commitment, page 10), we fear that they may not always benefit as a result of it. This analysis seems confirmed by a recent study of the energy markets³ showing that large numbers of consumers are ‘over switching’ and ending up with a worse deal.

Mortgages

The mortgage market has registered the most significant increase in switching levels and consumers’ expectations of savings to be made. Moreover, the numbers of people who consider switching and who would actually switch if it were free and simple are higher than in any other market. This is not surprising, since mortgages weigh particularly heavily on consumers’ finances, and it is a market in which there are significant price differentials.

However, the mortgage market is also the market where switching levels vary most dramatically across age and income groups. Indeed, the richest consumers are almost twice as likely to switch supplier as the poorest, and younger consumers are two and a half times more likely to switch as older consumers. This may suggest that the poorer and older consumers are being left with worse products than the younger and richer.

It is, however, necessary to be cautious when interpreting these results. For instance, older consumers usually have had their mortgages for a longer time and, consequently, have a smaller sum left to repay. They may, therefore, perceive switching to be less urgent than younger consumers who have larger sums of money left to repay and a longer period to go before they finish paying their mortgage. Similarly, wealthier consumers will generally be able

to obtain larger mortgages than poorer consumers and may, therefore, be more interested in switching to reduce the costs of their mortgages.

Current accounts

The current accounts market has remained the most static, with a significantly lower proportion of consumers switching to alternative providers than in the other markets included in the survey.

This market also registers the lowest number of people who would agree to switch if it were free and simple. This result might partly be explained by consumer inertia or conservatism and partly by consumers having difficulties in identifying the benefits of switching in this market.

Conservatism and the lack of awareness of potential switching benefits may also explain the relatively high levels of consumer satisfaction with existing current account providers. It is important to note, however, that consumers in this market have had more negative experiences of switching than elsewhere, which could indicate the existence of switching barriers.

Home insurance

Developments in the home insurance markets call for vigilance. Since 2000, levels of switching have dropped by seven per cent, the number of consumers willing to switch if it were free and simple has dropped by six per cent, consumer perceptions of the ease of finding out what companies offer have dropped by five per cent and consumers' expectations of making major

savings have dropped by 35 per cent. On the one hand, the reduction in switching could indicate that the potential switching benefits in this market have been reduced. On the other hand, it could indicate that consumers are being locked into longer-term relationships through a system of benefits based on contract renewal – or that consumers simply believe that such offers will be available if they stay.

Moreover, the home insurance market is the market where the distribution of switching levels across income groups is the most uneven. The richest consumers are twice as likely to switch as the poorest. This may be explained, at least in part, by the fact that richer consumers own more expensive property and pay more expensive insurance. They may, therefore, make potentially larger savings through switching.

Mobile telephony

Switching is limited in the mobile telephony market. This may be the consequence of high switching levels over the past few years leading to a reduction in current switching potential. Many mobile phone companies have improved customer retention through various marketing strategies, such as offering existing customers deals that are as good as those for new customers. This market also continues to be a 'young person's' market, with younger consumers being almost five times as likely to switch than older consumers.

Savings accounts

Finally, as with mobile telephony, the savings account market experiences limited switching. Consumer inertia and difficulties in identifying what benefits there are in switching seem to play a similar role as in the current accounts market.

Consumer views and attitudes

What are the key factors driving a consumer's decision whether to switch provider? How do consumers like to find out information about what's on offer from different providers? And once a consumer has decided to switch, how long are they prepared to spend looking around to get the best deal? Unsurprisingly, our research revealed that most consumers want to avoid unnecessary inconvenience. But there are variations in the attitudes of people from different demographic groups.

Avoiding hassle

The majority of consumers believe that life is too short to worry about saving a few pounds here and there, while virtually all are keen to avoid unnecessary inconvenience. Consumers also generally dislike being approached by sales representatives. However, at the same time, a large majority of consumers claim to shop around to get the best possible deal (see table 2).

Most consumers also like predictability. Our research further revealed that a significant majority of consumers believe that it makes sense to use a well-established, familiar company. Across all the markets surveyed, on average, 70 per cent of consumers believe that it makes sense to use an established familiar company rather than a new company offering a better deal. This conviction was strongest in the current accounts market (75 per cent), and weakest in the mobile telephony market (62 per cent). In the mortgage, current accounts and home insurance markets there has been a slight shift away from this belief since 2000, while in the other markets, it has been reinforced.

Table 2: Consumer beliefs

	Agree %	Disagree %	Neither %
I am happy for sales reps to call me about products and services I use	22	72	6
Life's too short to worry about saving a few pounds here and there	55	39	6
I like to shop around to get the best possible deal	77	17	7
I like predictability	86	8	7
I am very keen to avoid unnecessary hassle	95	2	3

Demographic variations

Consumers' attitudes often vary according to their demographic characteristics (see table 3). For instance, younger consumers are more willing to be approached by sales representatives and to shop around for the best deal than older consumers. Conversely, older consumers are more likely to believe that life is too short to worry about saving a few pounds here and there.

Richer consumers are less willing to be approached by sales representatives and more often disagree with the proposition that life is too short to worry about saving a few pounds here and there. However, a significant majority of consumers in all demographic groups seem to value predictability, and virtually all want to avoid unnecessary inconvenience.

Table 3: Consumer beliefs by demographic group

	16-34 %	35-54 %	55+ %	AB %	C1 %	C2 %	DE %
I am happy for sales reps to call me about products and services I use	32	23	17	16	16	25	32
Life's too short to worry about saving a few pounds here and there	42	57	61	50	53	58	58
I like to shop around to get the best possible deal	86	81	67	78	79	80	73
I like predictability	85	88	85	89	84	83	89
I am very keen to avoid unnecessary hassle	93	96	94	97	95	94	94

Balancing thought and practice

Some consumer views appear to be contradictory – or at least impossible to achieve fully at the same time. For instance, it is hard to imagine that consumers, who believe that life is too short to worry about saving a pound here and there (55 per cent), are keen to avoid unnecessary inconvenience (95 per cent) and prefer a familiar company to a new one offering a better deal (70 per cent), would dedicate too much time and energy to shopping around to get the best deal (77 per cent). There may, therefore, often be a difference between what consumers believe is the economically rational thing to do – shop around to get the best possible deal – and the most desirable thing to do – avoid unnecessary inconvenience or stay with a familiar brand.

We could also conclude that consumers may often value the

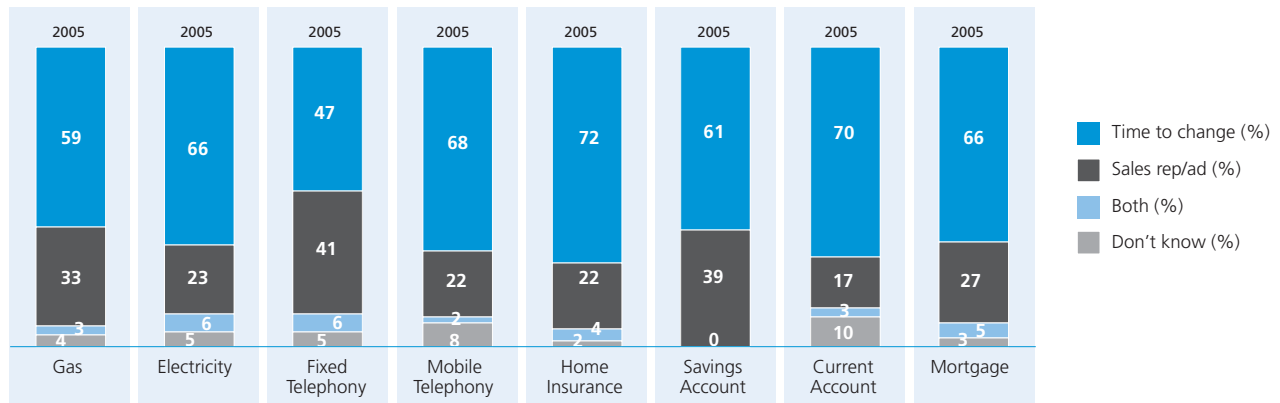
time and effort required for switching more than the potential benefits. While consumers think it easy to switch or find out what companies offer (see figure 3 and figure 5) and while, in principle, they consider shopping around for the best deal a sensible activity, in reality they may think that the time and effort it takes to switch outweigh the perceived benefits (see figure 4 and figure 6).

Reasons for switching

Even though most consumers dislike being approached by a sales representative, in many cases, a sales representative prompted their decision to switch (see figure 7). The triggering effect of sales representatives and advertisements on consumer switching is most significant in the fixed telephony, savings accounts and gas markets. It has the least effect in the current accounts market.

The willingness to be approached by sales representatives varies significantly according to the social groups. The poorer and the younger consumers are twice as likely to be willing to be approached by sales representatives as the richer and older consumers (see table 3). However, while sales representatives play an important role in triggering switching, they can also engage in undesirable sales techniques, such as pressurising and mis-selling.

Figure 7: Why do consumers switch providers?

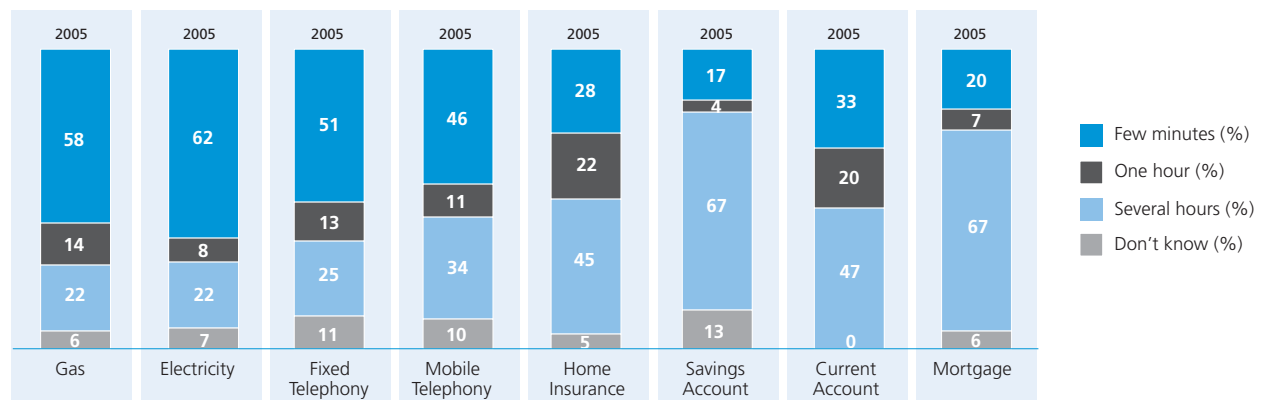


Time commitment

The desire to avoid inconvenience may cause consumers to spend little time researching available products prior to switching. The time spent looking around varies considerably across sectors. In the utility markets, the majority of consumers make their switching decision within an hour, with most of them deciding within a couple of minutes. In the financial markets, most consumers spend an hour or more considering their options before reaching a decision (see figure 8).

The difference between the time spent on researching alternatives prior to switching in the financial and utility markets may be explained by the different level of importance consumers place on these products. However, the disparity could also be caused by variations in the availability and comparability of information about products on offer. Even though consumers say they think it is easy to find out what financial companies offer, the time they spend looking around may suggest otherwise.

Figure 8: Amount of time spent looking around before switching



Conclusion

All the surveyed markets, with the exception of the insurance market, have registered an increase in the levels of switching since 2000. Consumers feel more confident about finding what companies offer and are positive about their switching experiences. However, with the exception of the mortgage market, consumers do not expect to make major savings through switching.

- **The mortgage market has become the most dynamic market**, while the current accounts market continues to be the most static. The home insurance market is the only market in which virtually all switching indicators declined.
- **Financial benefit is only one of a set of priorities that influence consumer switching behaviour.** It is not always the most important one. For example, consumers may be aware of the savings that they could make by switching, but may nevertheless be unwilling to dedicate even limited time and energy to choosing an alternative supplier for certain products.
- **Consumers generally believe that finding out what companies offer is easy.** However, given how little time they generally spend researching alternatives prior to switching, it is possible that they do not have sufficient knowledge of products they are purchasing or indeed of alternative products available in the markets.
- **Consumers generally dislike being approached by sales representatives.** However, in many markets sales representatives, together with advertisements, are an important influencing factor in a consumer's decision to switch.
- **There are significant differences in switching levels and consumer behaviour according to demographic groups.** For instance, older and poorer consumers often switch less and believe that life is too short to save a few pounds here and there.
- There seems to be a large proportion of consumers who are either **unaware of the benefits or possibility of switching or feel that the time and effort it takes to switch outweigh the expected financial benefits.**
- In theory, active consumers improve competition in the market, which in turn benefits all consumers, including the inactive consumers. In practice, however, suppliers are unlikely to automatically offer all existing customers the same benefits as new customers. We fear, therefore, that **inactive consumers are at risk of becoming a target for price discrimination.**

The future

The NCC is pleased to see that the levels of switching and consumer confidence about the switching process have increased in most markets. However, we have also identified several worrying tendencies, such as a large number of consumers who seemed to be left out of the switching process. We are also concerned that many consumers who have switched may not have benefited from it or could possibly have got a better deal. We will, therefore, continue to monitor these markets and remain vigilant about potential abusive business practices.

References and notes

1. **Wilson, Chris and Waddams Price, Catherine, Centre for Competition and Regulation and School of Management, University of East Anglia, CCP Working Paper CCR 05-4. *Irrationality in consumers' switching decisions: when more firms may mean less benefit*, 2005.**
2. **Department of Trade and Industry Consumer Affairs Directorate, *Switching suppliers*, 2000.**
3. See reference 1.

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