

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 3: Horizontal concentration in PCWs

Introduction

1. Price comparison websites (PCWs) have grown in popularity in recent years, reflecting increasing Internet usage and following high-profile advertising campaigns. Consumers are attracted to these sites in order to search quickly and to be able to compare across a range of private motor insurance (PMI) policies online (as well as other goods and services). PMI providers are incentivized to participate on the sites in order to reach potential customers.
2. The services of PCWs are 'free' to consumers in the sense that they do not pay to search. However, each time a consumer purchases a PMI policy, the PMI provider (ie insurer or broker) pays a cost-per-acquisition (CPA) fee.
3. PCWs are a significant sales channel for new business, both for those purchasing PMI for the first time and for those switching from their previous provider.
4. There are four large PCWs, which together constitute the vast majority of sales via this channel: Comparethemarket, Gocompare, MoneySupermarket and Confused.
5. In our statement of issues, we said that we would consider whether the level of concentration in PCWs gave rise to competition concerns. Such concerns may arise if the level of concentration results in one or more PCW having market power, which could allow that PCW to charge higher CPA fees to PMI providers. High CPA fees might, in turn, be passed on to consumers in the form of higher insurance premiums.

Summary

6. PCWs compete to win customers through advertising and marketing, by providing access to a wide range of competitive PMI policies and by offering a good customer experience. Of these, advertising and promotions appear to have had the biggest impact on the relative success of PCWs, giving rise to rapid changes in the share of supply between PCWs.
7. The direct impact of advertising campaigns and promotions appears to have been driven by consumer behaviour as many consumers have shown little loyalty to a particular PCW and have tended to compare policies on multiple websites and alternative channels, eg on PMI providers' own websites and by telephone. However, it appears that customers are, on average, shopping around less as the proportion of new customers (ie those using a PCW for the first time) declines, which suggests that the focus of competition between PCWs might change, from attracting new customers to encouraging further purchases from previous customers. Overall, though, it appears that the costs for consumers switching between PCWs are low and customers are probably still willing to switch PCWs if the offering of the PCW they currently tend to use declined.
8. PCWs compete with other sales channels to attract some customers but it appears that a large proportion (around half) of consumers who use PCWs use no other sales channel.
9. PCWs also compete to attract insurers and brokers to offer quotes on their websites, and to get exclusive pricing and promotional offers (both of which make the PCW more attractive to consumers). PCWs compete to attract PMI providers by offering access to potential customers, charging low CPA fees, and providing additional information and data services.

10. The ability of PMI providers to constrain the CPA fees charged by PCWs depends on their relative bargaining position with respect to PCWs. It appears to us that this depends on three factors:
- the relative importance of the PCW for the PMI provider: PCWs are an important source of new business for PMI providers and most PMI providers would lose sales by delisting from any of the four large PCWs;
 - the relative importance of the PMI provider for the PCW: there is some evidence that large or specialist PMI providers are in a better bargaining position than other PMI providers; and
 - customer behaviour: PMI providers are less reliant on a PCW if its customers shop around other PCWs or sales channels (or if they would if premiums rose).
11. Overall, it appears to us that the four large PCWs have some bargaining power against PMI providers as PMI providers believe that they would lose a significant volume of sales by delisting from any of the large PCWs. However, there is also evidence that PCWs face constraints in their ability to raise CPA fees to PMI providers. For example, large PMI providers typically pay lower CPA fees than small PMI providers (although the negotiating power of PCWs may still lead to an increase in CPA fees to PMI providers on average). Moreover, CPA fees are constrained by the possibility that many consumers shop around and PMI providers may be able to reach potential customers via other PCWs or sales channels. It appears to us that the constraint from other retail channels will depend on the proportion of customers who shop around and the relative cost to the PMI provider of using these other channels (eg selling direct). It will also depend on the scope and coverage of any Most Favoured Nation (MFN) clauses (see the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers').

12. The results of our survey of PMI policyholders (see the working paper ‘Survey report’) show that a relatively low proportion (10 per cent) of consumers searched on only one PCW and did not shop around further (ie ‘single-homing’). This would suggest that, for a PMI provider, each of the four large PCWs has approximately 2.5 per cent of potential PMI consumers who may not be reachable except through that site. In our view, since 97.5 per cent of potential customers are available through other PCWs or other sales channels, this suggests that a PCW may be constrained in raising CPAs.
13. However, we note that, of PMI consumers who last shopped around on a PCW (rather than all PMI consumers), 37 per cent only checked prices on a single PCW. This suggests that, for a PMI provider which only sold via PCWs, each of the four large PCWs would have approximately 9 per cent of potential consumers who may not be reachable except through that site. While higher than the proportion of all consumers, we consider that this is still a relatively low proportion. We also note that the proportion of ‘single-homing’ customers is likely to be higher in the presence of MFNs as more searching is less likely to result in finding a better deal.
14. We also found that CPA fees have risen only slightly during recent years, at near or below the rate of general inflation, while at the same time, PCWs have become a more important sales channel and the propensity for consumers to shop around has declined. Overall, it appears to us that this is consistent with PCWs having faced some constraint when setting their CPA fees.
15. We found that there is some evidence of the existence of barriers to entry or expansion for PCWs, including the use of MFN clauses and the substantial sums the four large PCWs spend on advertising. Also, we found little to suggest that the four large PCWs are constrained by the prospect of new entry.

16. We examined the profitability of [X] PCWs and found that, in aggregate, they had achieved an operating profit margin of around 25 per cent over the last three years. We did not conduct a more detailed analysis of their profitability but, in our view, this finding could be consistent with [X] PCWs having some bargaining power against PMI providers.
17. Overall, it appears to us that the four large PCWs have some bargaining power against PMI providers, derived from the fact that some consumers 'single home' and only search for a PMI policy on one PCW. However, a high proportion of consumers shop around and most PMI providers can utilize other sales channels to reach these consumers. In our view, it does not appear that horizontal concentration alone is likely to give rise to significant market power and is unlikely to be a major source of consumer detriment.
18. Nevertheless, it does appear to us that there are other factors arising from the nature of competition between PCWs which might cause consumer detriment, notably the existence of some wide-scoped MFNs in contracts between PCWs and PMI providers. The effect of these clauses may be to increase PCW market power by, for example, limiting price competition (reducing the incentives for consumers to shop around) and raising barriers to entry (see the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers').

Background

19. PCWs have grown in popularity in recent years, reflecting increasing Internet usage and following high-profile advertising campaigns. Consumers are attracted to use these sites in order to search quickly and to be able to compare across a range of PMI policies online (as well as other goods and services). PMI providers participate on the sites in order to reach potential customers.

20. PCWs have emerged as a significant sales channel for PMI, and account for an estimated 23 per cent of all PMI policies sold and between 54 and 56 per cent of new PMI business.¹ Furthermore, Aviva told us that a high proportion of customers used PCWs to search and compare PMI policies, even if they then purchased their preferred policy elsewhere, eg directly from the PMI provider.
21. As recognized by the OFT,² when operating effectively, PCWs enable consumers to compare products, reduce the amount of time spent searching and comparing PMI policies, increase price transparency and can potentially increase price competition. They may also be a cost-effective way for PMI providers to reach large numbers of potential customers.
22. The services of PCWs are 'free' to consumers in the sense that they do not pay to search. However, each time a consumer purchases a PMI policy, the PMI provider (ie insurer or broker) pays a CPA fee which ranges from £[£] to £[£].³
23. There are currently four large PCWs: Comparethemarket, Gocompare, MoneySupermarket and Confused.
24. We considered whether the level of concentration in PCWs gave rise to competition concerns. Such concerns may arise if the level of concentration results in one or more PCWs having market power, which could allow that PCW to charge higher CPA fees to PMI providers, which might, in turn, be passed on to consumers in the form of higher insurance premiums. On the other hand, if large PCWs benefited from

¹ Source: Datamonitor.

² 'Price comparison websites: trust, choice and consumer empowerment in online markets' (OFT 1467).

³ Range based on CPA fees charged by the four largest PCWs. PCWs may also provide additional services such as online display advertising and supply of data and information services. We noted, for example, that MoneySupermarket provides PMI providers with information and analysis on their brand's performance on the website.

economies of scale, they might face lower costs, which could be passed on to consumers in the form of lower CPA fees and lower insurance premiums.

25. In this paper, we consider the extent of concentration in PCWs and the effects of this concentration. We consider how PCWs' bargaining power against PMI providers might harm consumers and whether there is any evidence that consumer harm exists.⁴

How could concentration in PCWs harm competition?

26. We considered two ways in which a lack of competitive constraints on the behaviour of PCWs could harm competition.
27. First, we considered if PCWs could raise CPA fees to PMI providers. In the presence of market power, PCWs may use their bargaining position with PMI providers to charge higher CPA fees than they would in the presence of greater competition, ie if there were a larger number of alternative PCWs through which PMI providers could sell. This issue is the focus of this paper.
28. Second, we considered if PCWs could reduce the quality of services to consumers. A PCW with market power could reduce the quality of its services to consumers by, for example, investing less in maintaining and developing its website. This could impact several aspects of its service, including the speed and/or reliability of its website, the sophistication of its search functionality and how up to date and/or thorough is the information provided to consumers. However, it appears to us that PCWs face a strong incentive to attract high numbers of consumers in order to remain attractive to PMI providers, and internal documents supplied to us by PCWs supported this view,

⁴ We discuss other possible competition issues related to PCW in other working papers. We consider the effect of the MFNs in the contracts between PCWs and PMI providers in the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers'; and we consider the effects of the integration of some PCWs with some PMI providers in the working paper 'ToH 5: Vertical relationships involving PCWs'.

highlighting the importance of competition to win consumers via marketing strategies and by maintaining the quality of customers' experiences using their websites.

Therefore, we do not consider this issue further.

29. In this paper, we focus on the constraints PCWs face in charging PMI providers higher fees (or imposing other price restrictions).
30. We noted that there were two ways in which higher CPA fees might harm consumers:
 - (a) they might be passed on to consumers in the form of higher insurance premiums; and
 - (b) a PMI provider might choose to delist from the PCW or might limit the types of customers for which it is willing to quote through the PCW. In this case, a consumer may face higher search costs or miss out on the most suitable policy.

Extent of concentration between PCWs

31. As shown in Table 1, PMI search activity and PMI purchases on PCWs are concentrated in four providers: Comparethemarket, Gocompare, MoneySupermarket and Confused.

TABLE 1 **Share of PMI search activity and PMI policies sold**

PCW	<i>Per cent who searched Datamonitor (2012)*</i>	<i>CC consumer survey†</i>	<i>Policies sold 2012‡</i>
Comparethemarket	67	42	[X]
MoneySupermarket	48	23	[X]
Gocompare	43	45	[X]
Confused	49	17	[X]
Other	5	13	N/A

*Percentage of consumers who used each PCW, based on those consumers who purchased via a PCW. Source: Datamonitor's General Insurance Consumer Survey 2012.

†Respondents were asked which PCW(s) they looked at when they last compared insurance providers or policies. PCWs included within 'Other' were: Call & Compare, Compare NI, Google, Money Saving Expert, Quote Zone, Tesco Compare, uSwitch and several others.

‡Source: data provided by PCWs.

32. The discrepancy between the Datamonitor results and the results of our survey (see the working paper ‘Survey report’) in relation to search behaviour is likely to reflect the different sample groups surveyed. While the Datamonitor results show the behaviour of consumers who purchased their PMI policy using a PCW, the results of our survey show the behaviour of consumers who searched on at least one PCW the last time they compared PMI providers, but who may have made their purchase of PMI through another sales channel.
33. We asked the PCWs about which firms they perceived to be their competitors. The four large PCWs [✂].
34. We reviewed some of the internal documents of the four large PCWs and found that [✂].
35. The low proportion of searches made on PCWs other than the four large PCWs and [✂] suggests to us that the small PCWs may represent a weak constraint on the behaviour of the four large PCWs.
36. We considered the intensity of the competitive interaction between the four large PCWs, with respect to both competition for consumers searching for PMI policies and competition to attract PMI providers.

Competition for consumers

37. We considered both competition for consumers between PCWs and competition between PCWs and other sales channels.

Competition between PCWs

38. We reviewed some of the internal documents of the four large PCWs, and some publicly available information, and noted that PCWs appear to compete against each other to attract consumers by, among other things:

- marketing and advertising: each of the four large PCWs tries to create an awareness of its service and a strong brand through:
 - television advertising;
 - online search engine optimization and paid advertising; and
 - non-price promotions, such as free toys and Nectar points;
- providing access to a wide range of PMI providers and price-competitive PMI policies: in particular, policies which are of lower, or at least equal, cost to those available through rivals; and
- offering a good customer experience: the websites are designed to make a customer journey easy and to minimize the number of steps through which customers have to go before getting a quotation.

39. We considered how the market shares of the four large PCWs had changed in recent years as an indicator of the extent of rivalry between them. Figure 1 shows the results, indicating that there have been significant movements in market shares over the last five years.

FIGURE 1

Share of policies sold via PCWs, 2006 to 2012

[✂]

Source: [✂].

40. We found that Confused's internal documents indicated that changes in shares of supply had been driven by the success (or failure) of marketing campaigns and promotions. These documents noted, for example, that:

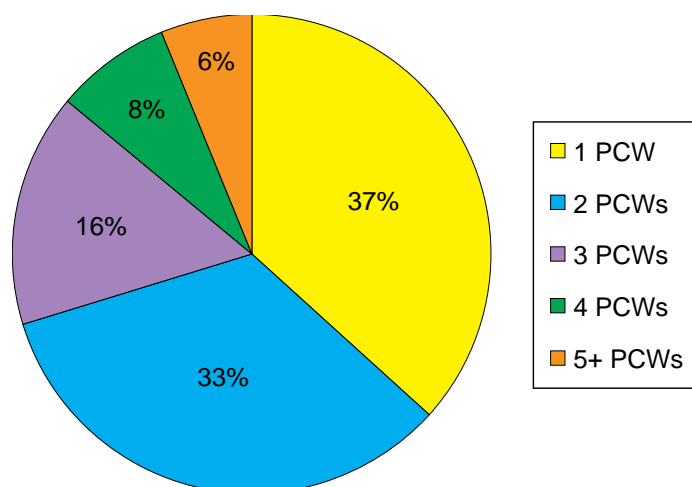
- Gocompare became the most-used PCW in 2009 after launching the Gio character in its advertisements; and
- Comparethemarket increased its market share after launching its meerkat commercials, later becoming the most-used PCW after launching its meerkat toys promotion in 2011.

41. It appears to us that the significant impact of advertising campaigns and promotions in driving consumer behaviour is indicative of a lack of consumer loyalty to any specific PCW. We noted that MoneySupermarket's board observed in February 2010 that 'price comparison sites appear to fall out of consumers' consciousness quickly when they stop advertising their services on TV'. Similarly, Confused's board observed that 'there is no innate loyalty to price comparison sites – customers often can't remember which site they used, or even if they used a price comparison site'.
42. Successful marketing campaigns may attract consumers to search on a PCW but our survey of PMI policyholders found that 63 per cent of the customers of PCWs search on multiple PCWs, as shown in Figure 2 (see working paper 'Survey report'). On average, consumers searched on 2.2 PCWs the last time they shopped around for PMI.⁵ As noted in a business plan presentation from Confused, the propensity for consumers to shop around appears to have been driven by the fact that they 'see little, if any, difference between the price comparison sites in terms of performance or customer experience.'

⁵ Similarly, MoneySupermarket told us that consumers searched on an average of 2.8 PCWs before making a purchase decision and its internal strategic plan noted that [3X] per cent of enquirers compared two aggregators or more.

FIGURE 2

How many PCWs did consumers use the last time they used a PCW to research PMI?



Source: CC Consumer Survey.

Note: Respondents were asked 'Which Price Comparison Websites did you look at'. (Base: all those who used price comparison websites last time they made a comparison, excluding 'don't know' answers, unweighted sample size = 724)

Features of competition between PCWs for consumers

43. Since many consumers shop around, PCWs compete to provide consumers with a better PMI policy than their rivals, whether in price or other features.
44. Many consumers use PCWs to find the cheapest PMI policy. MoneySupermarket told us that it estimated the proportion of customers on its website who bought the cheapest policy was 57 per cent. Datamonitor estimated that 37 per cent of customers who purchased from a PCW selected the cheapest quote.
45. MoneySupermarket told us that range was another important feature of competition for consumers, saying that a PCW needed to compare 'as many motor insurers as possible including the market leading and/or well known motor insurers in order to compete with other PCWs'. An internal board document from Confused confirmed that it monitored the number of PMI providers available through its competitors and said that it was 'critical' to offer more choice.

46. We found that competition between PCWs has been focused on attracting customers who actively shop around and are not loyal to a particular PCW. For example, [REDACTED]. We also found that the target of instilling loyalty among customers [REDACTED]. For example, we saw in [REDACTED]. We noted that PCWs usually send renewal emails to re-attract previous customers and to make use of the information provided by a customer during past searches.
47. As evidence of a lack of consumers' loyalty, [REDACTED].⁶ However, we noted that many of the customers who did not buy again from the same PCW did not buy a new policy on a different PCW or through a different channel, but renewed the policy directly with the same insurer (renewals account for an estimated 59 per cent of all policies sold⁷). We also found that the proportion of customers returning to the same PCW may be increasing. An internal document from [REDACTED].
48. We recognized that, even if consumers' propensity to shop around were to decline, this would not in itself indicate that switching costs were particularly high or that customers would not be willing to switch if their 'preferred' PCW's proposition declined. A sufficient number of active customers may remain to constrain the behaviour of PCWs effectively.

Competition between PCWs and other sales channels

49. Customers can purchase PMI policies through several alternative sales channels: directly from an insurer (online, by telephone, by post or in a branch), from a broker (through the same mediums), via a PCW, etc. The extent to which PCWs compete with other sales channels to win customers will depend on the ability and willingness of customers to switch to these other sales channels.

⁶ [REDACTED].

⁷ Source: Mintel.

50. To assess the importance of the different channels for the sale of PMI we looked at market research reports and responses to our survey. Respondents to our survey of PMI policyholders were asked what sales channel they used when they first purchased their PMI policy from their current provider (see the working paper 'Survey report'). Responses included 'over the phone', which accounted for 42 per cent of sales; 33 per cent said that they purchased online via a PCW; 9 per cent said they purchased through an insurer's or brokers' website;⁸ and 7 per cent purchased the policy in person.
51. An estimated 23 per cent of PMI policy sales are through PCWs (see paragraph 20). However, the total base from which this 23 per cent is derived includes sales to customers who opted to renew their policy with their current provider, and renewals account for about 59 per cent of all policies sold (see paragraph 47). Therefore, PCWs account for a greater proportion of new business (ie customers purchasing PMI for the first time or switching from their previous provider). Our survey found that 33 per cent of new PMI business was through a PCW (see working paper 'Survey report'); and Datamonitor estimates that, as of September 2012, between 54 and 56 per cent of new PMI business was bought through PCWs.^{9,10}
52. The reason for the large discrepancy between the results of our survey and those of Datamonitor is not clear. One explanation is that the share of new sales attributed to PCWs in our survey might be understated if any respondents answered with respect to their last policy purchase rather than with respect to the last time they switched PMI provider (as a number of respondents will have renewed their policy).

⁸ In total, 46 per cent of respondents said that they first purchased their PMI policy from their current provider 'online'.

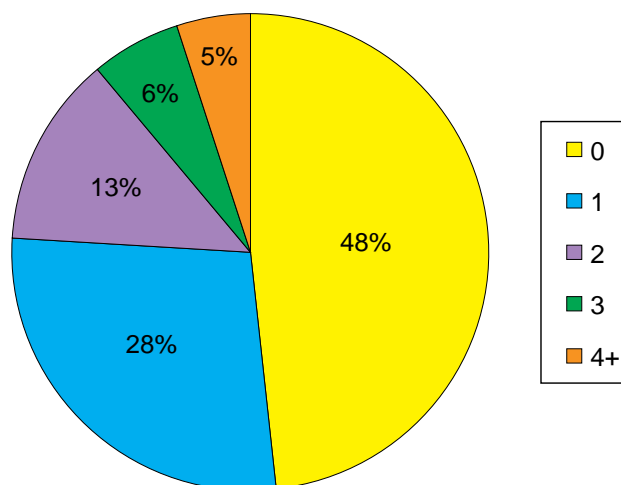
⁹ Source: Datamonitor.

¹⁰ [X]

53. Recognizing that changes in the shares of supply between different sales channels could be informative of the degree of rivalry between sales channels, we asked the ten largest UK PMI insurers to provide data on their new PMI business won by different sales channels in the last three to five years. Five insurers provided us with data which we could meaningfully compare. This data indicated that PCWs had become relatively more important as a source of new business for insurers, especially compared with call centres, suggesting that the constraint on PCWs from sales made by phone is likely to have declined over recent years.
54. However, we also recognized that shares of supply were less likely to be informative on the closeness of competition between sales channels if the different channels were differentiated, for example by catering for different customer needs. We noted that survey results presented in MoneySupermarket's Strategic Plan for 2012–14 showed that among the most common reasons for people not buying through a PCW (after using it to compare prices) was a preference for talking through options with someone and the possibility of discounts or cashbacks when contacting an insurer directly. This suggested that at least some consumers used a PCW for searching for PMI but were unlikely to use it for purchasing PMI, possibly limiting the extent to which the PCW would compete against other sales channels.
55. We considered the extent to which consumers used multiple search tools as another piece of evidence in assessing consumers' willingness to switch. The results of our survey of PMI policyholders indicated that 52 per cent of those who last checked PMI prices on a PCW also searched on other sales channels, as shown in Figure 3. Table 2 shows the relative importance of the alternative channels for searching.

FIGURE 3

How many sales channels other than PCWs did consumers check on the last occasion they compared PMI policies (of those who checked on a PCW)?



Source: CC Survey, based on responses to question 'When you compared insurance providers or policies did you ...' and 'and when you compared insurance companies or policies online was this ...'.
(Base: respondents who searched on a PCW on the last occasion they checked PMI policies, unweighted sample = 841.)

Note: Alternative channels include other online channels (brokers' websites, insurer's websites, cashback websites, websites of banks or building societies, websites of retailers and other websites) and offline channels (in person, over the phone, through the post, some other way).

TABLE 2 The proportion of consumers who searched on another channel as well as a PCW on the last occasion they checked PMI policies by other channel

	%
By phone	33
PMI provider's website	30
Retailer's website	10
In person	8
Bank/building society's website	5
Cashback website	4
Post Office website	3
Other website	1

Source: CC survey. (See notes to Figure 3 for details.)

Note: Unweighted sample = 841.

56. This survey evidence suggests that for those consumers who use a PCW to search for a PMI policy, call centres also remain a popular additional search method.

57. We noted that at least some PCWs had implemented or considered various strategies to compete more effectively with other sales channels. These included:

- developing their own telephony interaction;

- requiring contractual restrictions, like MFN clauses which limit the extent of pricing competition from providers' own websites and possibly from other sales channels (see the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers'); and
- offering cashback or blocking insurers from offering cashbacks.¹¹

Competition for PMI providers

58. PCWs also compete to attract insurers and brokers to the list of providers quoting for PMI through their websites. Almost all of the 10 largest UK PMI insurers currently quote on all four large PCWs. Internal documents from the PCWs confirmed that they considered it important to attract the large insurers. For example, in Confused's internal documents we noted the necessity of 'identifying and attracting up and coming brands'.
59. PCWs also compete to establish and maintain good relationships with PMI providers which may, for instance, allow them the opportunity to offer exclusive pricing deals and other promotions (within the restrictions set by MFN clauses).
60. We found that competition to attract PMI providers and to develop a close relationship with them included:
- offering PMI providers access to a large numbers of customers;
 - charging a low CPA fee; and
 - providing additional information and data services.¹²

¹¹ [X].

¹² We understand that PMI providers are typically charged for these additional services. [X].

Is the behaviour of the four large PCWs constrained by the bargaining power of PMI providers?

61. A PMI provider's bargaining position against a PCW will derive from the possibility that it could delist its products from the PCW and use alternative PCWs or sales channels (including direct selling).
62. In their submissions to us, PMI providers and PCWs were consistent on the factors which affected their relative bargaining positions, though they sometimes had different views on how these factors should be measured and on the scale of their impact. The four large PCWs also varied in their overall assessment of their bargaining positions. Two of the large PCWs noted that the dynamic of negotiations was specific to individual cases.
63. On the basis of the submissions we received, we identified three factors as likely to impact the relative bargaining positions of a PMI provider and a PCW:
- (a) the relative importance of the PCW and the PCW channel for the PMI provider;
 - (b) the relative importance of the PMI provider for the PCW; and
 - (c) consumer behaviour.
- We discuss each of these factors in turn.

Relative importance of the PCW and the PCW channel for the PMI provider

64. A PMI provider's bargaining position will be weaker if an individual PCW (or the PCW channel) represents a significant sales channel, such that it may lose a large volume of sales if it delisted. It will also be weaker if alternative sales channels, eg direct selling, are less attractive, eg because they entail higher costs per sale. The bargaining position of a PMI provider would be particularly weakened if losing sales via a PCW would reduce the efficiency of the PMI provider, harming its competitiveness.

65. Most of the large PCWs told us that the proportion of PMI policies sold via PCWs is relatively small. An estimated 23 per cent of all PMI policies are sold via PCWs (see paragraph 20). However, as pointed out by several PMI providers, the proportion of new business acquired via PCWs is much higher (see paragraph 51).
66. We noted that the large share of new business won via a PCW might not reduce significantly a PMI provider's bargaining position if it is able to access the customers of a particular PCW through other PCWs or sales channels at similar cost. We found that many customers shop for PMI policies using several PCWs and other sales channels (see paragraph 42). However, two PMI providers provided us with estimates of the proportion of customers of an individual PCW which could be recaptured on other PCWs or sales channels, suggesting that this was within a range of 30 to 42 per cent.¹³
67. The cost of selling through alternative sales channels is another determinant of a PCW's bargaining power. The AA told us that PCWs set the CPA at a level which made listing on a PCW marginally more attractive than using conventional direct marketing. The AA said that PCWs had been able to demand a higher CPA as the effectiveness of marketing channels such as online 'paid search' advertisements had declined.
68. We noted that delisting from a PCW could also lead a PMI provider to lose sales which would have been made on other sales channels as many consumers search on a PCW and then purchase elsewhere. Aviva told us that some customers used PCWs to get an indicative price and then visited the insurer's own website or contacted its call centre to see if they could obtain a better price or to obtain cash back.

¹³ One large PMI provider estimated that it would recover 30 per cent of the sales lost if it delisted from a large PCW; another large PMI provider estimated it would recover between 35 and 42 per cent of its lost sales.

69. As shown in Table 3, the reliance on the PCW channel (at least relative to own websites or call centres) appears to vary considerably across PMI providers. However, although some PMI providers use the PCW channel to a relatively small extent, we did not take this to mean that it would be easy for other PMI providers to reduce their reliance on PCWs, especially for those which do not have such a strong retail brand.

TABLE 3 Proportion of new business won through direct sales channels (ie excluding sales through brokers), 2012

	<i>per cent</i>							
	<i>Aviva</i> *†	<i>AXA UK</i> ‡	<i>CISGIL</i> ‡	<i>DLG</i>	<i>esure</i>	<i>LV</i> §	<i>RSA</i> ¶	<i>Zurich</i> ‡
PCW	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
PMI provider website	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
PMI provider call centre	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	100	100	100	100	100	100	100	100

Source: PMI providers.

*[redacted].

†[redacted].

‡[redacted].

§[redacted].

¶[redacted].

Note: We have sought to exclude sales made through brokers as not all parties submitted this information. However, some parties may have included sales made by a broker listed on a PCW within their numbers shown in the table above. Therefore, the figures above may, in some cases, understate the proportion of sales made through a PCW.

70. Evidence from both PMI providers and PCWs confirmed that the bargaining position of PMI providers was weaker when a PCW represented a significant proportion of their sales. For example, in 2012 Comparethemarket was the largest PCW [redacted] and [redacted]. MoneySupermarket also described this rival as being ‘willing to lose major partners that don’t pay or won’t agree to their terms’. [redacted].

71. MoneySupermarket also told us that [redacted].

72. Despite their differing relative bargaining strengths, almost all of the 10 largest insurers quote on all four of the large PCWs (see paragraph 58), which could suggest that the threat of completely delisting from one of them is not very credible. AXA told us that ‘providing quotes through the four large PCWs at least is a ‘must have’ in order to achieve sufficient market coverage’; and Aviva said that, to remain

competitive, it was necessary to quote on a minimum of three of the four main PCWs but it was desirable to quote on all four.

73. The large insurers told us that they had more bargaining power against those PCWs which were less significant sales channels for them. [§]; though this was contradicted by esure, which claimed that Google and Tesco Compare had equal bargaining strength to the four large PCWs. esure pointed to other sources of bargaining power for a PCW besides the share of supply, such as the extent of customer information to which the PCW had access and its potential for future growth.
74. We have very limited data on the CPA fees charged by Tesco Compare and Google, but [§]. In our view, this was consistent with these PCWs having less bargaining power than the four large PCWs, commensurable with their lower share of supply.
75. We noted that the bargaining dynamic between PMI providers and PCWs could change rapidly, in line with the trading positions of both the PMI provider and the PCW. [§]

Relative importance of the PMI provider for the PCW

76. A PMI provider's bargaining position with a PCW also depends on the additional value of the PMI provider to the PCW, given the other PMI providers the PCW already offers on its site. This value is likely to be greater if the PMI provider has a large customer base or 'must have' brands which consumers would expect to see offered. Aviva told us that the four large PCWs would always have the balance of negotiating power given that no provider on a PCW had a large share. However, Admiral told us that being large did improve the bargaining position.

77. Gocompare told us that, in recent years, consumer surveys and anecdotal feedback suggested that it had become the 'trusted' brand for consumers rather than the individual PMI providers. Insurers also told us that the impact of delisting would be larger for them than for PCWs. DLG told us that:

when a consumer is obtaining a quote on a PCW, he/she will not generally go looking for a particular brand, and in general will not know whether a brand's absence from the leading quotes is due to a higher premium, a decline to quote, or the absence of the brand from the PCW altogether.

78. RSA told us that:

on more than one occasion, PCWs have presented RSA [REDACTED]. By way of example, [REDACTED] has effectively forced RSA to accept a [REDACTED] conversion floor for eChoice and a [REDACTED] floor for MoreThan as a condition of relisting RSA's insurance products.^{14,15}

79. We noted that bargaining power could be concentrated among a relatively small proportion of the PMI providers offered by a PCW. An internal document from [REDACTED] indicated that [REDACTED]. However, we also noted that specialist or niche PMI providers with high conversion rates (ie high numbers of consumers purchasing a policy after searching) could also have bargaining power, as they could make the PCW more attractive to specific types of drivers.

80. Some of the PCWs told us that consumer confidence in their services was based on their perceived ability to cover as much of the market as possible. Consequently, the removal of even one PMI provider could undermine confidence that the consumer

¹⁴ With these conversion floors, RSA agreed to convert a proportionate minimum number of click-throughs from PCWs into actual sales on its website. This guaranteed a minimum cost per click to PCWs, regardless of how many actual sales were concluded through the PCW.

¹⁵ We also note that [REDACTED] has a conversion floor agreement with [REDACTED].

was able to achieve the lowest price possible. However, we noted that the number of PMI providers on PCWs is both large and variable between PCWs. It did not appear likely to us that the loss of an individual PMI provider would lead to a loss of consumer confidence unless the provider had significant brands or was particularly price competitive in a market segment.

81. Supporting this view, we found that, as the number of PMI providers offered by PCWs had grown, so the large PCWs had appeared to focus on factors other than encouraging PMI providers to sell through them. In its strategic plan for the years 2012 to 2014, MoneySupermarket stated: ‘We will re-focus around preferred partners – this leads to best products, budget allocation and test partners’. Moreover, we found that the large PCWs had been willing to remove PMI providers from their websites (albeit this was probably driven by considerations of poor performance (eg poor conversion rates)).
82. We found some evidence that the bargaining position of smaller PMI providers with [redacted] PCWs is weaker than for larger (or otherwise more important) PMI providers. In particular, we found that the level of average CPA fees varied depending on the size of the PMI provider. We plotted the level of the average fee against the providers’ PMI sales on the PCW and observed that [redacted] Figure 4 shows the CPA fees charged by [redacted] in 2012, with similar analysis for [redacted] and [redacted] shown in Appendix 1.

FIGURE 4

CPA fees and sales volume by provider [redacted], 2012

[redacted]

Source: [redacted].

83. We noted that the CPA fee may also relate to the value that a PMI provider derives from a policy sold. Therefore, the higher CPA fees paid by specialist or niche insurers

may reflect the higher value of such policies, as well as possibly reflecting a poorer bargaining position due to the size of these providers.

Consumer behaviour

84. To the extent that consumers would switch away from a PCW in response to an increase in the CPA fee (because of increased premiums or less choice (see paragraph 30)), their behaviour adds an additional constraint on a PCW's behaviour.
85. Our survey found that, when consumers searched for PMI, around 10 per cent of them searched on just one PCW and through no other sales channels (so-called 'single homing'). Therefore, for a PMI provider, each one of the four large PCWs has approximately 2.5 per cent of potential PMI customers who can only be reached through that site. None of these customers would be accessible other than through that PCW. By being the gatekeeper to these customers and the value they represent to the PMI provider, the PCW derives bargaining power. However, with 97.5 per cent of potential customers remaining available through other PCWs or other sales channels, we might expect PMI providers to be willing to at least consider delisting from a specific PCW.
86. However, we note that, of consumers who last shopped around for PMI and used a PCW, 37 per cent of these consumers only checked prices on a single PCW. This suggests that, if a PMI provider only sells via PCWs, each of the four large PCWs has approximately 9 per cent of potential consumers who are not accessible via another PCW. While higher, we consider that this is still a relatively low proportion.
87. The extent to which customers utilize one PCW or shop around multiple PCWs and/or sales channels will likely depend on two factors: (a) their expectations of

getting a better deal from searching more widely; and (b) the level of search and switching costs. We discuss both these factors in turn.

Customer expectations of getting a better deal

88. Customer expectations of getting a better deal through shopping around will rely on the perceived level of differentiation between the PMI policies available on rival PCWs and through other sales channels. If consumers believe that most of the policies relevant to them (or a sufficiently high number) are available on a PCW, then they will be unlikely to look further. Confused told us that 'customers ... believe that you need to use more than one price comparison site, as well as go direct, to get the best deal'. We noted that the presence of MFN clauses was likely to reduce the incentive for a consumer to shop around.

Search and switching costs

89. The extent to which customers shop around (or would in the event of a price rise or lessening of choice) is also likely to depend on the costs involved in searching between PCWs (and other sales channels). The cost of searching for a PMI policy is reduced by PCWs but consumers still invest time (typically around 5 to 10 minutes) in finding a PCW and entering their details. This is likely to explain partially why customers, on average, only search on 2.2 PCWs.
90. We found some indications of a decline in shopping around between PCWs in recent years (see paragraph 47), which appeared to us to indicate that, while new customers had tried a few PCWs, many had then become less willing to shop around due to their familiarity with a site or because they saw little distinction in the results. We noted that repeat search costs might be particularly low with the same PCW if the PCW saved the consumer's details such that they did not have to be re-entered. We found evidence in the internal documents of the large PCWs which showed that they

spend considerable effort in making use of information gathered through previous purchases and in making a returning customer's repeat purchase as easy as possible.

Evidence of negotiation outcomes

91. As evidence of bargaining power possessed by the PMI providers, we observed that:

- Large PMI providers are able to negotiate CPA fees which are lower than those paid by some smaller providers (see Figure 4 and Appendix 1, and paragraphs 82 and 83).
- CPA fee increases have been close to or below the rate of inflation. [REDACTED]
- Some PCWs told us that PMI providers had negotiated CPA fee increases down from their initial proposals. MoneySupermarket told us that this was due in part to the well-resourced negotiating teams that PMI providers used. However, while some PMI providers recognized that they had been successful in negotiating lower fee increases, they told us that the initial fee increase proposals of the PCWs had been unrealistically high. By contrast, [REDACTED] told us that the PCWs' fee increases [REDACTED] imposed on a 'take it or leave it' basis, leaving little room for negotiation.¹⁶

92. As evidence of bargaining power possessed by the PCWs, we observed that:

- Almost all of the 10 largest insurers are listed on all four of the large PCWs.
- There appear to have been very few instances of PMI providers choosing to delist from one of the large PCWs as a result of negotiation.¹⁷

¹⁶ [REDACTED]
¹⁷ [REDACTED]

Does the threat of entry (or expansion) constrain the behaviour of PCWs?

93. Entry or expansion, or the prospect of it, may stimulate competition within a market and limit the market power of incumbents. However, this source of competitive discipline is reduced by barriers to entry or expansion, which may give incumbent PCWs an advantage over efficient potential rivals and therefore reduce competition.
94. We considered the scope for new entry, evidence of recent attempted entry and the features of the market which may represent a barrier to entry or expansion.

Customer switching

95. The scope for new entry will depend on the ease with which a PCW can win new customers. This will rely on the propensity for customers to switch from rivals and the scope for customers to use PCWs at the expense of other sales channels.
96. We noted that, in recent years, the number of customers switching to the PCW channel had been significant (see paragraph 19), and that most customers used multiple PCWs or sales channels, showing little loyalty to any specific PCW (see paragraph 42). However, we also noted that the rate of customer switching from other sales channels appeared to be declining, in particular as existing users of PCWs became more attached to a specific PCW. Nevertheless, given many customers' current apparent willingness to shop around multiple PCWs, it does not appear to us that a lack of customer switching is a significant barrier to entry at present.

MFN clauses

97. In our working paper under Theory of Harm 5 on the impact of MFN clauses in contracts between PCWs and PMI providers, we discuss the possibility that wide MFN clauses might restrict entry by making a price-cutting entry strategy impossible.

We find some evidence that entry with this strategy may have been restricted by such clauses, though we state that we intend to consider this issue further.

Indirect network effects

98. In a two-sided market, if a customer on one side derives more utility when participation on the other side is greater, the market is said to be subject to indirect network effects. With regard to PCWs, a customer may prefer to use an established PCW over a new entrant if it offers the products of more PMI providers. Similarly, a PMI provider may prefer to participate on a PCW which has a large customer base. If indirect network effects are strong, then established PCWs may have an advantage over new entrants.
99. We recognized that these indirect network effects were likely to apply but noted that they would be dampened by the fact that PMI providers typically pay PCWs a fee per transaction. Under this pricing structure, a PMI provider would face little disincentive to participate on a new PCW, albeit with fewer customers. We found that some of the small PCWs offered the products of as many PMI providers as the four large PCWs.

Economies of scale and scope

100. Firms whose costs are, to a large extent, fixed rather than variable may benefit from economies of scale. To the extent that this is the case, incumbent PCWs would be able to spread fixed costs over a wider customer base, providing services at a lower cost than new entrants.
101. We found that the large PCWs adopted very different approaches to assigning costs as being either variable or fixed. [X].

102. We noted that all four large PCWs spent substantial sums on advertising and marketing, of which a significant proportion was offline. It did not appear to us likely that a new entrant would be able to enter successfully without also incurring the cost of a high-profile advertising campaign, unless it already possessed a very strong brand. On this basis, it appears to us that there are significant economies of scale.
103. The four large PCWs also offer a range of services on their websites, including life assurance, and insurance for home and contents, travel, bike, pet, etc. They also offer other financial products. We found in the internal documents of MoneySupermarket that cross-selling to customers is raised as a main objective; and [REDACTED]. Therefore, it appears to us that economies of scope also exist, although it is not clear whether successful entry would require being able to offer multiple product lines.

Sunk costs (eg advertising and marketing)

104. Sunk costs are investments which cannot be recovered upon exit and hence would commit a PCW to stay in the market. For example, the cost of establishing a trusted and recognized brand would represent a significant sunk cost for a new entrant.
105. PCWs invest heavily in advertising and marketing. Comparethemarket told us that [REDACTED]; and MoneySupermarket's 2011 annual report shows that its marketing investment amounted to £78 million, corresponding to around 43 per cent of its revenue in the same year.
106. We found that the three main forms of marketing costs for the large PCWs have been:
- (a) television advertising;
 - (b) online paid search or pay per click (PPC); and

(c) promotions (including toys).

107. We noted [REDACTED]. We found that:

- Some PCWs considered that [REDACTED] or had an ‘overreliance’ on television advertising, [REDACTED].
- PPC advertising was noted to have become more expensive due to aggressive bidding by both PCWs and insurers on key search terms. Gocompare also noted that PPC prices had risen as a result of Google reducing the availability of premium search positions after launching its own price comparison service.
- [REDACTED]

108. It appears to us that the large marketing expenditure of the four large PCWs has been driven by the intense competition between them to win customers, rather than representing any strategic effort to raise barriers. [REDACTED] We noted that expenditure on television advertising may decline as the number of new customers declines and, [REDACTED].

109. We also recognized that a significant proportion of the advertising expenditure incurred by the PCWs might not have been incurred had there not been wide MFN clauses. It appears to us that these clauses tend to reduce price-based competition, thus encouraging advertising-based competition between PCWs instead. We discuss this possibility in our working paper ‘TOH 5: Impact of MFN clauses in contracts between PCWs and PMI providers’.

Regulatory barriers

110. PCWs need to obtain relevant permissions from the FCA and need to comply with the FCA’s guidance on the sale of PMI through PCWs. However, no PCW raised this as a significant barrier to entry.

Evidence of the threat of entry as a constraint

111. We reviewed [REDACTED] the threat of entry (or expansion by a small provider). In particular, we found that [REDACTED].¹⁸ However, we found little evidence that the behaviour [REDACTED] had been impacted [REDACTED].
112. Tesco Compare entered the market in 2008 but less than 1 per cent of respondents to our survey of PMI policyholders recalled searching on it the last time they checked PMI policy prices (see working paper 'Survey report').¹⁹ Also, the potential entry of [REDACTED] has not materialized.
113. Google entered the market in September 2012, which we found, [REDACTED]. However, we found little evidence that Google had impacted the PCW market significantly so far. From the results of our survey of PMI policyholders, it appears that less than 1 per cent of people searching on PCWs for PMI were able to recall looking at Google the last time they checked prices.

¹⁸ [REDACTED]

¹⁹ [REDACTED]

Analysis of CPA fees and sales

FIGURE 1

CPA fees and sales volumes [✂], 2012

[✂]

Source: [✂].

FIGURE 2

CPA fees and sales volumes [✂], 2012

[✂]

Source: [✂].

Profitability of [X] PCWs

1. This appendix examines the profitability of [X] PCWs.

Why we look at profitability in market investigations

2. The CC's updated *Market Investigation Guidelines*²⁰ (the guidelines) state that outcomes of the competitive process in their different forms in a market, eg prices and profitability, can provide evidence about its functioning.²¹
3. The guidelines²² state that, in practice, a competitive market would be expected to generate significant variations in profit levels both between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. The profitability of some firms may exceed what might be termed the 'normal' level, for example as a result of past innovation or superior efficiency, but a situation where the profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process. Examples of these limitations could be the presence of entry barriers, or the existence of significant market power.
4. The guidelines²³ mention four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the guidelines (Market characteristics and outcomes) states²⁴ that where capital employed cannot be reliably valued, the CC may consider alternative measures, such as the return on sales or other relevant financial ratios.

²⁰ *Guidelines for Market Investigations: Their role, procedures, assessment and remedies*, April 2013; CC3 (Revised): www.competition-commission.org.uk/assets/competitioncommission/docs/2013/publications/cc3_revised.pdf.

²¹ Paragraph 103.

²² Paragraphs 117–118.

²³ Paragraph 107.

²⁴ Paragraph 15.

Analysis

5. The [X] PCWs were not able to provide figures from their management accounts for PMI-only profit because they did not allocate costs to PMI sales. Therefore, we asked the [X] PCWs to provide us with an analysis which would identify the operating profit for the PMI part of their business for the last five years. We did not look at other measures of profitability such as return on assets or return on capital as we considered that it would be very difficult for the PCWs to calculate an appropriate asset base and cost of capital for the PMI part of their business only. We asked the PCWs to set out clearly their approach for allocating both their direct and indirect costs to the PMI part of their business, if necessary differentiating between divisional, group and holding company overheads. We said that we expected to see at least the following headings in their analysis: turnover/income, cost of sales, gross profit, expenses, contribution, allocation of shared costs, operating profit, interest, and profit before tax.
6. [X] PCWs [X] provided us with a profitability analysis.
7. Table 1 shows the combined turnover, operating profit and operating margin for [X] PCWs for the three years 2010 to 2012 for the PMI part of their business.

TABLE 1 Summary of total PMI profitability, 2010 to 2012

	<i>£ million</i>		
	<i>2010</i>	<i>2011</i>	<i>2012</i>
Turnover	[X]	[X]	[X]
Operating profit	[X]	[X]	[X]
	<i>per cent</i>		
Operating profit margin	[X]	[X]	[X]

Source: CC calculations based on data provided by the parties.

8. Turnover [X] by [X] over the three-year period; operating profit [X] by [X]; and the operating profit margin [X].

9. Overall, we noted that, in aggregate, [REDACTED] PCWs had achieved an operating profit margin of around [REDACTED] per cent over the last three years. We did not conduct a more detailed analysis of their profitability but, in our view, this finding could be consistent with [REDACTED] PCWs having some bargaining power against PMI providers.
10. In the rest of this appendix [REDACTED].

[REDACTED]