Contestability

# Presentation 1 – Intro and Impacts

Take notes. Your notes should cover the following questions:

* What is meant by a contestable market?
* What conditions are required for a market to be contestable?
* What are the impacts of contestability?

# Task: Barriers to Entry

**Instructions:**

* Complete the table to explain why the below factors reduce contestability in a market

|  |  |
| --- | --- |
| Factor: | Justification of why this reduces contestability:  |
| High start up costs |  |
| Requirement to buy specific assets |  |
| The existence of well-known brand names |  |
| Customer inertia |  |
| Information asymmetries / R&D requirements |  |
| IPRs (especially patents) |  |
| Economies of scale possessed by incumbents – Natural Monopolies  |  |
| Exclusive supply / distribution agreements |  |
| Regulations limiting capacity (e.g. planning permission, airport landing slots, etc) |  |

# Case Studies Task: Contestable or Not?

**Instructions:**

* Read, highlight and annotate the case studies
* Determine whether the market is contestable or not

**Case Studies**

**Banking**: Customers' reluctance to switch banks is making it difficult for new, small banks to enter the sector, a review has found. The Office of Fair Trading (OFT) concluded that new entrants to retail banking faced significant challenges in attracting customers. One of the barriers was current account customers' loyalty to established brands, the OFT said. Watchdog Consumer Focus has argued that the loyalty is "often misplaced". The OFT found that people were more likely to shop around for loans, but personal or business current account holders were reluctant to switch and had a preference for banks with a local branch. Customer loyalty was particularly strong for brands in Scotland and Northern Ireland, the OFT found. However, Sarah Brooks, of Consumer Focus, said: "Often people are unhappy with their bank but still do not switch - put off by things going wrong, the hassle involved or a negative effect on their credit rating. "The unacceptably high level of bank complaints suggest that this loyalty is often misplaced. Until people start voting with their feet, banks have little incentive to raise their game and consumers may be missing out on better deals and service." The British Bankers' Association, which represents the main High Street banks, said: "UK banks welcome open competition and choice for customers. The UK has a competitive market in High Street financial services with both more choice of provider and cheaper services than in many other countries." The OFT's review found that some firms reported problems in becoming authorised by the Financial Services Authority to accept deposits, with a lack of transparency and uncertainty causing them delays and difficulties in raising funds. Requirements on the amount of capital they must hold could also disproportionately affect new entrants and smaller banks, it said. However, it said a number of firms had recently entered the market - such as Metro Bank - and more were expected to follow.

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**Petrol Stations:** in the petrol industry, we could simplify the industry to four different stages of production: 1. Oil drilling. – When firms build an oil well and pump out raw crude oil. 2. Oil refining – the process where the crude oil is refined into petrol / diesel. 3. Transport – where the petrol is transported to retail markets. 4.Retail – Where petrol stations sell petrol / diesel to customers at the different petrol stations, such as Esso, Shell, BP, Tesco, Asda, and independent petrol retailers. Suppose, you want to set up a petrol station to sell petrol in your local town. The costs of buying a premise to sell petrol is relatively low. The big difficulty will be buying petrol from the large oil companies who produce and refine petrol. There are very significant economies of scale in drilling and refining oil so that market is not very contestable. It is dominated by a small number of large firms. The big oil companies, like Shell, BP, Esso may decide to collude and sell petrol to independent retailers at a very high price making it unprofitable for independent retailers to sell petrol in a petrol station. Therefore, this is a barrier to entry for a new firm setting up a petrol station. The lack of vertical integration, the difficulty in getting access to relatively cheap petrol. Unsurprisingly, many small independent petrol stations have been squeezed out of the market because they can’t remain profitable on the small margins between buying petrol and selling it to customers. Big oil companies like Shell say there is a very small profit margin on selling petrol. That might be true, but their main profit margin comes on the mark up between producing oil and selling petrol to the petrol stations.

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**Street food:** The street food sales market is made up of many small firms or individuals, with some larger firms dominating in providing certain foods. Overall, chained street stalls/kiosks is highly fragmented, with the top two players accounting for 40% of all outlets in 2013. In chained street stalls/kiosks, ATM Coffee was the leading player with 70 outlets in the country. Nevertheless, there is an increasing trend for emerging foodservice players (either in full- service or fast food) to set up street stalls/ kiosks. There is perfect information in the sense that all outlets have access to the same knowledge through the internet . But those who are more aware of potentially profitable areas (in the city) may have an advantage. Also have access to best technology as there are no IPRs or patents on the vans or technology, since most will buy from a supplier, not develop themselves. However, they may be limited in terms of the methods of food preparation that only rivals may now of, e.g. Secret sauce. Most advertising is done on the vans themselves as they move around, which would represent a small cost. Most are also able to freely advertise on social media through Twitter and Facebook. Some may face difficulties in reaching a large audience it they are not already popular or well-known and have not been reviewed by food bloggers. You are legally free to enter the market and only require a street traders’ license from the council. Food must be of a minimum standard and employees must have insurance. Relatively low start up costs compared to other industries- can be under £5,000 for a second hand van. However, some of the sunk costs may be recouped by selling van and other machinery/capital, reducing the sunk costs. However, there are also barriers to entry, such as: The limited amount of space on streets, particularly in high-demand areas. There is also a requirement to buy specific assets and presence of sunk costs in the setting up of the shack/van, so it is not a perfectly contestable market. There can also be exclusive supply/distribution agreements, for example, official food stands at an event or attraction may have exclusive rights to setting up a food stand there.

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**Rare Earth Elements:** There are 17 rare earth elements which, when mined and processed are crucial in a range of uses such rare earths including oil refineries, permanent magnet wind turbines, cars, and many high tech and household electronic devices such as smart phones and tablet computers. Global supply of rare earths is predominantly sourced from China. Until recently their mines accounted for 97% of world production and 30%of proven reserves. In other words, China enjoyed a dominant monopoly in rare earth supply and when in 2010 China decided to restrict rare earth exports, the world price surged creating a degree of panic for manufacturers of products reliant on rare earths as a key input. One of China's justifications for cutting back export production was that rare earth processing / separation was extremely damaging to the environment, at the same time as their export cut-backs, they announced efforts to crack down on illegal mining products. But in March 2014 a judgement from the World Trade Organisation (WTO) said that the export restrictions broke world trade rules. One of the effects of the increase in rare earth prices was to improve the incentives for other producers to increase their investments in extraction and processing. A good example of this is Lynas Corporation in Australia that expanded capacity at a key mine at Mount Weld and at their processing plant at Gebeng in Pahang, Malaysia. Molycorp - based in Colorado in the United States, restarted a rare earth mine in California that had been mothballed in 2002 over environmental concerns. Japanese businesses - which in the past have imported 60% of their rare earths from China - opted to source more supplies from mines in Mongolia which has a rich supply of proven reserves.

In this way, the dominant monopoly of China has become a contestable monopoly. Total market supply has increased by around a third and the inevitable result has been a sharp drop in rare earth prices. Lynas Corporation has seen its average rare earths 'basket sales price' fall from above US$200 per kilogram in 2012 to US$18.25 per kilogram in the summer of 2014. The risk for them is that this low price will fall below the price needed solely to cover operating costs and certainly well under the level required to earn a sufficient rate of return on their capital investment. This reminds us that an expansion of market supply has the effect of lowering prices and eroding monopoly profits. It will take some time for the industry to settle down to a price level sustainable for suppliers in a complex and highly capital-intensive sector.

Contestable or not contestable:

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# Presentation 2 – Factors Promoting Contestability and Evaluation

Take notes. Your notes should cover the following questions:

* What factors can promote contestability?
* What are the limitations of the impacts of contestable markets?

# Article Task: Energy switching - Why the customer inertia?

**Instructions:**

* Read, highlight and annotate the article
* Make notes for the discussion question
* Discuss your answers as a class

**Article:**

*Customers are constantly being urged to switch utility providers. But what are the psychological barriers that stop them?*

We're more likely to get divorced than move bank accounts. Four-fifths of people cannot be bothered to look for cheaper gas or electric bills despite the urging of numerous consumer gurus to switch.In short we'd rather pay hundreds of pounds a year extra on phone, broadband and utility bills rather than have to enter the mind-numbing world of the price comparison websites. The inertia of the British public has been highlighted after Energy Secretary Chris Huhne chastised people for not seeking out the cheapest gas and electricity deals. "They do not bother," he said in an interview with the Times.

"They spend less time shopping around for a bill that's on average more than £1,000 a year than they would shop around for a £25 toaster." He denies accusing the public of "laziness" but many consumer experts say that the public are apathetic about getting a bad deal.

**Perhaps the last thing people want to do at nine o'clock at night is save money on their utility bill”** Prof James Devlin

Energy regulator Ofgem found in a survey this year that four out of five consumers are failing to shop around for gas and electricity, costing themselves an extra £100 a year. So why are people so reluctant to save money on bills when they delight in bargains at the supermarket or online? For some it's a lot of hassle thinking about what, for most people, is a fairly dull subject. There is also the possibility that the public is suspicious of firms who try to lure them away from their current provider. In July, a committee of MPs said that energy firms were using "Del Boy" tactics to get consumers to switch provider.

Consumer experts also say that many consumers wrongly fear that by moving, their service may be interrupted. In most cases - broadband apart - this worry is false. Energy is the most glaring case because the product - gas in the pipes and electricity in the wires - is identical whichever provider you opt for. The only difference is the cost and the call centre you have to deal with.

Tom Lyon, energy expert at price comparison site uSwitch.com, says it takes no more than 15 minutes to change energy provider. "It's not a particularly sexy or fun thing to do. But if you've never switched before you could save £300 to £400 a year."

Misleading doorstep selling when the energy market was first liberalised may be partly to blame for people not trusting the firms involved, he says. Then there's the question of price. How do you know that as soon as you move the new firm won't raise prices?

There's another reason why people don't switch, says Moneysavingexpert.com founder Martin Lewis. People want instant gratification but the savings from switching may take time to register. For that reason people should stop talking about monthly bills and focus on the annual amount, he says.

**Discussion Question:**

*Why does consumer inertia directly counteract the impacts of contestable markets?*

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# Assignment: Contestable Markets

**SECTION A (Short Answer Questions)**

1. Customer loyalty cards at supermarkets are likely to make the industry

1. Less profitable.
2. Less contestable.
3. Less concentrated
4. More contestable.

**SECTION B (Data Response)**





1. Discuss the level of contestability in the e-bike market.

[15]

**SECTION C (Essay)**

1. Discuss the likely effects on a business’s behaviour of an increase in contestability in its market.

[25]