

Agenda

Advancing economics in business

Watching the watchdog: the NAO's review of the OFT

In recent years, the powers and resources of the UK Office of Fair Trading have been significantly enhanced. Yet how effective is it as the guardian of consumer interests and fair and competitive business practices? Peter Langham and Louise Campbell from the Competition and Regulation Team of the National Audit Office discuss a new report on the OFT's organisational performance

Until recently, attention in the world of competition enforcement both in the UK and internationally has tended to focus on issues of law and economics—for example, the merits of economic effects analysis versus a form-based approach. However, there has been an increasing interest in academic discourse in institutional capacity as a determinant of success. In the competition sphere, this has manifested itself in discussion of the characteristics of effective competition enforcement agencies.¹ The National Audit Office (NAO) has published a report examining the organisational effectiveness of the OFT's competition enforcement work.²

The OFT is frequently in the UK press, although the past few months have seen even more prolific coverage with the change in leadership at the OFT in early October,³ press interest in a number of its high-profile cases, including the inquiries into independent schools, credit

cards and supermarkets; as well as the discussions about the OFT's future role in consumer regulation work following the Hampton Review.⁴ The NAO report does not, however, directly cover these issues, particularly since we did not review individual investigations nor seek to second-guess the OFT's judgement. Furthermore, our report did not examine the OFT's work on market investigations or consumer protection; rather, the focus of our study was on whether the OFT is an effective competition enforcement body.

The NAO has not looked at competition enforcement in the past, but for a number of reasons the time appeared to be right to undertake a study of this topic now. The Department of Trade and Industry's White Paper in 2001⁵ stated that one of the government's principles was that competition decisions should be taken by strong, proactive and independent competition authorities. The OFT's competition powers had been strengthened

Who we are

The NAO scrutinises public spending and reports to the Parliamentary Public Accounts Committee. The primary function of the Committee and the NAO is to hold the executive to account for the expenditure of public funds. Around 60 reports to Parliament are published each year assessing the value for money (defined as economy, efficiency and effectiveness) with which government departments and agencies have spent their money.¹ The NAO, which is totally independent of government, is headed by the Comptroller and Auditor General, Sir John Bourn.

Of the 60 reports published each year, three will typically focus on the work of the UK's economic regulators. The

NAO's value-for-money work in this area covers both competition regulation and sectoral regulation undertaken by regulators such as the Office of Gas and Electricity Markets (Ofgem) and the Office of Communications (Ofcom). In recent years, studies have examined initiatives to open markets to competition (eg, the Directory Enquiries report published earlier this year²) and issues relating to the consumer experience of regulated industries (eg, the 2004 report on Energywatch and Postwatch³). The recent report on competition enforcement by the OFT reflects the focus on both competitive markets and consumer welfare.

Notes: ¹ The NAO is also responsible for auditing the accounts of all government departments and agencies, and many other public bodies. ² NAO (2005), 'Directory Enquiries: From 192 to 118', report by the Comptroller and Auditor General, HC 211 Session 2004–05, March 18th. ³ NAO (2005), 'Energywatch and Postwatch: Helping and Protecting Consumers', report by the Comptroller and Auditor General, HC 1076 Session 2003–04, October 15th.

considerably by the Competition Act in 1998 and the Enterprise Act in 2002. This had also been matched by a significant increase in the OFT's resources (up 70% since 2000–01) and had led to mounting expectations from stakeholders for delivery of high-profile cases. In addition, the White Paper invited Parliament to hold government accountable for its actions. The NAO seemed best placed to carry out a study of the OFT's competition enforcement work, and the OFT welcomed the NAO's independent scrutiny of its progress to date, and saw the study as having the potential to add value.

The NAO review of the OFT's competition enforcement work used a wide variety of research methods. The subject area created some initial challenges in developing a suitable methodology, not least because the OFT's enforcement remit is so broad and each investigation is different. As with most NAO reports, we focused on understanding what users of the system require and how the OFT is applying its resources to meet those needs. We started by consulting extensively with business, and legal and economic practitioners to ascertain their direct experience of the OFT's investigations. Alongside this work, the NAO also commissioned a survey of OFT staff involved in investigations to access their views on issues such as case management and training. We then undertook comparative benchmarking of management processes at other competition authorities in the UK, the USA, Germany and with the European Commission's DG Competition. The NAO review also included analysis of casework statistics, looking at factors such as the duration of different types of case resolution. Finally, we assessed the performance measures used by the OFT. The review was carried out from February to June 2005 and the report was published in mid-November.

What we found

An effective competition authority helps make markets work well for consumers. Consumer detriment that results from price fixing and abuse of market dominance can be significant. The OFT lies at the heart of the UK's modernised competition regime. While the UK competition regime is still relatively young compared with those of many other major economies around the world, the OFT has established a growing reputation internationally since its competition powers were strengthened. It is recognised for leading the intellectual debate on substantive issues in competition analysis, and, overall, the UK regime was ranked among the best competition regimes in the world in 2004.⁶

There are, however, issues of institutional capacity which determine the impact that a competition agency can make. Effective management of people and processes is as fundamental as the correct analysis of market definition or abuse of market power, for example.

Despite differences in jurisdiction and workload between competition authorities, there is a series of behaviours that represent the ideal characteristics of an effective competition authority:

- commitment to critical self-assessment (such as periodic review, evaluation of performance, assessment of human capital, and comparative study with other authorities);
- commitment to transparency (such as disclosure of databases and explanation of actions taken and not taken).

There has been a tendency for international competition conferences and inter-agency meetings to focus almost exclusively on disseminating research and analysis of substantive issues rather than sharing good practice in managing competition enforcement work. There appears, however, to have been a change in mood more recently. For example, a working group of the International Competition Network is developing merger guidelines, and a recent session of the OECD Competition Committee discussed performance measurement.

Managing investigations

Competition investigations sit at the intersection of law and economics. The inherent complexity of this environment means that cases are time-consuming and require tight quality control. Each year, the OFT identifies between 30 and 50 cases that merit a full investigation from a large number of complaints received, and aims to resolve five to ten of these each year with a formal decision.

Our analysis of investigation timescales indicates that most cases take between one and three years for the OFT to reach a decision, although, as at April 2005, six of the 37 ongoing investigations had exceeded three years, including one very complex case which had been investigated for over five years. Decisions that are appealed to the Competition Appeal Tribunal can extend timescales even further. The OFT is by no means unique—discussions with other overseas competition authorities revealed that they also face some difficulties with the timescales of cases. The OFT is taking steps to address some of these concerns—in particular, in June 2005, it created a new senior competition director post to focus on delivery, with day-to-day oversight of how cases are prioritised, planned and resourced. The OFT is also making changes to the structure of its investigation teams in order to improve their flexibility and to ensure that priority work is properly resourced. Nevertheless, we believe that generic project management disciplines such as setting timescales, instituting continuous quality control and engaging openly with interested parties, wherever appropriate, will help enormously.

Figure 1 Options for securing business compliance**Examples:**

Guidelines **Speeches** **Interventions** **Voluntary codes** **Warning letters** **Negotiated settlements**
Reports **Trade shows** **Advocacy** **Compliance programmes** **Meetings** **Decisions** **Fines**

Source: National Audit Office (using information from *Securing Compliance*, Karen Yeung (2004) and the Canadian Competition Bureau).

The OFT has introduced systematic case review meetings, held towards the end of each investigation and before case findings are published. These reviews are designed to challenge any elements of the case and ensure the findings are fair and sufficiently robust to withstand critical public scrutiny. We consider, however, that the OFT could enhance its internal quality control of cases by strengthening the internal challenge on each case before the decision is taken to proceed to full investigation. This would help ensure that resources are committed only to cases that are robust enough to continue to merit investigation. The use of ex post evaluation of its interventions, including why cases were selected, would also help inform future decisions on prioritisation.

There is a level of uncertainty that is unavoidable for businesses that are subject to an OFT investigation. In our consultations with practitioners, a common concern raised was that OFT case teams sometimes create undue uncertainty by not engaging constructively or regularly with the parties involved. The OFT's investigations can be costly to businesses involved as well as to the OFT itself. Uncertainty over the timescales of an investigation can create additional costs. More open engagement with parties to the investigation where appropriate would help reduce uncertainty for parties and some of the resultant costs incurred by businesses. However, there is also a responsibility on the parties involved in investigations themselves—for example, interested parties frequently miss deadlines for providing information.

Compliance

The value of a competition enforcement body such as the OFT arises not only from the adversarial enforcement of competition law and its deterrent effects (the 'tough but fair' enforcer), but can also be achieved by encouraging business compliance with competition law through advocacy, promotion, guidance and education. It is, however, the responsibility of each individual company to understand and comply with the

law. The OFT has some discretion in the way it determines its competition enforcement programme, including the balance between 'soft' and 'hard' enforcement activity (Figure 1). Currently the OFT uses some alternative case resolutions, although it is yet to fully explore the scope for achieving better outcomes by balancing enforcement and compliance tools.

Organisational capacity

It is a truism to say that staff are pivotal in driving organisational capacity. Nowhere is this more the case than for a public institution engaged in technically complex work. The OFT faces an ongoing challenge in recruiting and retaining suitably qualified staff. This was illustrated by a peak in competition staff turnover of nearly 20% in 2004–05. Losing experienced staff, combined with difficulties in recruiting more senior case officers, contributes to an experience gap perceived by practitioners. The OFT is considering addressing this gap by strengthening the mentoring of junior staff, enhancing the training and personal development of case officers, and increasing the input of senior case officers to investigations.

Measuring value

Publicly funded bodies such as the OFT are under significant and constant pressure to demonstrate their value. The OFT's ultimate goal is to make markets work well for consumers and fair-dealing businesses. However, measuring the influence of competition enforcement on the economy is difficult. Some outcomes, such as deterrence effects, are generally considered to be hard to measure with any confidence. Others, such as reducing the level of anti-competitive behaviour and developing a competition culture in the UK, are also not straightforward, as the OFT cannot fully control whether it achieves this goal. Other competition authorities in the USA and Netherlands do attempt to measure some of the benefits they achieve for consumers. The OFT has recently set up an evaluation unit in order to take this step in quantifying the benefits it achieves for consumers and the wider economy.

Concluding remarks

The OFT is well respected and should be able to translate its intellectual leadership internationally in competition issues into greater practical results by building on its achievements and refining further its approach to competition enforcement. The recent changes in leadership at the OFT present it with an opportunity to meet these challenges head on and to

enhance its reputation as an effective competition enforcer. The new team should pay attention not only to the technical content of its workload but also to basic management disciplines to lift organisational capacity and performance.

**Peter Langham and
Louise Campbell**

¹ Leading experts in the field who we met in the course of our study include Professor William E. Kovacic, George Washington University Law School, and Karen Yeung, Fellow in Law, St Anne's College, Oxford.

² NAO (2005), 'The Office of Fair Trading: Enforcing Competition in Markets', report by the Comptroller and Auditor General, HC 593 Session 2005–2006, November 17th. Available at the NAO website: www.nao.org.uk.

³ A new Chairman, Philip Collins, and a new Chief Executive, John Fingleton, took up post at the OFT in October 2005.

⁴ The Hampton Review proposed that a new consumer and trading standards agency be set up to take over the OFT's consumer protection responsibilities (HM Treasury 2005, 'Reducing Administrative Burdens: Effective Inspection and Enforcement', Philip Hampton, March).

⁵ Department of Trade and Industry (2001), 'Productivity and Enterprise: A World Class Competition Regime', July.

⁶ KPMG (2004), 'Peer review of Competition Policy', report prepared for the Department of Trade and Industry. The report concludes that the UK's competition regime has been ranked third highest (behind the USA and Germany) by expert commentators.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email d.holt@oxera.com

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