HOME CREDIT

Statement of issues

1. On 20 December 2004 the Office of Fair Trading (OFT) referred the home credit market to the Competition Commission (CC) for investigation. The reference followed an initial OFT study into the sector, which was undertaken in response to a complaint from the National Consumer Council (NCC).

2. 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.

3. The CC is required to determine whether any feature of the home credit market prevents, restricts or distorts competition.[1] If this is so, there will be an 'adverse effect on competition'. The competition issues set out in this statement (which we distinguish from issues of consumer protection or social policy, which we have no power to resolve) are those which may be of relevance to our eventual decision. We have not yet reached conclusions on any issue set out in this statement.

4. This issues statement is based on the evidence so far submitted to us in writing and at hearings by, for example: customers, suppliers, trade associations, public sector

[1]Section 134 of the Enterprise Act 2002.

bodies, academics, interest groups and other interested parties. Its purpose is to show the nature of the issues raised and to invite comment on these or any other relevant issues.[2] We plan to hold further hearings with interested parties during May and June 2005, including an open hearing.

5. Following these hearings, we expect to publish an 'emerging thinking' document for consultation. We may then hold further hearings before publishing our provisional findings. If we were provisionally to have found that there were adverse effects on competition, we would then consider possible remedies.

Presentation of the issues

6. The issues which appear to be relevant to the decision as to whether any feature of the market prevents, restricts or distorts competition are detailed below under the following headings: market definition, market structure (including regulation), conduct of firms in the market, conduct of customers, the competitive impact of prospects for entry to the market, and prices and profitability as indicators of the extent of competition. We also consider possible detrimental effects on customers, the applicability of Articles 81 and 82 of the EC Treaty, and indicate the focus of our analysis.[3]

A. Market definition

7. Identifying the relevant economic market or markets provides the framework within which our assessment of competition and the effects of market features can be carried out. We note that whatever market definition we adopt, products outside that market may impose a competitive constraint on that market.

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[2]Other issues may arise as the inquiry progresses. We will of course take them into account.
[3]In addressing the issues that appear to arise in this inquiry, the CC has adopted the approach set out in the guidelines for market inquiries in its published document *Market Investigation References: Competition Commission Guidelines* (CC3). (A copy of this document is on the CC's web site. The relevant sections of *CC3* for the purposes of this statement of issues are Parts 2 and 3.).

8. Our present working hypothesis is that the supply of home credit, as defined by our terms of reference, can be regarded as a relevant market. However, we are considering the following issues in more detail:

(a) the scope for substitution between home credit and other forms of credit including:

(i) other commercially provided forms of sub-prime credit, such as pawnbroking, pay-day advances, sub-prime credit cards, and agency mail order;

(ii) credit other than home credit provided by home credit suppliers;

(iii) credit provided by lenders who are not engaged in the supply of home credit (often described as 'mainstream lenders');

(iv) loans from the Social Fund; and

(v) loans from credit unions;

(b) the proportion of home credit customers who have access to and use other credit products, their perceptions of those products and the use they make of them;

(c) whether there are separate markets (or separate segments within the same market) for customers who do and do not have access to other credit products;

(d) the extent of switching between home credit and other forms of credit;

(e) the sensitivity of home credit customers to changes in price, service or quality and the nature of their response to such changes;

(f) whether vouchers for which payment is collected at the customer's home are part of the same relevant market as cash loans;

(g) whether hampers or other goods for which payment is collected at the customer's home are part of the same relevant market as cash loans;

(h) whether insurance purchased with or as part of a cash loan is part of the same relevant market as that loan; and

(i) the extent to which other forms of credit, even if outside the relevant market, impose competitive constraints on home credit, or may do so in the foreseeable future.

9. We are also considering:

(a) the extent to which suppliers of other products (for example, other home-delivered products or other credit products) could provide home credit in the event of a price rise; and

(b) the geographic extent of any relevant market, in particular:

(i) whether the market is national, regional or local;

(ii) whether market structure varies across the UK;

(iii) whether the conditions of competition vary across the UK;

(iv) whether differences in local market structure affect the outcomes for customers; and

(v) the extent to which prices vary across the UK.

B. Market structure

10. The home credit market appears to have become increasingly concentrated, following consolidation over the past 10 to 12 years. It has been put to us that:

(a) The number of companies with over 1,000 agents has declined from six to four since 1993.

(b) The four largest home credit suppliers currently account for over two-thirds of the market in the UK as a whole, including the market leader (Provident Financial plc), which has around half the market in the UK as a whole.[4]

(c) The number of small companies and sole traders in the market has declined.

11. We are considering:

(a) what are the correct figures for share of supply at a national, regional or local level;

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[4]The Herfindahl-Hirschman Index (HHI) of the home credit market for the UK is around 2,600. The HHI is an indicator of market concentration and is calculated as the sum of the squares of the market shares of all providers in a market; it therefore ranges from 0 to 10,000. The threshold above which most competition authorities consider a market to be concentrated is 1,800.

(b) whether the level of concentration has increased at a national, regional or local level, and if so why;

(c) whether any such increase is indicative of any features that might prevent, restrict or distort competition; and

(d) whether effect (if any) of the level of concentration on the conduct of some or all suppliers or customers.

Regulation

12. We are considering the current and future regulation of home credit in the UK, and in particular whether the regulation of the market acts to prevent, restrict or distort competition by, for example, creating switching costs or barriers to entry. We recognize that there may be a tension between the promotion of competition and the protection of consumers. We take this tension into account.

13. Consumer credit in the UK is largely governed by the Consumer Credit Act 1974. Regulations that may bear on competition in the market include:

(a) *Licensing*. The OFT issues consumer credit licences[5] to individuals or groups that meet certain conditions. We are considering the extent to which the fitness test and the cost of application might prevent new entrants from competing in the market.

(b) *Unsolicited visits*. It is illegal in the UK to canvass debtor-creditor agreements away from trade premises. We are examining whether this regulation acts as a barrier to new entrants who are attempting to attract customers, or inhibits competition among existing providers.

(c) *Advertisements.* The Consumer Credit (Advertisements) Regulations 2004 require credit providers to state the annual percentage rate (APR) of their loans in advertisements. We are considering the implications of this requirement.

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[5]A licence is required to carry on a consumer credit business involving credit of £25,000 or less. There is no minimum limit.

(d) *Regulated agreements.* The Consumer Credit (Agreements) Regulations 1983 require regulated agreements to include specific information about loan terms. We are considering the implications of this requirement.

(e) *Right to complete payments ahead of time*. Customers are entitled at any time to terminate their loan by giving written notice and paying off their remaining debt (including interest, but less any statutory rebate). We are considering the practical implication of this requirement, and its effect on switching between providers.

(f) *Others*. Customers may be affected by regulations on cancellation rights, default notices, and extortionate credit bargains. We are considering the implications of these.

C. Conduct of firms in the market

14. The following matters have been brought to our attention as potentially preventing, restricting or distorting competition: the relationship between customers and agents, information asymmetries, lack of transparency of creditworthiness information, step-up loans, renewals or rollover loans, early settlement arrangements, the nature of pricing and other dimensions of competition, and variation of conduct between providers. These matters are detailed as follows.

The relationship between customers and agents

15. We have been told that lenders' agents develop close relationships with their customers, and that most new business comes from current customers taking out further loans or from referrals from existing customers. We are exploring several issues relating to these relationships, including:

(a) the propensity of customers to stay with a company (or switch to another company) because of their relationship with the agent, regardless of considerations of price or whether the customer's credit needs could be met in other ways;

(b) the incentives on agents created by their remuneration structure, and the consequences for agents' behaviour; notably whether they engage in overt or subtle selling practices which induce customers to take further loans, and whether there is a disincentive for agents to suggest that reliable customers switch to cheaper loans offered by the same company but collected other than at the customer's home;

(c) any sense of obligation felt by customers towards agents because of their awareness of agents' commission-based remuneration structures, because of agents' ability to allow reduced or deferred repayments or because of an agents' role as suppliers of much needed credit;

(d) the role of the agent as a source of financial advice to customers and its impact on their choices; and

(e) the impact of the fact that most transactions are conducted in or at the customer's home.

Information asymmetries

16. The NCC complaint stated that customers are often in a weak bargaining position when loans are offered, because they are unaware of the availability or cost of alternatives to the loan they are offered. We are considering whether suppliers or agents take advantage of their greater knowledge of the availability and cost of alternative sources of credit to the customer, and the bases on which suppliers decide to offer, or decline to offer, credit.

Lack of transparency of creditworthiness information

17. We have been told that the majority of home credit companies do not register individual loan information with credit reference agencies because of the high price of

credit checks in relation to home credit loans and because it might not be in customers' interests for imperfect payment records to be recorded. We have also been told that home credit companies do not check other information on customers held by reference agencies because of the limited value of the information held by credit reference agencies in predicting the reliability of home credit repayment. These practices may prevent customers from building a fully portable credit history which they could use to demonstrate creditworthiness to another lender. We are considering:

(a) the extent of sharing of negative data on customers' credit history (including whether the lack of sharing is in the customer's best interests);

(b) the extent of sharing of positive data on customers' credit history (we have been told that some use is made of home credit payment books to demonstrate a record of payment);

(c) whether the absence of data sharing inhibits customers from improving their creditworthiness in the eyes of other lenders; and

(d) whether the absence of data sharing makes suppliers reluctant to offer loans to new customers, or enables them to make it more difficult for existing customers to switch.

Step-up loans

18. "Step-up loans" refers to the practice whereby home credit companies lend small amounts to new customers because of the risk that they will default, and offer larger amounts once customers have developed a good repayment record over a period of time. We are considering:

(a) the extent to which step-up loans tie established customers to a supplier and provide an incentive to take further loans from the same provider;

(b) the role of step-up loans as a means of testing the creditworthiness of customers (thus promoting responsible lending and reducing the incidence of bad debt); and

(c) whether suppliers need to rely on step-up loans to establish creditworthiness because of the absence of data sharing.

Renewals or rollover loans[6]

19. A renewal or rollover loan is a single loan (on which interest is payable) that discharges the existing loan or loans with the same lender (including the interest payments due for the remainder of the term less any rebate) and provides a further advance. We are considering:

(a) the incidence of renewal or rollover loans;

(b) the structure of renewal or rollover loans;

(c) the recalculation of charges following a renewal or rollover loan (and whether customers understand their entitlement to—and get—an appropriate rebate for early settlement of the previous loan);

(d) customers' awareness of the extent to which their debt increases and the basis on which charges are recalculated;

(e) incentives for agents to sell such loans; and

(f) selling practices for such loans (including the extent to which this practice meets genuine customer demand).

Early settlement

20. It has been put to us that some home credit providers do not provide an appropriate rebate (to which customers who repay their loans early are entitled). We are considering:

(a) whether all providers explain the existence of rebates for early settlement, and if they do, at what point in the life of the loan;

(b) whether all providers give the required rebates of interest and other charges for early settlement;

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[6] The practice described as 'rollover loans' by the NCC and others is generally termed 'renewal' by home credit companies.

(c) whether the methods for calculating rebates unduly favour lenders;

(d) whether any failure to pay the required rebates (or any rebates at all) inhibits switching and/or encourages renewal or rollover loans with the same lender; and

(e) the effect of changes to the regulations on early settlement rebates due to come into force on 31 May 2005.

Pricing and other dimensions of competition

21. It has been put to us that prices and product offerings show little variation. We are considering:

(a) the extent to which home credit providers compete on price;

(b) whether there is scope for and evidence of price leadership or coordination between suppliers;

(c) the consistency of pricing, and whether it gives rise to cross-subsidy of some customers by others;

(d) the extent and nature of competition on other dimensions (for example, the duration of the loan, the availability of further credit, the ability to reduce or defer repayments or the nature or quality of services provided to customers); and

(e) whether there has been any recent change in the level of price or other competition.

Variation between providers

22. We are considering whether there are any important differences between the conduct of companies of different sizes or natures.

D. Conduct of customers

23. The following matters have been brought to our attention as potentially preventing, restricting or distorting competition: exclusion and self-exclusion, reluctance to compare prices, and reluctance to switch. These matters are detailed as follows.

Exclusion and self-exclusion

24. A significant number of home credit customers are excluded, or exclude themselves, from using other types of credit. We are considering:

(a) the extent to which customers are able to access other types of credit;

(b) the nature and extent of self-exclusion;

(c) the extent to which customers are homogeneous (or not) in terms of their attitude to and use of credit; and

(d) the impact of any lack of choice for some customers on competition in home credit.

Reluctance to compare prices

25. We are considering:

(a) the extent to which customers compare the price of a home credit product (both with the prices of other home credit products from the same or other suppliers and with the prices of other types of credit product), and the influence of price and other factors in customers' choice of lender and loan product;

(b) the extent to which low levels of financial literacy and poor understanding of financial products prevent some customers from making informed choices, in particular:

(i) the level of customers' understanding of financial products;

(ii) customers' understanding of the terms used in credit agreements;

(iii) customers' understanding of the cost of loans (and the APR measure in particular); and

(iv) whether home credit customers use alternative measures of the cost of credit, such as the total cost of the loan or the level of weekly repayment; and

(c) whether established measures of comparing the cost of credit are deficient, including:

(i) whether the APR offers a fair comparison between home credit and other types of credit;

(ii) the extent to which measures of the cost of home credit are influenced by, for example: the absence of default charges or penalties for late payment, the short-term nature of home credit loans, and factors such as the home collection service provided; and

(iii) whether there are methods of comparing the cost of different home credit products, or the cost of home credit with other forms of credit, other than APR.

Reluctance to switch

26. The NCC found low levels of proactive switching between home credit companies, a similarly low level of switching between home credit and other forms of borrowing, and that stopping using home credit was not usually a proactive decision on the part of the customer. We are considering:

(a) what prompts switching within or beyond home credit;

(b) whether there are barriers inhibiting proactive switching;

(c) the role of the agent relationship (if any) in inhibiting switching; and

(d) whether the threat to switch exists to a greater extent than the reality of switching, and whether it imposes a competitive constraint on suppliers.

E. Entry

27. We are considering whether there are barriers to entry or expansion, particularly to large-scale entry, and their effect, including:

(a) the extent to which the market is expanding or contracting, and whether it is attractive to new entrants;

(b) whether switching costs may create a barrier to entry or expansion, including:

(i) whether an entrant will always be at a disadvantage to an established supplier because, when faced with equivalent price offers, the customer will prefer to stay with the current supplier to avoid switching costs; and

(ii) whether the lack of publicly available information about home credit customers' creditworthiness would prevent new entrants from assessing whether customers would be likely to pay back their loans;

(c) whether established firms enjoy advantages over new entrants in terms of the following:

(i) economies of scale;

(ii) avoiding default risk by having established networks of frontline staff;

(iii) employing established agents who can be trusted to collect money and lend responsibly, and who are restricted by covenants from moving to other companies and taking their customers with them;

(iv) the ability to attract word-of-mouth recommendations, which we have been told are the most reliable way for an agent to build up a good-quality customer base;

(v) levels of bad debt, and whether new entrants are likely to attract disproportionate numbers of customers who have been turned down by other suppliers or represent higher risk of default than average;

(vi) other start-up costs, including capital for providing initial loans, renting premises, purchasing systems for recording and monitoring loans, and for collecting loan instalments as they fall due; and

(vii) customers' loyalty to well-established brands;

(d) whether providers are prevented from entering or expanding in the market because of the need to comply with regulatory requirements (see paragraph 13), including:

(i) the need to secure a consumer credit licence; and

(ii) the restriction on direct canvassing for new customers;

(e) whether new entrants are prevented or deterred from entering or expanding in the market because of the actions or expected actions of incumbent providers;

(f) the relative ease of small-scale entry in comparison to large-scale entry or expansion to large scale;

(g) any perceived risk to the reputation of mainstream lenders of being associated with home credit; and

(h) whether historical entry/exit patterns suggest it is difficult to enter the market, or subsequently expand, on any significant scale.

F. Prices

28. The CC's guidelines on market investigation references say that it will consider the pattern of prices over time as one indicator of the extent of competition.[7] We are considering:

(a) whether the price of home credit exceeds the levels that could be expected in a competitive market;

(b) whether the history of price movements is indicative of competition; and

(c) whether the price of home credit can be justified by the implications of the home credit business model, including:

(i) the cost of home collection;

(ii) the risk of default of home credit customers; and

(iii) the absence of charges for missed repayments.

G. Profitability

29. The CC normally considers profit levels, usually in terms of rates of return on capital in the market or markets concerned, as a further indicator of competitive conditions.[8] We are therefore considering:

[7] CC3, paragraph 3.79.
[8] CC3, paragraph 3.82.

(a) whether any firm, or firms, that represent(s) a significant part of the home credit market makes profits substantially in excess of its cost of capital, over an appropriate time period. We shall assess:

(i) the revenues and costs for home credit providers;

(ii) the capital employed by, and the capital structure of, home credit providers; and

(iii) the appropriate cost of capital that we should use in assessing whether profits are excessive; and

(b) whether there is any evidence that the level of costs of any supplier is higher than would be sustainable in a competitive market.

H. Possible detrimental effects on customers

30. We shall determine whether any effect on customers in the form of higher prices, lower quality or less choice of goods and services, or less innovation has resulted from, or may be expected to result from, any adverse effects on competition in the relevant market or markets.

I. The applicability of Articles 81 and 82 of the EC Treaty

31. Under the EC Modernisation Regulation,[9] national competition authorities applying national law must also ensure that Articles 81 and 82 of the EC Treaty are applied to agreements or conduct that have an effect on trade between member states.[10] We therefore need to consider whether Articles 81 or 82 of the EC Treaty are applicable to any agreements or conduct in the relevant market or markets.

[9]Council Regulation 1/2003/EC, Article 3(1).

[10]In addition, the CC is subject to Article 10 of the EC Treaty, which requires that member states cooperate fully with the European Community in the attainment of the objectives of the EC Treaty, and that application of national law must not prejudice the full and uniform application of EC law, including Articles 81 and 82.

J. Focus of analysis

32. While we have yet to reach a view on any of the issues set out above, the evidence received to date leads us to concentrate our analysis principally on:

(a) the impact of industry structure (including of potential entry and expansion) on competition;

(b) the extent to which customers have, perceive they have, and exercise choice in, access to credit;

(c) the similarity of essential features of the home credit product offering;

(d) the impact of the agent/customer relationship on competition;

(e) the prevalence and effect on competition of renewal or rollover of loans;

(f) how far evidence on pricing and profitability indicates the extent of competition; and

(g) the ease of comparison of different home credit loans, and comparability between home credit loans and other forms of credit (including the suitability of the APR as a basis for comparing costs of credit).