Home credit market inquiry

Emerging thinking

Introduction

1. Home credit is defined in our terms of reference as:

> the provision of credit, typically small sum loans, the repayments for which are collected in instalments (often weekly or fortnightly) by collectors who call for that purpose at the customer's home. For the avoidance of doubt: 'home credit' includes the provision of shopping vouchers, hampers or other goods on credit when these are used to attract customers for cash loans; and 'small sum' does not imply any upper financial limit.[1]

2. Our inquiry into home credit is a market inquiry under the Enterprise Act 2002 (the Act). Section 134(2) of the Act requires us to consider whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK'. 'Features' means:

(a) the structure of the market concerned or any aspect of that structure;

(b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or

(c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

The process which our inquiry is following is explained in Annex A.

3. In the statement of issues,[2] we set out what we considered to be the most important issues relating to competition in the market for home credit in the UK. This document sets out our emerging thinking on these issues on the basis of the evidence so far presented, gathered and analysed.

4. We recognize that neither the home credit industry nor our examination of it exist in a vacuum. The industry, its customers, and some broader public policy issues which bear on it, have been subject to close examination in recent years from a variety of perspectives. For example:

- access to credit for people on a low income (seen by many commentators as an essential means of managing finances and a key component of financial inclusion) has been the subject of considerable research and policy thinking; the NCC told us that the super-complaint[3] which gave rise to this reference forms part of a broader campaign focused on the fact that poor people pay more for many basic services;

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[1]Home credit is described in more detail in some of the research papers listed and summarised on our web site and in the National Consumer Council (NCC) 'super-complaint' that gave rise to this reference (see Annex A). We do not repeat the detailed description here.
[2]Published on 18 April 2005.
[3]http://www.ncc.org.uk/moneymatters/index.htm.

- the extensive legislation governing all forms of consumer credit has been subject to review at UK and EU level. Following a white paper in 2003,[4] new regulations have recently come into force[5] and a new Consumer Credit Bill is currently before Parliament. On 25 February 2005 the Department of Trade and Industry (DTI) issued a consultation paper on a proposed revised EC Directive on consumer credit;

- other parts of the consumer credit industry continue to attract attention from the public, from Government and from regulators:

  - the Competition Commission (CC) itself is investigating store cards;[6]

  - the Office of Fair Trading (OFT) has recently issued a decision under the Competition Act 1998 on Mastercard's domestic interchange fees and a Statement of Objections under the Competition Act 1998 on Visa's domestic interchange fees;

  - the OFT and the House of Commons Treasury Select Committee have recently investigated credit card default charges; and

  - the OFT has recently announced a further investigation (following a super-complaint from Citizens Advice) into payment protection insurance;

- following increases in borrowing by consumers and in overall levels of consumer debt in recent years, concern over levels of consumer debt, overindebtedness and irresponsible lending has been expressed (including by the DTI) and has recently resulted in initiatives sponsored by HM Treasury; and

- concern over the extent of illegal lending and its links with other forms of crime has also led to initiatives mounted by the DTI and OFT designed to assess its extent and nature, and to examine how best to prevent it.

We expect to see continued attention to these issues, and to home credit, from various arms of Government and elsewhere, and further change to the policy and regulatory landscape throughout the life of our inquiry.

5. We have heard evidence on all of these issues; this has provided helpful context to our investigation. However, we are neither able nor empowered to conduct a wide-ranging inquiry into all aspects of consumer credit, nor into the place of home credit in any of the broad public policy issues noted above, though we recognize that any action we might take could have implications beyond home credit. We have been asked to look specifically at home credit, so we are concerned with the nature, extent and effect of competition in the provision of home credit; essentially with whether competition is working to the benefit of consumers. We are, however, well aware of this broader context and would wish any conclusions we reach to be understood in that context. Our emerging thinking should be seen in that light.

[4] *Fair, Clear and Competitive - The Consumer Credit Market in the 21st Century*, DTI, 8 December 2003.
[5] The Consumer Credit (Advertisements) Regulations 2004, the Consumer Credit (Agreements) (Amendment) Regulations 2004, the Consumer Credit (Disclosure of Information) Regulations 2004, the Consumer Credit (Early Settlement) Regulations 2004, the Consumer Credit (Miscellaneous Amendments) Regulations 2004 and the Consumer Credit Act 1974 (Electronic Communications) Order 2004. Some of their implications are discussed in paragraphs 59 to 64.
[6] The store cards market inquiry released its provisional findings on 14 September 2005. Further information can be found at: http://www.competition-commission.org.uk/inquiries/current/storecard/provisional_findings.htm.

Summary

6. In summary, our current thinking is that while home credit meets the requirements of its customers well, it does so at a high cost, a cost which is borne by customers in the price they pay for credit. On the specific issues raised in our Issues Statement, we think that:

Market definition

(a) The provision of home credit in the UK provides an appropriate framework in which to assess competition:

(i) We have not seen evidence that persuades us that constraints imposed by other forms of credit are such as to justify a broader product market definition.

(ii) Though consumer choice takes place locally, the conditions of competition (notably the existence of national providers) are similar across the UK, which suggests that there is national market.

Market outcomes

(b) We have seen evidence of high levels of satisfaction with home credit among existing customers. However, we have also seen evidence of market outcomes which indicate a lack of effective competition:

(i) the price of home credit appears high (this is in part because home collection by agents is costly to provide and the risk of bad debt is high), and appears to have been relatively static over an extended period; there is little or no evidence of prices falling in recent years despite increases in competition from other forms and providers of credit reported by lenders;

(ii) the home credit product and business model appear to have been largely unchanged over an extended period; we have seen little or no evidence of significant product or process innovation;

(iii) it appears possible for some home credit companies to earn returns in excess of their cost of capital over an extended period, and companies representing a significant proportion of the market appear to have done so; and

(iv) shares of supply of home credit have remained stable over an extended period.

Characteristics of the market

(c) The market is highly concentrated; we are not yet entirely clear what implications this has for competition, but we think that the strong market position of the largest provider (Provident Financial plc (Provident)) creates barriers to entry and expansion by other providers or potential providers, and enables it to benefit from its uniquely extensive knowledge of the home credit customer base.

(d) There are barriers to entry and to rapid expansion which limit the constraint imposed by potential entry or expansion by rivals on home credit lenders.

(e) Home credit is highly regulated, and some aspects of that regulation (and the industry's response to it) may deter entry, discourage innovation and weaken other aspects of competition.

(f) There are characteristics of the market, which derive from the interaction of customer and supplier behaviour, which contrast with what we might expect to find in a competitive market; specifically:

(i) there is little switching by customers between providers; customers do not seek to switch, nor do lenders encourage them;

(ii) there is little price competition between providers, and almost no differentiation in price between customers (on grounds of loyalty or quality of payment record, for example); customers appear insensitive to price differences between lenders;

(iii) there is some non-price competition between providers, but it appears to focus on retaining existing customers and lending them more, and tends further to inhibit switching, to reinforce incumbency advantage and to keep prices high;

(iv) the extent of competition between providers to attract good agents seems questionable; there has been almost no change in the level or structure of agent remuneration in the last ten years and the balance of incentives appears to discourage agents from moving between providers; and

(v) by contrast with other consumer credit markets, there is little sharing of creditworthiness data among lenders, which further discourages switching and reinforces the position of incumbent lenders.

7. The following paragraphs set out our emerging thinking in more detail on these points. We have not reached firm findings on any of these issues; all statements are based on the evidence we have heard and seen to date. Other matters in the issues statement that are not included below are currently of less concern, though still subject to further consideration.

Market definition

8. Market definition is one part of our assessment of competition for the provision of home credit. Evidence of strong constraints on home credit from other products could indicate that the relevant economic market is wider than that defined in our terms of reference.

9. We took as our starting point the terms of reference (see paragraph 1), and the fact that home credit appears to have unique features, most notably the home collection service itself. We considered two groups of credit products which might be thought to impose a competitive constraint on home credit providers:

- 'alternative' credit products (those generally targeted at low income consumers). These include credit from agency mail order, credit unions, and unlicensed moneylending; and

- 'mainstream' credit products (the most common among the majority of the population). These include credit cards, personal loans and bank overdrafts.

10. No ‘alternative’ credit products appear to be close enough substitutes to home credit to impose a significant competitive constraint on home credit providers. Of those which appear to be the closest and are most often cited by home credit customers:

- *Agency mail order* has some similarities in that credit for goods purchased is repaid in regular instalments. But it differs from home credit in that it offers goods on credit, rather than cash loans. The agency structure, while it has some similarities, operates in a significantly different way[7]. We think that this is more likely to be a complement to home credit than a substitute for it.

- *Pawnbroking* is only accessible to those with an item of value to pawn or sell (and as such, unlike home credit, is secured). Moreover, it does not involve repayment systems that suit household budgeting strategies, and is conducted entirely on trade premises.

- *Credit unions* are accessible only to their members; membership is limited to those who share a ‘common bond’[8] (for example those living in a particular area). With most credit unions, loans are accessible only after a period of saving and only for a limited multiple of the savings on deposit, and there is no home collection service.

- *Social Fund budgeting loans* are only available to people who have been on certain benefits for 26 weeks (repayment is by deduction from benefit) and are thus likely to be accessible to fewer than one-quarter of home credit customers. The Social Fund has limited funds available.

- *Illegal loans (*loans made in the course of business without a consumer credit licence) may be available to some home credit customers, but we have only limited evidence regarding the extent of illegal lending, and no evidence to suggest that it is a close substitute for home credit.[9]

We recognize that some home credit customers may use one or more of the above. Though some have loans from these sources at the same time as home credit loans (one survey suggested that over a third are using AMO at the same time as home credit), market research evidence suggests that few customers considered these options when taking out their last home credit loan. In our view, this is consistent with them being seen as complements for home credit rather than substitutes.

11. It has been put to us that providers of ‘mainstream’ credit products are increasingly targeting home credit customers (for example through the introduction of credit cards targeted at ‘sub-prime’ customers,[10] some of whom may use home credit). We have been told that the variety of credit products available to home credit customers has increased in recent years, in line with increases in credit availability more generally, that most home credit customers are aware of other credit options as a result of targeted marketing efforts, and that over two-thirds believe that they have more credit options than ever before.

12. Increasing numbers of home credit customers have bank accounts, which are often

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[7]The CC has investigated agency mail order, most recently in *March UK Ltd and the Home Shopping and Home Delivery Businesses of GUS plc (2004).*

[8]The common bond requirements are set out in section 1 of the Credit Unions Act 1979.

[9]Further detail on alternative credit products and their potential as substitutes for home credit is in our working papers on Product Market Definition and on Small Sum Credit, published on our web site.

[10]The sub-prime market is a generic term originating from the USA for below-prime retail borrowers, often representing the highest credit risks. Such borrowers often have a history of late or missed payments. UK borrowers with one credit refusal are more likely to be viewed as ‘near-prime’.

the gateway to other credit products. Estimates of penetration of bank accounts among home credit customers vary from 70 to 85 per cent, up from around 60 per cent seven years ago.[11] We have seen estimates that up to 45 per cent of home credit customers have credit cards, though most of the evidence we have seen suggests that the figure is somewhat lower (Provident, the largest home credit lender, told us that around a third of its customers held credit cards). Other evidence suggests that not all make regular use of them (the NOP survey suggested that only 14 per cent of current home credit customers were also currently borrowing on a credit card).

13. However, it is not clear that the effect of this increase in availability of credit has been to increase competitive constraints on home credit providers. The evidence we have seen suggests that:

- the price of home credit has remained relatively stable (and has certainly not declined in the last six years), despite this supposed increase in competition;

- home credit customer numbers have remained broadly stable at something over 2 million;

- only a small proportion of customers appear to be sensitive to the price of home credit relative to other products—of the 64 per cent of respondents to the NOP survey who said they had considered other forms of credit, only 22 per cent (around 14 per cent of all respondents) had found out what it would cost to borrow from another source (the difficulties of comparison are addressed at paragraph 20);

- home credit customers appear to regard different forms of credit as complements rather than substitutes. 85 per cent of respondents to the NOP survey said that they had only considered home credit for their last loan (that figure fell to 37 per cent when they were prompted with a range of possible alternative sources); and

- our analysis of several recent price changes suggests that a small change in price does not materially affect home credit suppliers' ability to attract new business.

14. We have also been told by some providers of mainstream products that lending to the demographic groups well represented among home credit customers is not attractive for them. Many feel that they are poorly equipped to assess and manage risk among customer groups with which they are unfamiliar in the absence of data which they can process through the electronic risk management tools and credit scoring systems on which they generally rely (see paragraphs 87 to 88). Others told us that they would not want to be associated publicly with the interest rates they would need to charge to lend profitably to this customer group.

15. It does not appear to us that any other forms of credit impose sufficient competitive constraint on home credit to be regarded as part of the same economic market as home credit. However, we recognize that they may nevertheless have some impact on the nature and intensity of competition among home credit suppliers, and we will continue to treat this as a factor in our competitive analysis.[12]

16. As regards the geographic dimension of the market, the evidence suggests that

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[11]A quantitative customer survey conducted for the CC by NOP World and published on our website (the NOP survey) suggested that one-third of home credit customers who have a bank account may have only a basic bank account, ie one with no credit facility.
[12]The analysis that leads us to this view is set out in more detail in our working paper on product market definition.

customer choice takes place locally, and we have seen some evidence that the degree of rivalry between home credit suppliers may vary from location to location. However, it is not clear that the conditions of competition vary much if at all by location. We note that where home credit companies operate nationally they operate national pricing structures, and that while there is some variation in the number of competitors operating in any given locality, they always appear to comprise at least one large national company (generally Provident and sometimes others) and one or more smaller lenders. The evidence we have seen to date is consistent with a view that there is a national market, but we have not completed our analysis in this area and we are doing further work, including some to establish whether the conditions of competition in Northern Ireland differ markedly from those in Great Britain.

17. The remainder of this document is structured as follows:

- first we identify the market outcomes which suggest that competition may not be working well in this market (and which in themselves might be seen as having detrimental effects on customers); and

- we then go on to identify the characteristics of the market which we think give rise to those outcomes and those detrimental effects.

Market outcomes as indicators of the extent of competition

18. The CC's guidance[13] identifies indicators which the CC considers when assessing whether there are adverse effects on competition in a market. We have identified some market outcomes which suggest a lack of competition.

(a) High and static prices

19. It has been put to us by several home credit customers[14] and ex customers, and by a number of interested parties[15] that the prices charged by home credit providers are high. In one customer survey approximately 12 per cent of former customers cited high price, unprompted, as a reason for no longer using home credit. Customers interviewed as part of the qualitative research conducted for the CC by Andrew Irving Associates (AIA) referred to the high cost of home credit, setting it alongside more positive attributes of the product, as did customers interviewed in other customer research we have seen. Prices are reported as high regardless of the choice of measure of price used, whether one uses the annual percentage rate (APR), total cost of credit (TCC) or other measures of cost (the Zacchaeus 2000 Trust, for example, presented its evidence in terms of the weekly interest burden on a low-income family).

20. The price of home credit, whether expressed by APR or TCC, appears to be high in comparison to other forms of credit. We note, however, that there are difficulties with using APR to make such comparisons, notably:

- the weakness of the APR as a basis for comparison of prices between different types of credit with different terms and charging structures (for example between a home credit loan and a credit card); furthermore, some credit products such as

[13]CC3 paragraphs 3.78 to 3.90.
[14]Including some who contacted our telephone hotline.
[15]Interest groups who gave evidence include Debt on our Doorstep and Church Action on Poverty.

overdrafts are not required to disclose APR; and

- APR is a measure of the expected cost of a loan at its outset. The actual cost of a loan may turn out to be different to the APR because of variances in the timing of repayments and application of contractual charges that are not required to be included in the APR. For example, missed payments would cause the actual cost of a credit card loan to be greater than the APR because of the default fees charged, but would reduce the effective interest rate paid on a home credit loan below the APR because of the additional time taken to repay it.

21. Home credit providers have stated that the level of prices is largely a result of the significant bad debt risk associated with the home credit customer base and the costs of the home credit business model. The principal cost is the labour-intensive network of branches and agents which helps to contain bad debt risk and is one of the features of home credit most valued by customers. We recognize both of these factors. However in a market characterized by vigorous price competition, we would expect the price of a home credit loan to be set close to a level that covered the costs of an efficient provider of these services, including its cost of capital. We consider whether this is the case in our analysis of profitability in paragraphs 29 to 32.

22. We have heard evidence from some home credit providers which suggests that prices are set more with a mind to expected level of return than to competition in the market. The evidence we have heard is consistent with a pattern of low price-sensitivity among customers and at best muted price competition between suppliers (see paragraphs 71 to 74).

23. The NCC super-complaint drew our attention to the issue of loans which are renewed, and we note that the price of loans which are renewed is high.[16] Renewal loans (which arise where a customer takes out a new loan before the previous one is paid off, and uses some of the new loan to pay off the balance) appear to meet a clear demand on the part of some customers for further credit advances while keeping weekly repayments at an affordable level. However, they appear to be more expensive (both APR and TCC are higher) than other ways of borrowing through home credit (for example parallel loans[17]). This is because when a customer repays an existing loan early (in this case using a new loan), the customer incurs a penalty. This is only partially offset by the rebate for early settlement of the outstanding balances, which is low by comparison with the charges outstanding on the loan.[18] The ability to smooth weekly repayments thus comes at a price. In a simple example developed in our working paper on renewals the customer pays over £10 more per £100 borrowed for a renewal loan with unchanged repayments than for a parallel loan which provides the same cash advance, but which would temporarily increase weekly repayments.[19] We discuss renewals further in paragraphs 81 to 82.[20]

24. The home credit market is also characterized by prices which appear to have been relatively static over an extended period and do not appear either to have declined with general economy-wide improvements in productivity, nor responded to general or industry-specific external shocks.[21] This may indicate a lack of competitive pressure on prices. Despite the growth in the availability of credit to home credit

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[16]Our analysis of renewals is set out in our working paper on renewal loans.
[17]Where a customer takes out an additional loan alongside an existing one we term this a parallel loan.
[18]Put another way, the customer needs to borrow enough to cover both the repayment of the existing loan and the new advance. Thus the customer borrows more than they would by taking out another loan in parallel with the existing one, and has to service the larger loan.
[19]The annualized interest rate on the renewal loan is 415.2 per cent, compared to 399.7 per cent on the parallel loan.
[20]Some lenders disagree with our interpretation of renewal loans. The issues are discussed in our working paper on renewals.
[21]See our working paper on pricing.

customers (described in paragraph 11), prices certainly appear resistant to downward movement. Five of the six largest providers, which between them account for over three-quarters of all new loans issued, have raised prices of at least some products in the last few years, while there is almost no evidence that prices have fallen. The evidence on prices charged by smaller providers is less complete. It suggests that prices charged by smaller lenders are more varied (prices charged by small lenders for a 20-week loan, for example, varied from around 200 per cent APR to around 800 per cent APR), but that many are lower than those charged by larger providers.

(b) Lack of product innovation

25. We have seen no evidence of recent significant product innovation in home credit. All large and medium-sized providers offer relatively standard products; which are available through all their agents with little or no scope for variation. There is no variation in price depending on the size of loan or any other variable. We have been told that the development of retailer-specific plastic cards and the expansion of the retailer base for the use of vouchers are examples of innovation. However, lending through vouchers is not new (there is evidence of the use of credit tokens as far back as 1880), and represents less than 10 per cent of total home credit lending.

26. We consider such innovation as we have seen from larger providers (for example the introduction of a Visa Electron card and of the Vanquis card by Provident) to have been at the margins of home credit. Like other developments in the broader credit realm, it appears to have had little effect on the core home credit product, which is offered and delivered in the same way now as it has been for many years.

27. We note that the presence of a trade association, while assisting competition by helping to sustain small players (see paragraph 49), may also have the unintended consequence of inhibiting innovation. For example, the Consumer Credit Association (CCA), the trade association for home credit lenders in the UK and Ireland, offers template loan agreements and other standard documentation for its members to use when setting up loans with their customers. Small providers often use this documentation because it is more costly to draw up bespoke documents and smaller providers cannot spread this cost over a large volume of business. This may result in some similarities in the terms on which some products are offered by many providers belonging to the CCA (see also paragraph 63).

28. There also appears to have been relatively little process innovation in recent years. While other financial service products have evolved significantly over recent decades (for example dramatic declines in branch networks in banking, the elimination of home collection in insurance, the provision of different channels through which customers can access services, and much increased use of information technology), home credit has largely retained its traditional business model. There have been some developments (for example some concentration and consolidation of branch networks by Provident and by London Scottish Bank (LSB), and the development of an IT-enabled behavioural credit scoring system by Provident) but these seem less dramatic than might be expected in a competitive market.

(c) High and sustained profitability

29. The CC's guidance[22] says that 'a situation where, persistently, profits are significantly in excess of the cost of capital for firms that represent a substantial part of the market could be an indication of limitations in the competitive process'. Our initial analysis has concentrated on the analysis of returns on capital employed, calculated from published information. We have been assisted in this by the amount of information published by Provident on its web site; calculations in respect of those who publish less financial information may be less reliable.

30. Our work to date suggests that Provident (which represents over half of the market) may have been earning returns on capital employed consistently in excess of its cost of capital for some time. Returns of other large and medium-sized providers show a less stable pattern; at least one other may be earning returns in excess of its cost of capital; others appear to be earning returns at or below their cost of capital, and some companies' returns may be declining. While the data is less reliable, we think that many smaller providers may also be able to earn returns in excess of their cost of capital.

31. Our approach to date is described in the Working Papers on profitability and on small and medium lenders—published on our web site. We have not, however, completed our analyses of profitability. Some lenders have told us that our approach is at best incomplete. We will continue to assess whether our approach is right and to test our findings. In particular, we will look at alternative measures of profitability (including some put forward by large providers), and at the treatment of intangible assets in analysis of return on capital.

32. If competition is not fully effective, it might also be expected that the level of costs may be higher than in a fully competitive market. However, we have not yet done any analysis which would determine whether or not this is the case, nor are we clear that such an analysis is feasible.

(d) Market share stability

33. The market shares of the main providers have remained static over a long period of time. While there have been some recent small shifts in market share, the positions of the two largest lenders, Provident and Cattles, are remarkably similar to their positions when the Monopolies and Mergers Commission (MMC) examined the check trading market in 1981.[23] Then, Provident was the largest provider (with over half the market) and Cattles was the second-largest; while below them were hundreds of small check traders. This mirrors closely the position in home credit today. We discuss market shares and the implications of market structure for competition further in paragraphs 39 to 50.

(e) Customer satisfaction

34. Home credit is characterised by high reported levels of satisfaction among existing customers. Provident Financial reports from its research that 93 per cent of its customers are 'satisfied' and 66 per cent are 'very satisfied' with the service they

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[22]CC3 paragraph 3.82.
[23]*Trading Check Franchise and Financial Services. A report on the supply of trading check franchise and financial services in the United Kingdom*, Monopolies and Mergers Commission, December 1981.

receive. The qualitative research which we commissioned from AIA found evidence of satisfaction among existing customers. The quantitative research which we commissioned from NOP also found high satisfaction levels among customers.

35. Research which we commissioned from MORI shows, not surprisingly, more grounds for dissatisfaction among customers who have left home credit than among those who are still customers, and also evidence that some customers leave home credit because of dissatisfaction with the agent.

36. We note, however, that while a third of new customers do not return to home credit after their first loan, up to half have had home credit loans for over five years and 30 per cent for over ten years. Although we have been told that home credit may contribute to overindebtedness, credit counselling services and Citizens Advice Bureaux, which handle many cases of overindebtedness or other debt problems, have told us that they receive few complaints and advise on few problems related to home credit. While we have heard some complaints from customers, the weight of the evidence available to us points to high overall levels of customer satisfaction with the service provided. This conclusion, however, needs to be qualified in that the various research findings may measure whether service provision meets expectations (which may be low) rather than absolute levels of customer satisfaction.[24]

37. We have been told by lenders, borrowers and commentators that home credit is a model of lending which meets the requirements of its customers well. This is consistent with the findings of independent academic researchers over a long period[25]. When making the super-complaint, the then Chair of the NCC, Dame Deirdre Hutton, described home credit as fitting the needs of some of its customers 'like a glove'. However, it does so only at a high cost. Customers, many of whom are on low incomes and some of whom have few if any realistic alternative sources of credit, bear that cost in the price they pay for credit.

Characteristics of the market

38. The market outcomes identified above may be the result of characteristics of the home credit market. Some of these may be features which act to prevent, restrict or distort competition. We set out our emerging thinking on the characteristics of the market under the following headings:

(a) The structure of the market:

(i) concentration in the market;

(ii) barriers to entry and expansion; and

(iii) regulation;

(b) other characteristics of the market;

(i) price competition;

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[24]When questionnaire surveys are used rigorously to measure consumers' judgements about the quality of service that they have received, the questionnaire will typically involve a substantial number of questions rather than a single invitation to assess satisfaction. One instrument invites respondents to agree or disagree with two matched sets of 22 questions.
[25]A description of much of this research is our working paper on independent research.

(ii) non-price competition; and

(iii) transparency and portability of creditworthiness information.

(a) The structure of the market

(i) *Concentration in the market*

39. There are several hundred providers of home credit in the UK, most of them small businesses that operate in a limited geographical area. The five largest providers are quoted companies that operate in several regions of the UK.[26] A further large provider, Mutual Clothing and Supply (Mutual), operates from 16 branches, mostly in the East Midlands. Most providers of home credit in the UK are members of the CCA (though Mutual, for example, is not).

40. We estimate, based on information provided by home credit lenders, that the market (measured by value of new loans issued) grew between 1999 and 2002, but has declined since to around the 1999 level. Estimates by Datamonitor[27] also suggest that the market is contracting slowly.

41. The market is highly concentrated. The six largest lenders account for over 85 per cent of the supply of home credit in the UK. The market leader (Provident), supplies more than half of all home credit in the UK.[28]

42. It is less clear whether the market is becoming more or less concentrated. The OFT found there was high and increasing concentration in the market. Our research suggests that the share of the market accounted for by the top six lenders is similar to the position in 1999. Datamonitor has suggested that the market may be becoming somewhat less concentrated, but we have seen nothing to suggest that this trend is very marked.

43. We indicated in paragraph 33 that there has not been much change in the pattern of market shares over time, which is not generally consistent with a dynamic, competitive market. Recent developments in the market include the expansion, largely by acquisition of smaller players, of Cattles (from 1999 to 2002) and its subsequent contraction (from 2002 to date) and the entry and growth in share of Park (from nothing to about 3 per cent of the market). These have had little effect on the broad pattern of market shares of supply at a national level, or on Provident's position as the largest lender.

44. We have considered whether Provident's substantial market share could confer significant advantages. Economies of scale might include the ability to share head office overhead, branding, regulatory compliance or central processing costs over a larger number of customers. The existence of economies of scale in itself need not give us cause for concern, if they enable Provident to provide loans at a lower cost to customers. However, we have seen no evidence that Provident passes the benefits of its economies of scale to customers in the form of lower prices. It seems more likely that in the absence of competitive pressure forcing prices down (see

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[26]Provident, which trades as Provident Personal Credit and Greenwoods Personal Credit, Cattles, which trades as Shopacheck, LSB, S&U which also trades as SD Taylor and Wilson Tupholme, and Park.
[27]*UK Non-standard and Sub-prime Consumer Credit 2005* Datamonitor 20 May 2005
[28]These figures are somewhat higher than estimates published by Datamonitor. We have discussed the differences with Datamonitor and we think that our calculations, based on responses from 15 companies representing, we think, around 90 per cent of the market, are probably more accurate estimates of current market shares.

paragraphs 22 and 71 to 74) Provident would have the opportunity to reap any benefits of economies of scale in the form of better returns.

45. Provident's size and share of the market may also enable it to behave in a manner which, whether intended or not, creates barriers to entry and expansion beyond those which already exist (see paragraphs 51 to 58). We are still considering this issue. However, we think that Provident's strategy of operating two brands (Provident Personal Credit and Greenwoods Personal Credit) might restrict the opportunities for new entrants by reducing their scope to position themselves or their products in a way which is distinctively different to Provident. Provident told us that where customers wanted to use more than one agent, it preferred the customer to use a Provident agent and a Greenwoods agent rather than agents of competing lenders. Provident's position may also be of value in the market for good agents (Provident told us that it seeks to attract agents by advertising its commitment to the home credit business). Provident has around two-thirds of the agents currently operating in the market, and given agent churn, may be expected to know of many more former and potential agents and their quality. Good agents may be more willing to work for established firms because of their reputations and established customer bases. They may also be deterred from moving to other lenders by restrictive covenants in their contracts (see paragraph 54). To the extent that good agents are a pre-requisite for a strong home credit business, this will add to incumbency advantage.

46. Provident also has a relationship with over half of current home credit customers and, through its data on past customers who might return to home credit, a further group of potential customers, and thus has an information advantage over any potential entrant through its knowledge of their characteristics, payment records and creditworthiness. This advantage may be increased by the existence of Provident's own proprietary IT-enabled behavioural credit scoring system which uses customer data to assess creditworthiness. It seems reasonable to suppose that Provident may at present be the only home credit provider whose customer volumes could justify such a system on a standalone basis. We consider the implications of the absence of sharing of data on customers' creditworthiness further in paragraphs 85 to 91.

47. We have considered whether Provident's size might confer other potential advantages:

- Its high market share might be expected to enable it to raise prices above competitive levels in a way that others could not. However, we have seen that Provident's prices are not at the top end of the range. Provident told us that it compares its prices against other national providers to ensure that its prices are competitive, and in particular aims to ensure that its prices are lower than those of Cattles' 'Shopacheck' brand.

- Similarly, it might confer the opportunity of price leadership. We have not seen evidence of a pattern of Provident setting or raising prices and others following, though other lenders told us that they set their prices by reference to Provident's. Our emerging thinking on price competition is set out in paragraphs 71 to 74.

- Its national coverage (which is the most comprehensive in the industry) means that it can continue to serve customers who move location (though we have heard no evidence that this is a significant advantage).

- Its size and quoted status might in theory enable it to raise funds more cheaply. Although we have heard some evidence that raising funds for a home credit business can be difficult for start ups, we have seen no evidence that Provident enjoys any advantages over the other larger lenders in this regard.

We are not clear at this stage whether Provident in practice exploit these potential advantages; nor whether some or all of these potential advantages, if exploited, could have an appreciable impact on competition. More generally, however, where incumbent lenders enjoy advantages (we discuss this in paragraph 69) Provident will benefit to a greater extent than any other lender.

48. Given our thinking on the geographical dimension of the market (see paragraph 16), economies from national scale may be less important than economies of local density. If a firm's customers are located closely together, its agents can cover their rounds more easily and more quickly. Repayments can be collected in a shorter time, which is beneficial for the firm and for the agents (who have an easily earned income stream and are more likely to stay employed by the firm). Many agents now have cars and can cover wider areas, and some lenders' branches have wider coverage than before. Further work is underway to assess the impact of concentration on competition and barriers to entry at a local level.

49. The CCA may mitigate the effects of concentration through enabling smaller players to compete more effectively with larger players than they otherwise could (see also paragraphs 27 and 63). The CCA does this by:

- giving smaller members some benefits of scale in dealing with regulation (for example by developing and selling standard documentation packages) and public scrutiny; and

- giving smaller members some benefits of scale in voucher procurement.[29]

50. Overall, the degree of concentration in the market noted at paragraph 41 might be thought be one among several factors which could in principle facilitate co-ordination. However, we have not in our work to date detected any pattern of co-ordinated activity.

(ii) *Barriers to entry and expansion*

51. Barriers to entry or expansion may reduce the threat of entry or expansion by smaller suppliers, or the expansion of larger providers into areas where they do not currently operate, and limit possible constraints on the prices charged by established home credit providers. We considered whether economies of scale available only to Provident might enable it to contribute to the existence of barriers to entry in paragraph 45.

52. Some of the barriers to entry which the CC often examines do not seem substantial:

- regulatory barriers are low. We have heard no evidence that a consumer credit licence is hard or expensive to get (nor is it designed to be). Regulatory requirements on the nature and amount of paperwork associated with a loan are extensive, but the CCA eases this burden by providing standard documentation to members;

- initial investment requirements are low. A business requires modest premises and IT facilities; the working capital requirement can be built up over time; and

- access to start-up capital does not appear overly problematic, though we did hear

[29] Lenders buy vouchers at a discount from retail outlets to provide an alternative product offer to cash loans

some evidence that banks were reluctant to lend to small home credit businesses.

53. We have also considered two further points put to us:

- that the regulatory prohibition on door-to-door canvassing of cash loans may restrict entrants' ability to access new customers. We think that this impact can be overstated (see paragraph 60); and

- that there are reputational barriers to entry (for high street banks, for example). Their evidence to us, however, suggests that the risks associated with lending in an unfamiliar way to an unfamiliar customer base may be more powerful influences then reputational concerns of this kind dissuading them from entry.

54. However, the nature of the business implies some barriers to entry and expansion. Access to a critical mass of trustworthy agents and creditworthy customers is essential to the profitability of an expanding business. Even a sole trader requires enough customers to sustain a desired income level. An entrant seeking to build a network of customers and/or agents faces obstacles:

- capable, experienced agents with established rounds have an incentive to remain with their current provider, where they are likely to enjoy an established income stream which they have helped to develop;

- restrictive covenants inhibit agents from moving to a new lender. These restrict agents' ability to deal with customers of a lender for whom they have worked for a period after leaving that lender, often even if the customer is also a customer of the new firm;[30]

- good customers may be hard to find—a new entrant seeking customers is likely to attract a disproportionate number of poor credit risks (who are seeking credit but may have been refused it by other lenders). The problems of adverse selection and the 'winner's curse' (which affect entrants or lenders seeking to expand their customer base) are referred to in our working paper on entry and are recognized by home credit lenders. An entrant is at a disadvantage to incumbent lenders because of the information the latter possess on customers and potential customers. This is discussed in the context of Provident in paragraph 46, but all incumbent lenders have an advantage over a new entrant in this respect; and

- there is no reliable creditworthiness information on potential home credit customers (see our thinking on the absence of sharing of creditworthiness data in paragraph 85 to 91).

55. There are also barriers to exit. We were told that running down a business is difficult. When customers recognize that no further credit will be forthcoming from a particular source, collection rates fall and the level of default increases. Traditionally, those seeking to exit have sold businesses to larger companies, but we were told that prices for businesses were currently low, with home credit receivables being sold at a greater discount to book value than in recent years.

56. There is some recent evidence of entry and exit from the market, certainly on a small scale. Evidence from the CCA on the history of entry suggests that entry on a small scale is possible and has occurred. In the five years between 1 January 2000 and 31

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[30]We understand that most lenders who use agents have such covenants; they exist in the CCA standard form agent agreement.

December 2004, 93 new member businesses (comprising 21 per cent of current membership) joined the CCA.[31] Of these 93, 39 were sole traders and 46 were businesses with up to ten agents. Others have cited the history of Park's entry into the market as evidence of larger scale entry and of expansion.

57. However, other evidence suggests that there are barriers to rapid or widespread expansion:

- Park told us that its experience had been difficult, and that with hindsight it might have expanded rather more slowly (and possibly in fewer locations);

- Cattles' experience of rapid expansion in 1999 to 2002 was marked by dramatic increases in bad debt and was swiftly reversed;

- others' patterns of operation (Cattles' recent consolidation, S&U's concentration of activity in particular geographical areas, the tight geographical focus of many smaller players) suggest a focus on a geographical or customer niche. Patterns of customer turnover show that, of larger lenders able to provide data, only Park (substantially) and Mutual (more modestly) increased their customer numbers between 2001 and 2004;

- with the exception of Park, we have seen no evidence of companies being able to grow from small to medium-sized, or from medium-sized to large,[32] in recent years;

- if it is true, as has been suggested to us, that some banks are reluctant to lend to home credit businesses because of their risk profile, lack of access to loan capital might be a further barrier to rapid expansion; and

- the pattern of the evidence on profitability suggests that it is easier for very large, tightly-focused or very small firms to earn good returns, which is consistent with the evidence that local density may be important to profitability.

58. We note, moreover, that such entry as has occurred does not appear to have had any significant impact on the behaviour or profitability of the larger lenders, or on shares of supply. Prices have not been adjusted. Nor, to the extent that we have been able to analyse them, do returns appear to reflect the extent of entry in any given region. Our initial analysis of Provident's performance by branch does not, for example, show much difference between branches in the East Midlands (where there has been recent entry and Provident's market share is lower than in other regions) and branches in Scotland (where Provident's market share is higher and we have not heard of significant entry).[33] We were told by Provident that it had intensified its local marketing efforts (but had not departed from its national pricing) in areas where it perceived most competition.

(iii) *Regulation of the industry*

59. We recognize that the legislation[34] which governs all forms of consumer credit, including home credit, has in general been designed with the promotion of

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[31]In the same period there were 235 resignations from the CCA.
[32]The definitions we used are in our paper on small and medium providers.
[33]We recognise that a region may not be a useful unit of analysis, and are doing further work at a more local level to test these findings.
[34]The legislation is summarized in our working papers on regulation.

competition in home credit being, at best, one of a number of considerations. Some consumer credit regulation has its origins in European Union Directives. UK consumer credit regulation has been designed to govern the whole of the broader consumer credit realm. This may have desirable effects in terms of consistency of regime for those offering different products, and in enabling customers to compare products. However, it means that the regime may not take full account of the peculiarities of the home credit sector. We have considered whether any of the legislation currently in place acts to prevent, restrict or distort competition in the home credit market. We have not completed our consideration, but our initial views on what seem to us to be the key regulatory issues are set out below.

60. In principle, the legislative prohibition on *unsolicited canvassing* might serve to prevent home credit providers from reaching potential customers new to home credit or from seeking to attract customers from other providers. However, we note that attracting either new customers or customers of other lenders carries a significant risk of adverse selection; the risk of default among these customers is likely to be highest. Lenders have told us that indiscriminate canvassing is one of the least reliable ways of attracting good new customers. We have also been told that home credit providers have been able, legitimately, to circumvent the prohibition, for example by canvassing directly to potential customers with offers of vouchers or goods. The legislation relating to canvassing may not, therefore, inhibit competition in practice as much as we might expect, but we remain concerned about its possible impact.

61. Regulations governing the precise form of *advertisements* may restrain companies from being creative in seeking to compete on different dimensions. In particular, the requirement to display an APR as part of any advertising which quotes price might provide an incentive for lenders to remove all forms of pricing data from some advertising material (we have seen much material which makes no reference to price). It may also discredit advertising and price competition in the eyes of customers for whom the APR is either incomprehensible or recognized as a poor measure. However, it is not clear to us that the regulations themselves influence the extent to which price is the focus of home credit advertising (paragraphs 71 to 74 discuss the muted nature of price competition). In other credit markets that are subject to the same regulations (for example, credit cards and personal loans) APR appears frequently in advertisements and other promotions.[35] We are not sure that competition on price (reflected in advertising) would be any more intense or effective if the regulations were not there.

62. We indicated in paragraph 10 that neither *credit unions* nor other alternative credit providers impose a significant competitive constraint on the home credit market. We have been told by commentators that it would be desirable if the credit union movement could develop to the point where it could impose such a constraint. Existing regulations, specifically the limit on interest rates chargeable on loans, prescription of the nature of the common bond and of the permitted level of deposits, have also been cited as inhibiting such development. Changes to the most significant variable (the limit on interest rates chargeable on loans) have, however, already been proposed by HM Treasury. We have also been told that there are other (non-regulatory) barriers to growth and development of the credit union movement in the UK, and we think that the existence of regulation is only one among several factors inhibiting the development of credit unions as a competitive constraint on home credit.

[35]We note that a recent trading standards review identified variable compliance with the latest regulations.

63. Consumer credit regulation (in particular the requirements for various forms of *documentation* when entering into an agreement) imposes a burden on all home credit lenders, but one which falls disproportionately on smaller firms. In particular, most of the costs of compliance with, for example, requirements to provide pre-contract documentation, do not vary with the number of loans issued, so can readily be spread over a larger volume of business by larger lenders. The existence of an active trade association can mitigate the worst of these effects by providing model documentation and advice on compliance. However, it is unlikely to be able to eliminate them entirely. And side effects of such activity may include stifling of innovation (see paragraph 27) and discouraging competition on aspects of service covered by regulation. These possible disadvantages lead us to think that regulation in its existing form may distort competition in home credit.

64. In our issues statement we drew attention to other aspects of regulation. We consider the issues surrounding early settlement rebates further in paragraphs 83 to 84). Apart from these and those discussed above, we have received no evidence to date which gives us any great cause for concern. We have, however, seen evidence that home credit providers devote considerable effort to complying with legislative requirements.

(b) Other characteristics of the market

65. The Act requires us to identify 'features of the market' which adversely affect competition. 'Features' include customer conduct and supplier conduct. In this market, some of the practices of home credit providers and customers may prevent, restrict or distort competition. In many cases the conduct on the part of each is linked and it is not yet clear to us which causes the other. An absence of switching between providers, for example, may reflect both an inherent reluctance of customers to switch and absence of active competition for potential switchers; both elements of conduct could be expected to reinforce the other. In the following paragraphs we set out our current thinking about conduct that might have adverse effects on competition without seeking to make a sharp distinction between the conduct of customers and the conduct of suppliers.

66. We note in particular that, in contrast to what we might expect to find in a competitive market, there seems to be relatively little switching of customers from one provider to another (eg increasing—or starting—the use of one supplier while reducing—or stopping—the use of another); still less switching in order to find a better deal. Customers do not seem to seek to switch, nor suppliers to encourage it.[36] Many customers do, however, take home credit from multiple sources. Around half of all home credit customers have simultaneous loans from more than one home credit provider. This may indicate that many of these customers are either credit constrained or opportunistic in their borrowing; we have seen evidence which suggests both of these. And while it demonstrates that these customers are aware of other providers, in the absence of switching it does not amount to clear evidence of competition in the market.

67. Not only do customers not appear to switch, but they do not appear to shop around and compare offers. We have been told that customers are on average aware of 2.8 other home credit suppliers. However, the NOP survey found that fewer than one in ten home credit borrowers found out the price of an alternative home credit loan.

68. This apparent reluctance among customers to switch reinforces suppliers' incentive

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[36]See our working paper on customer turnover, multi-sourcing and switching.

to concentrate on securing more business from existing customers rather than seeking to attract customers new to home credit or to win customers from other lenders. Data from large lenders show that around 15 per cent of their loans in 2004 were to new customers. The remaining 85 per cent of loans to are long-term customers, and account for over 90 per cent of the value of their home credit loans.[37] We would expect nearly all profits to be made from existing customers, since :

- the headline price of the loan per £100 is the same to existing as to new customers;
- the default risks are lower for existing customers;
- the amounts lent are higher, because of step up loans[38] (note that for a larger loan the fixed costs of the loan can be spread over a larger amount);
- set up costs are lower; and
- where the customer renews a loan, the price will be higher than for an initial, standalone loan.[39]

69. We have also identified what appear to be substantial advantages for incumbent lenders, who have:

- knowledge of customers' circumstances (including both what they can afford each week and their payment history) enabling them to make better judgements on creditworthiness and on customers' potential ability to repay larger loans than others could;
- knowledge of the timing and nature of customers' credit needs, enabling them to offer credit at the best moment; and
- the benefits of the established relationship between customer and agent (where that relationship is good).

70. Reluctance to switch, a strong incentive for lenders to concentrate on existing customers and the advantages of incumbency all tend to reduce competition for new customers and potential switchers. We analyse the impact of this in more detail below.

(i) *The approach to price competition*

71. Most home credit providers do not appear to compete with each other using the price of their loans as a competitive weapon. Those providers who operate over a wide area do not vary prices by location or customer type. This may be a result of several factors, including that:

- other aspects of the home credit offering from any provider may be more important to customers (fewer than one in ten respondents to the NOP survey cited price or value for money as a reason for their choice of lender);

[37] See our working paper on customer turnover, multi-sourcing and switching.
[38] See paragraph 89.
[39] See our working paper on renewals.

- it may be complex and expensive to vary prices between locations or customer groups;

- price does not seem to be a key determinant of customers' choice in home credit (our analysis of three large lenders' recent price changes—see our working paper on pricing—shows that customers' demand for a loan product does not fall as price rises);

- it is difficult to compare prices with those of other home credit products (paragraph 61 identified the limited use of price in some home credit advertising; we have also been told that some providers only quote prices via an agent calling on the customer). Moreover, customers may find it hard to compare products the terms of which (eg the length of loan) are not directly comparable;

- home credit customers may have difficulty assessing the price and value of products. We have been told by lenders that home credit customers are no less able to analyse the terms and conditions of financial products than other consumers. However, financial products in general are notoriously hard to understand, and understanding of APRs, for example, among consumers generally is poor;[40]

- given that loans are often issued at customers' homes by an agent of one lender (or even in a branch office) there is unlikely to be any competition at point of sale. Moreover, faced with an immediate requirement for credit (and an offer of it from a trusted source), customers may not be inclined to assess the offer in detail.

72. Lenders have argued that competitive pressure from other forms of credit for those customers with ready access to alternatives has the effect of protecting all customers, since terms and conditions, which are standard across all customer groups, have to be set in a way which avoids loss of those customers who have alternatives. As indicated in paragraph 13, we have seen no evidence that such competitive pressure serves to constrain home credit prices in practice.

73. Most home credit pricing structures do not differentiate between customers. That means that in general customers pay the same for a loan regardless of:

- loyalty. Consistent long-term customers pay the same as new ones or those who use home credit intermittently;

- payment record. Those who pay consistently gain no price benefit by comparison with those who regularly or frequently miss payments; and

- attractiveness to other lenders, whether home credit lenders or providers of other forms of credit. Lenders do not appear to make better offers to those of their customers who may be, or even to those who are known to be, likely to defect.

In all these cases, customers of greater value to the lender pay the same as customers who are less profitable. We recognize that it is not possible to distinguish between these groups in advance of the first loan. However, it would be possible to reward loyalty or good payment records once they had been established. In practice, new customers and those who represent a higher default risk are subsidized by established customers whose risk profile is better (and who therefore pay more than

[40]See for example, *Measuring financial capability: an exploratory study* prepared for the Financial Services Authority by Personal Finance Research Centre, University of Bristol, June 2005.

their risk and payment profile might warrant). While some element of cross subsidy of this kind is likely in all risk markets, we find the extent of it in home credit remarkable given the prevalence of price differentiation (for example, risk-based pricing and no claims bonuses) in other financial services markets.

74. We have seen some evidence of smaller lenders actively seeking to compete on price (notably Your Finance's evidence to our open meeting). However, we have seen no evidence of larger home credit lenders adjusting prices in response to competitive pressures from within the market (for example, the entry of a smaller lender competing on price) or from outside the market (for example penetration of sub prime credit cards into parts of the home credit customer base), despite the fact that both have taken place in recent years. Nor have we seen any evidence of price competition for renewals (see paragraphs 81 to 82), either directly or through the level of rebates offered (see paragraphs 83 to 84). We do not think that such limited price competition is consistent with a competitive market.

(ii) *The approach to non-price competition*

75. Home credit providers told us that they compete on service quality more than on price. We take 'service quality' to mean the development and maintenance of a good relationship between the agent and the customer (which includes issues like the agent calling regularly and reliably at the same time every week). This appears to us to represent good business practice, and clearly provides what the customer wants (see the evidence on customer satisfaction in paragraphs 34 to 37). However, an effective agent/customer relationship is costly to maintain and the costs of the relationship are borne by the customer in high charges for credit. Moreover, a close agent/customer relationship may entrench incumbency advantage, establishing barriers to switching for the customer and providing further incentives for companies and agents to lend more to existing customer base (which may also dampen their incentives to compete to attract customers from other suppliers).

76. The NCC supercomplaint suggested that the relationships which develop between agents and customers left agents in a position to take advantage of customers. While we heard some anecdotal evidence of this, the NOP survey did not suggest that this was a widespread problem; rather that the majority of agent customer relationships were good, but businesslike.

77. We have been told that home credit providers compete for agents—a provider's established agents are often targeted by other home credit firms. We have not yet completed our analysis of competition for agents. However, we have noted that the longer the agent's tenure, the less likely the agent is to leave their lender. There have been no substantial changes in commission structures or levels in recent years. Financial inducements designed to attract agents from competitors are only offered by a few of the largest companies. Where they are offered, packages only relate to some new agents and tend to be small. The guaranteed incomes provided by some lenders to new agents appear to be designed to compensate for the poorer returns to be expected from new rounds. It is not clear from our initial research that home credit providers compete vigorously for agents by offering better deals to good agents than their competitors.

78. The existence of restrictive covenants which limit, usually for a period of six months, the scope for agents (and often their new or future employers) to target customers of their previous company may also inhibit competition. While understandable in that they allow companies to protect their investment in building a customer base, they may discourage agents from moving and entrants or other lenders from seeking to

recruit their competitors' agents. This could be expected to restrict both the mobility of agents and the effectiveness as competitors of former agents, whether operating on their own account or for another lender.

79. The balance of incentives thus appears to discourage agents from moving from one lender to another. It appears more advantageous to remain on an established round with a relatively predictable income than to move, and risk having to build or develop a new round, which would be likely to entail starting with lower loan amounts (and thus lower commission income), and incurring more risks of default by customers initially less well known to the agent. To the extent that this incentive not to move provides an incumbency advantage, Provident, which has around two-thirds of all agents, will benefit from it to the greatest extent.

80. Both customers and providers have told us that willingness to provide credit is a means of competing. We have seen that around two-fifths of customers take out more than one loan with the same provider at the same time. Others multi-source, using different providers either sequentially or simultaneously. For some this may be a way of maintaining multiple lines of credit for use when necessary, for some a means of maintaining revolving credit. We have seen evidence of both of these. It could also be a route to switching supplier for some, though we have not seen evidence that this is the case in practice. We note that if there is competition in willingness to lend, it could create pressure on companies to lend irresponsibly, but have been told by home credit providers that there are countervailing pressures on home credit companies and agents to lend responsibly.

81. In contrast to other credit markets where refinancing is common (for example re-mortgaging or debt consolidation), we have not seen any evidence of competition between lenders for renewals. We have been told that a small proportion of loans are renewed (our estimates suggest at least a third). However, we have seen nothing to suggest that more than one or two per cent are refinanced by a home credit company other than the existing lender. We have also been told by lenders that the initiative for renewal generally comes from customers. The NOP survey provides some support for this view; of those who had renewed a loan, two-thirds said they had thought of the idea themselves. It is clear that renewal loans meet an identifiable demand on the part of some customers for further credit without an increase in weekly repayments (though we note that some customers seeking further credit may have no option to renew if lenders do not believe that they can meet increased weekly repayments). As indicated in paragraph 23 renewing a loan appears to be more expensive than the other way of increasing home credit borrowing (taking a parallel loan). Moreover, because the costs associated with a renewed loan are lower than the costs of a first loan we would expect them to be more profitable for lenders, perhaps substantially so. Home credit companies and agents both have an incentive to offer renewal loans to customers.[41]

82. The practice of renewing loans may also serve to raise barriers to switching, and competition at the point of renewal may be limited or distorted. Firms who have provided the loans which are to be renewed have a point of sale advantage because other home credit firms are likely to be unaware that a customer wishes to renew their loan at a certain point. The incumbent lender will also have the best, most up to date information on the customer's circumstances and thus on the bad debt risk they represent.

83. When renewing loans (or in any other circumstances where a loan is repaid early),

[41] See our working paper on renewals.

lenders are obliged by legislation[42] to pay a rebate to borrowers.[43] Most large lenders do not use the amount of the early settlement rebate as a competitive tool. We have been told of only two lenders who do this. While lenders do not have to offer any more in rebate than the minimum required in law, in a competitive market lenders might be expected to compete to offer better terms. This is a complex area on which we are doing further work.

84. We are also considering further whether:

- in the peculiar circumstances of a home credit loan, the rebate paid by lenders represents a fair balance between the interests of the borrower and the lender, and whether lenders profit from early settlement; and

- the rebate system has any effect on competition at the point of renewal.

(iii) *A lack of transparent, readily-available data about the creditworthiness of customers*

85. Home credit appears to be unique among unsecured lending activities in making almost no use of shared data held by credit reference bureaux (CRBs) on the creditworthiness of customers. Most unsecured lenders share data on their borrowers and draw on reciprocal data when making lending decisions. They clearly believe that the benefits of sharing data in predicting default outweigh both the costs involved and the sacrifice of any advantage conferred by possession of proprietary data on customers. There is a body of academic literature which suggests that increasing transparency reduces bad debt risk and thus cost in the system, and hence benefits most lenders and customers.[44] Yet we have found only one major home credit lender who makes any use of full shared reciprocal data held by CRBs in making lending decisions, and only 10 per cent of CCA members share default data with a CRB. Hence would-be lenders have no accurate way of judging the payment histories (which we have been told are the best indicator of creditworthiness) of other lenders' customers, and customers have no credible way of demonstrating their creditworthiness to lenders other than those who already lend to them.

86. The lack of an accurate portable credit history for many home credit customers (and potential customers) reduces lenders' incentive to seek new customers, acts as an impediment to switching and makes any threat to switch by customers less credible. For an incumbent lender, knowledge of a customer's payment record is a source of competitive advantage which enables them to lend more (in a situation where bigger, longer loans may be more profitable). We have been told that payment history is much the best predictor of payment performance. A new customer represents a higher risk for a new lender who does not know that payment history; and it may take time for the new lender to develop trust in the customer. They may therefore be less willing to lend, and/or willing to lend less[45] (this incentive particularly affects agents, who bear some of the credit risk in that if the customer does not pay, they receive no commission).

87. This problem applies to lenders within the home credit industry (who rely on home credit payment records and agents' judgement to assess credit risk). It applies even

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[42]The Consumer Credit (Early Settlement) Regulations 2004.
[43]See our working paper on early settlement rebates.
[44]See our working paper on credit scoring.
[45]In theory a lender might also lend at a higher (risk based) price in such circumstances, but we know of no home credit lender who prices in this way.

more strongly to lenders from outside home credit (who generally rely on CRB data to assess creditworthiness for the initial loan and who thus have no basis for assessing creditworthiness of individual home credit customers). Evidence from providers of mainstream credit suggested that this was a significant barrier to them providing credit to the home credit customer base. It thus constrains competition from outside the market.

88. We have been told by lenders that most customers keep a payment book and can use it to demonstrate a good payment history (and therefore creditworthiness) to another lender. However, not all customers keep up-to-date payment books (the NOP survey suggests that up to one in five do not). Home credit lenders have told us that they treat payment books with some caution as customers may not always show them comprehensive data on their payment histories (and, if in need of credit, have an incentive to conceal defaults or imperfections). Moreover, a payment book does not help a provider of mainstream credit products reliant on electronic records to assess creditworthiness remotely.

89. Step-up loans (the practice of lending larger amounts only when customers have proved their creditworthiness by paying back smaller loans) are a rational response to the absence of better information.[46] We have been told that this practice contributes to responsible lending and, by minimizing bad debt costs, reduces prices overall. However, this practice also reinforces incumbency advantage (in the absence of shared creditworthiness data, only an incumbent lender has the knowledge to offer a larger loan without incurring significant additional risk). It may also encourage customers to maintain one or more existing relationships rather than switching away from an existing lender.

90. We have been told that there are two disadvantages (peculiar to home credit) to sharing creditworthiness data:

- Traditional credit scoring methods have proved a poor predictor of payment performance, so the cost of developing scoring systems has not been justified by likely reductions in bad debt. We note that at present only public and search data (the least predictive of the data held by CRBs) is available to home credit companies; one lender has told us that there might be a stronger case if comprehensive data on home credit customers were available. We note that Provident has now developed a proprietary IT-enabled system which contains data on its customers and former customers and on which, we presume, it places some reliance.

- Lenders have told us that data sharing is not in customers' interests, since most miss at least some payments in the life of a home credit loan and if these were recorded as defaults, customers' prospects of getting other credit might be damaged. This problem is particularly acute if the missed payment results from a failure on the part of the agent, not the customer.

91. It seems to us unlikely, given the significance of bad debt in lenders' cost structures and the costs of the branch and agent network which control bad debt risk, that a cost-effective data sharing system which can address the peculiarities of home credit is impossible to develop. We understand that systems have been developed which meet the particular needs of credit unions, one of the larger home credit companies and some smaller CCA members at a price they can afford. It seems more likely that the advantage to incumbent lenders from the absence of transparency (a lack of

[46] Step up loans were mentioned as an area of concern in the NCC super-complaint.

competition for the best customers) outweighs the likely benefit to them of greater transparency; hence they have not sought to develop a more transparent system. In particular, Provident's market share makes it likely that a system which did not include its customers might not be cost effective, but the benefits for Provident of sharing data might not outweigh the incumbency advantage it currently enjoys.

The inquiry process

Events leading to reference

1. On 14 June 2004 the NCC submitted a super-complaint to the OFT on the market for home credit (also referred to as doorstep lending). The complaint followed NCC research which identified a range of impacts of low-income families who use this form of credit. More information on the super-complaint can be found at: http://nccdev.keymedia.info/moneymatters/index.htm#supercomplaint.

2. The super-complaint procedure was introduced by the Act, where a complaint can be made by a designated consumer body when it thinks that a feature, or combination of features, of a market is, or appears to be, significantly harming the interests of consumers. The OFT must publish a response within 90 days of receiving the complaint, stating any action it is proposing to take and the reasons behind this decision. On 10 September the OFT published its response to the super-complaint by the NCC[47] and a consultation paper on making a market reference to the CC. Under section 169 of the Act, the OFT must consult any person on whose interests a proposed market reference is likely to have a substantial impact. The consultation with providers of home credit closed on 18 October.

3. Having considered the NCC super-complaint, and the responses to its consultation, the OFT took the view that the legal test for a market investigation reference was met. It concluded that competition among home credit lenders appeared to be restricted, with providers having limited incentive to compete on price or to attempt to win business by taking over other providers' loans. The OFT decision can be found at:
http://www.oft.gov.uk/Business/Market+investigation+references/home+credit.htm.

4. On 20 December 2004 (under section 131 of the Act) the OFT referred the investigation into the supply of home credit in the UK to the CC. The statutory deadline for completion of the CC's inquiry is 19 December 2006.

Conduct of CC inquiry

Prior to Emerging Thinking

5. The CC has used various means of collecting evidence for the purpose of the inquiry. These include requests for written material, invitations to oral hearings and advertisements in the press and radio seeking views.

6. The CC sought initial background information and submissions from certain providers of home credit; and submissions from other providers and from interested third parties which it had identified. These included bodies representing home credit

[47]Although the NCC was not at the time formally designated a as super-complainant, the OFT decided to treat the NCC's submission as a super-complaint.

consumers. An invitation to submit evidence was also placed on the CC—Home Credit web site together with an administrative timetable for the inquiry.[48]

7. All documents published by the CC in relation to home credit can be found at: http://www.competition-commission.org.uk/inquiries/current/homecredit/index.htm

8. Submissions received from providers of home credit and third parties were placed on the web site. At the request of respondents, some have been anonymized and/or exclude commercially-sensitive material. In March 2005, the group of members conducting the inquiry (the group) held hearings with a number of third parties, including the NCC.

9. Between February and April 2005, certain home credit providers[49] arranged for members and staff from the home credit inquiry to accompany agents on their rounds. This gave the inquiry team the opportunity to meet home credit customers and observe the home credit market at work.

10. The CC published a statement of issues on 18 April 2005. This statement was based on evidence that had been received in the first four months of the inquiry. Its aim was to highlight issues which appeared relevant in deciding whether features of the market for home credit prevented, restricted or distorted competition. Following the publication of the issues statement, the group held hearings with the CCA and the six largest providers of home credit.

11. The CC held an open hearing in Manchester on 19 May 2005. Advertisements were placed in the local media which invited home credit customers to the meeting or alternatively invited them to ring the CC on a freephone line or write to a freepost address. Press advertisements were placed in: *Manchester Evening News*; *Salford Advertiser*; *Tameside and Glossop Advertiser*; *North East Manchester Advertiser*; *Oldham Advertiser*; and *Manchester Metro News*. A series of radio advertisements were run on the Manchester-based stations Galaxy 102; Key 103; and Magic 1152, from 9 to 18 May 2005. After the open hearing, over 12,000 posters were distributed via the Benefits Agency Publicity Register to be displayed in locations like GP surgeries, CABs, libraries and job centres, again asking to hear from customers of home credit. A summary of responses to the advertisements has been published on the web site—see paragraph 7.

12. The open hearing concentrated on four of the perceived major issues; sources of credit open to home credit customers, the relationships between providers, agents, and customers, price comparisons, and entry and expansion. Providers who contributed presentations included Cattles, LSB, Park, Provident, S&U, County Finance and Your Finance. The CCA, Church Action on Poverty, the DTI, Liverpool John Moores University and Policis also made presentations. Transcripts of the open hearing, covering both the presentations and the subsequent open discussions, are available on the web site—see paragraph 7.

13. The CC had in the meantime commissioned research to explore users' and agents' perceptions and experiences of home credit. AIA carried out qualitative research in April 2005, conducting group discussions and face-to-face interviews with recent and current users of home credit, and agents and managers of home credit providers. NOP World was commissioned to carry out a quantitative survey. In May and June 2005, NOP World conducted quantitative research by means of 1,000 telephone

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[48]The administrative timetable was published on 11 February 2005.
[49]Cattles plc, London Scottish Bank plc, Park Direct Credit Ltd, Provident, Financial plc, S&U plc, County Finance and Bristol Finance.

interviews from a sample of customers of a number of providers. In September 2005, Mori Financial Services produced a survey for the CC which compared the profiles of current and paid-up home credit users, non-home credit users and users of mainstream credit products. In addition, in July 2005, the CC commissioned British Market Research Bureau (BMRB) to analyse home credit customer data collected in their regular survey of consumers' buying decisions. The results of these surveys are published on the home credit web site. We have also seen customer and other survey material commissioned by home credit providers and other bodies.

Publishing an Emerging Thinking document

14. Since publication of the issues statement, the CC has considered further written and oral evidence. In the light of all the evidence submitted throughout the inquiry, it has begun to focus its thinking. Emerging Thinking explains the group's current views. Alongside the Emerging Thinking document we have published a series of working papers which reflect the group's thinking, based on the evidence it has seen to date, on some of the key issues. Comments are welcome both on the Emerging Thinking document and on its supporting working papers.

15. In publishing our working papers, we have removed from them some material which home credit lenders have told us is commercially sensitive. We have done so without prejudice to possible disclosure in the course of the inquiry, for example when we issue our provisional findings. Before we disclose any such material we shall have regard to the statutory considerations on disclosure of information in section 244 of the Act, which are summarized in our guidance (CC7). In particular, we shall decide which parts, if any, of currently excised material should be published because they are essential to an understanding of our findings

16. Issues which have been raised in the issues statement but are not included in detail in the emerging thinking document appear currently to be of less concern, although they may yet be subject to further consideration.

What happens next?

17. The deadline for written responses to Emerging Thinking is **18 November 2005**. As part of its consideration of these responses, the CC envisages another round of hearings.

18. The CC will use the Emerging Thinking document, its accompanying working papers and any further evidence as the basis for its Provisional Findings. This is expected to be published in January 2006 and will, in accordance with the CC's rules, be followed by a further consultation period. If the Provisional Findings were to point towards an adverse effect on competition, then the CC would consider what, if any, remedies would improve the situation. It would publish a notice of proposed remedies at about the same time as the Provisional Findings. Hearings would be held to discuss proposed remedies. Interested parties would have the opportunity to convey their views on proposed remedies.

19. At the end of this consultation period, the CC's final report into the home credit market will be published. We currently expect this to be in the early summer of 2006.

20. We would like to thank all those who have assisted in our inquiry to date.