

## STORE CARDS MARKET INQUIRY

### Issues statement

#### Introduction

1. In this inquiry, the CC is required<sup>1</sup> to decide whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of the following reference services:
  - (a) store card credit services to retailers and services related thereto (store card credit services); and
  - (b) consumer credit through store cardsin the UK or a part of the UK. If it decides that there is such a prevention, restriction or distortion, then there is an adverse effect on competition.<sup>2</sup>
  
2. If the CC decides that there is an adverse effect on competition, it is required<sup>3</sup> to decide the following additional questions:
  - (a) whether action should be taken by it under section 138 for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition;
  - (b) whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition; and
  - (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

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<sup>1</sup>Section 134(1) of the Enterprise Act 2002.

<sup>2</sup>Section 134(2) of the Enterprise Act 2002.

<sup>3</sup>Section 134(4) of the Enterprise Act 2002.

3. In addition, pursuant to Article 10 of the EC Treaty and in the light of Council Regulation (EC) No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the EC (the Modernisation Regulation), the CC needs to consider the requirement that the application of national competition law must be consistent with, and must not prejudice, the full and uniform application of EC competition law.
  
4. In this issues statement we set out a number of issues which, on the basis of the evidence so far submitted to us in this inquiry, appear to be relevant to:
  - (a) the decision (mentioned in paragraph 1) as to whether any feature of the market or markets in which the reference services are supplied prevents, restricts or distorts competition. It should be noted that a number of the issues raised (for example, those relating to transparency) may not in themselves directly prevent, restrict or distort competition in the relevant market(s), but may be relevant as indicating the presence of conditions that could give rise to, or facilitate, adverse effects on competition in that market or those markets; and
  - (b) the requirement mentioned in paragraph 3.
  
5. The question of what, if any, remedial action might be necessary (see paragraph 2) is a matter which the CC will address, if necessary, at a later stage. However, this statement does raise the question whether any adverse effect on competition in the relevant market or markets has resulted in, or may be expected to result in, any detrimental effect on customers in the form of higher prices, lower quality or less choice of goods or services, or less innovation in relation to such goods or services.<sup>4</sup>

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<sup>4</sup>Section 134(5) of the Enterprise Act 2002.

6. No decisions have yet been taken on any issue set out in this statement. Its purpose is to expose the CC's current thinking as to the nature of the issues raised, and to generate further views and evidence. The CC plans to hold a number of issues hearings with interested parties during October and November.

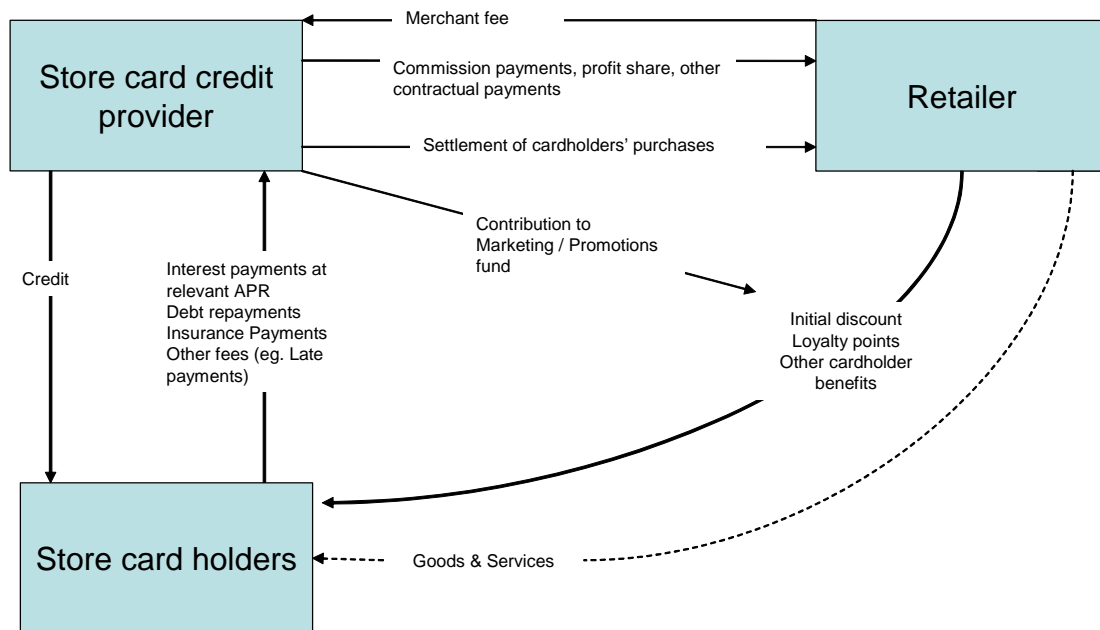
### **Presentation of the issues**

7. In addressing the issues that appear to arise in this inquiry, the CC has adopted the guidelines for market inquiries set out in its published document *Market Investigation References: Competition Commission Guidelines (CC3)*.<sup>5</sup> As explained in that document, the CC's approach to market investigations will normally be framed in terms of two related matters. The first is the identification of the relevant economic market or markets for the goods or services concerned. These define the boundaries within which the assessment of competition is carried out. The second is the assessment of competition and involves a consideration of whether any features exist that might prevent, restrict or distort competition within the economic market or markets concerned.
8. CC3 suggests that features which might adversely affect competition may be viewed as falling into three broad categories: structural features of the market, the conduct of firms in the market (whether as buyers or sellers), and the conduct of customers. In addition, it suggests that other indicators of competition should be considered, such as prices and profitability. Finally, in the light of the Modernisation Regulation, the CC needs to consider the possible applicability of Articles 81 and 82 of the EC Treaty.

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<sup>5</sup>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.

9. Store cards are plastic cards that can be used to buy goods or services in a specific retailer or group of retailers. For the consumer, they provide a means of payment for goods or services, a credit facility and (in many, although not all, cases) the means to obtain discounts or other benefits or concessions. Retailers offering store cards obtain demographic and transactional information on those customers who take them up; they also hope to build loyalty from those customers and hence encourage them to increase their purchases.
  
10. So far as the conduct of firms and customers (referred to in paragraph 8) is concerned, the provision of store card services involves the interaction of three parties: the store card credit provider, the retailer (who markets store cards to its customers), and the retailer's customers (whom we term 'store card holders'). A contractual relationship exists between the store card credit provider and the retailer (in respect of the store card credit services supplied to the retailer), and between the store card credit provider and the store card holder (in respect of the supply of consumer credit accessed through the store card). The initial marketing of the store card is undertaken by the retailer (usually in the retailer's premises), not by the credit provider. The following diagram illustrates the three-way interactions typically involved.



11. The issues set out below accordingly cover, among other matters:
- (a) the contractual arrangements made between the store card credit provider and the retailer;
  - (b) the contract between the store card credit provider and the store card holder; and
  - (c) the marketing of a store card to a customer by a retailer when that customer buys its goods or services.<sup>6</sup>
12. Adopting the broad conceptual framework for assessing market inquiries outlined in paragraphs 7 and 8 above, we have grouped the issues under the following headings:<sup>7</sup>
- A. Market definition
  - B. Structural features of the market(s)

<sup>6</sup>The Government is in the process of reforming the statutory provisions governing consumer credit as a whole, including the provision of credit through store cards, to improve transparency for consumers; moreover, the credit industry has recently introduced measures to increase transparency on a voluntary basis. The focus of our inquiry is primarily on the matters raised in subparagraphs 11(a) and (b) above and the market conditions in which they take place.

<sup>7</sup>Certain issues may fall under more than one heading, leading to some degree of overlap of the issues—for example, issues relating to structural features of the market may also involve the conduct of firms.

- C. The conduct of store card credit providers
- D. The conduct of retailers
- E. The conduct of customers (store card holders)
- F. Prices and profitability
- G. The applicability of Articles 81 and 82 of the EC Treaty
- H. Possible detrimental effects on consumers

## **The issues**

### ***A. Market definition***

- (i) Whether there exists a single market which includes two elements, namely the supply by store card credit providers of store card credit services to retailers and the supply by store card credit providers of consumer credit through store cards. Or whether there are (at least) two relevant markets: one involving the provision of store card credit services to retailers and the other involving the provision of credit (or a means of payment) to store card holders through particular retailers. Or whether the market or markets should be defined in some other way.
- (ii) As regards the products to be included in the relevant market or markets, whether all, or only some, store cards should be included; whether the relevant market or markets should be extended to include other products such as store-branded credit cards, general credit cards, promotional and other instalment credit, and personal current accounts (providing debit cards and overdrafts); and whether the relevant market or markets should be extended to include loyalty cards and other similar products.
- (iii) What should be regarded as the geographical extent of the relevant market or markets and, in particular, whether that market or those markets extend beyond the UK.

## **B. Structural features of the market(s)**

- (iv) *Market power:* Whether any firm is able unilaterally to exert market power in the relevant market or markets, whether through its market share or otherwise.
- (v) *Concentration and/or other structural conditions:* Whether concentration and/or other structural conditions in the relevant market or markets are such that two or more firms can collectively exercise market power in that market or those markets.
- (vi) *Recent developments:* Whether the relevant market or markets are stable, growing or declining; and whether recent developments in the store cards sector (for example, the introduction of new products or the entry of new store card credit providers) have affected competition in that market or those markets.
- (vii) *Switching:* Whether the costs incurred, or the risks perceived, by retailers and/or store card credit providers when retailers switch from one credit provider to another give such retailers an incentive to remain with their incumbent credit provider (whether by extending or renegotiating an existing contract rather than going out to formal or informal tender, or by remaining with their incumbent credit provider even after carrying out a tender); and whether this adversely affects competition in the relevant market or markets.

Such switching costs may include:

- the costs both to retailers and credit providers (outgoing and incoming) of the tendering process;
- the costs both to retailers and credit providers of transferring store card portfolios.

Such perceived risks may include:

- the risk of loss or corruption of customer data and consequential damage to the retailer's relationship with its customers;
- the risk to retailers of losing customers if card holders are invited to sign a new contract with a different credit provider; and
- the risk to a new credit provider arising from lack of information about a particular retailer's store card customers.

- (viii) *Barriers to entry:* Whether there are any barriers to entry into, or expansion within, the relevant market or markets. For example:
- (a) regulatory barriers;
  - (b) the need for specialized operations, infrastructure or systems (IT or otherwise);
  - (c) sunk investment costs associated with the provision of store card credit services;
  - (d) switching costs of retailers and/or store card credit providers;
  - (e) the existence of long-term contracts or long notice periods in contracts between store card credit providers and retailers;
  - (f) exclusivity provisions in contracts between store card credit providers and retailers, either (i) as regards the provision of store card credit services themselves, or (ii) as regards particular aspects of those services—for example, provisions governing the ownership and use of data, or provisions governing rights to cross-sell other financial services; and
  - (g) economies of scale, market reputation or other advantages enjoyed by store card credit providers already in the market.
- (ix) *Buyer power:* Whether, in respect of their contracts with store card credit providers, retailers are able to set the terms relating to matters such as the length of the contract or when retendering should take place; and whether this gives them countervailing buyer power sufficient to offset any exercise of potential market power

### **C. *The conduct of store card credit providers***

- (x) *Tendering:* Whether potential entrants to the market or markets for the provision of store card credit services to retailers are disadvantaged by aspects of the tendering process.
- (xi) *Exclusivity:* Whether the contracts between store card credit providers and retailers usually involve exclusivity being granted to one store card credit provider to serve a retailer's customers in the provision of store card credit services (whether in respect of a single retail brand or across several brands belonging to the same retail group).

Whether this means that insufficient competition takes place within the market or markets for the provision of consumer credit through store cards, and that too few of the resulting benefits accrue to store card holders. Or whether the competition between store card credit providers to provide store card credit services to retailers compensates for any lack of competition brought about by such exclusivity.

- (xii) *Provision of information:* Whether incumbent providers of store card credit services to retailers place restrictions on the information that those retailers may provide to other store card credit providers tendering to win store card contracts from such retailers, or place restrictions on the timely provision of such information; and whether such information asymmetries restrict competition to provide store card credit facilities to retailers.
- (xiii) *Transfer of receivables or customer databases:* Whether potential entrants to the market or markets for the provision of store card credit services to retailers are disadvantaged by certain contractual terms in agreements between credit providers and retailers, for example terms governing the transfer of receivables or customer databases; and whether such terms reduce competition in the relevant market or markets.
- (xiv) *Pre-emptive renegotiation of contracts:* Whether incumbent store card credit providers seek pre-emptively to renegotiate contracts in order to discourage retailers from going out to competitive tender, and whether this reduces competition in the relevant market or markets.
- (xv) *Pricing practices:* Whether potential entrants to the market or markets for the provision of store card credit services to retailers are disadvantaged by the pricing models or structures, or any aspect of the pricing practices, of incumbent credit providers; for example, the payment of commission, upfront payments or contributions to the retailer's marketing costs.
- (xvi) *APR levels:* Whether retailers as well as store card credit providers benefit from high APRs; and whether the parties share a common interest in keeping APRs high.

What pressures, if any, are exerted on store card credit providers by retailers to set APRs at competitive levels.

- (xvii) *Information available to store card holders:* Whether store card credit providers make sufficient, or sufficiently clear, information available to consumers, either when they enter into contracts for store cards or subsequently, as regards matters such as:
- (a) the costs of store card credit (in particular, the APR and charges for late payment); and/or
  - (b) the conditions governing their use of store cards, for example the cost of not repaying the balance of their account in full each month; and/or
  - (c) the facility of making payments by direct debit (thereby enabling store card holders to benefit from a slightly lower APR and reduced fees for late payment); and/or
  - (d) the costs and benefits of ancillary products offered with store card credit services, including payment protection and card protection insurance.
- (xviii) *Ancillary products:* Whether ancillary products related to store card credit services, particularly payment protection, card protection and price protection insurance, are:
- (a) effectively bundled with store cards, because consumers are invited to buy these when they buy store cards and the information about such insurance appears on the same form as the offer of a store card; and/or
  - (b) bundled together as an ancillary package of two or more products, because consumers are not offered the choice of purchasing any one of them separately.
- (xix) *Competition to provide ancillary services:* Whether firms unconnected with the provision of store card credit to consumers can exert sufficient, or any, competitive pressure on the provision of payment protection, card protection or price protection insurance to retailers, card providers or card holders; and if not, why not.
- (xx) *New insurance regulation:* Whether new regulations governing the selling of insurance products to consumers are likely to change the competitive conditions for the sale of insurance products linked to store cards; and if so, in what ways.

(xxi) *Innovation*: Whether store card credit providers have been, or are currently, subject to competitive pressures sufficient to encourage them to innovate in the provision of store card credit services.

#### **D. The conduct of retailers**

(xxii) *Tendering*: Whether potential entrants to the market or markets for the provision of store card credit services to retailers are disadvantaged by aspects of the tendering practices of retailers.

(xxiii) *APR levels*: Whether retailers as well as store card credit providers benefit from high APRs; and whether these parties share a common interest in keeping APRs high. What pressures, if any, are exerted on store card credit providers by retailers to set APRs at competitive levels.

(xxiv) *Buyer power*: Whether, in respect of their contracts with store card credit providers, retailers are able to set the terms relating to matters such as the length of the contract or when retendering should take place; and whether this gives them countervailing buyer power sufficient to offset any exercise of potential market power by store card credit providers.

(xxv) *Exclusivity*: Whether the practice carried on by retailers of granting exclusivity to a store card provider to serve their customers in the provision of store card credit services (whether in respect of a single retail brand or across several brands belonging to the same retail group) means that insufficient competition takes place within the market or markets for the provision of store card credit services, and whether this means that too few of the resulting benefits accrue to store card holders. Or whether the competition between store card credit providers for the market provided by retailers compensates for the lack of competition brought about by such exclusivity.

(xxvi) *Competition between retailers*: Whether, and if so to what extent and in what ways, retailers use store cards as a means of competing with other retailers.

(xxvii) *Retailers' favouring of store cards:* Whether retailers actively favour their store card as a means of payment or source of credit over other alternatives and whether this disadvantages consumers in terms of their choice of payment method.

(xxviii) *Information available to consumers:* Whether retailers fail to ensure that their customers are fully informed about the terms and conditions of holding store cards, and in particular the levels of the APR and of other charges, when marketing their store card to customers.

### ***E. The conduct of customers (store card holders)***

(xxix) *Access to credit:* Whether some customers take up store cards because they are easier to obtain than credit cards and/or because they cannot readily get access to other forms of credit; and whether this indicates that there is a potentially captive group of customers for store cards.

(xxx) *Access to sufficient information:* Whether consumers have sufficient information to enable them:

(a) to make informed choices about the range of credit options available to them;

(b) to manage their credit balances on store cards;

(c) to find out about, and assess the merits of, transferring their balances between store cards and other credit products which may be cheaper; and

(d) to judge the desirability of purchasing ancillary services with store cards, such as card and payment insurance.

(xxxi) *Ancillary products sold with store cards:*

(a) Whether consumers know what insurance they are buying, in terms of the nature and extent of the cover, and how each type of cover is priced.

(b) Whether consumers are aware of their cancellation rights and/or their right to defer their purchase of insurance to a later date.

(c) Whether consumers are aware that the insurance cover they are purchasing may partly or wholly duplicate cover they already have under an existing policy.

- (d) Whether consumers are able readily to compare the prices of the insurance they are offered when they take out a store card with the prices of equivalent insurance available elsewhere.

## ***F. Prices and profitability***

(xxxii) Whether the prices of store cards—that is, APRs, late payment or other charges, and insurance cover—are set at competitive levels and whether prices respond flexibly and quickly to changes in market circumstances. The CC will consider the following matters, among others:

- (a) how the profitability of store card credit providers on their store card operations should be measured, for example using a return on equity or some other measure;
- (b) the overall level of profitability of store card credit providers in respect of their store card operations, and the trends in their profitability over time;
- (c) the level of profits earned on ancillary products sold with store cards, in particular payment protection, card protection and price protection insurance;
- (d) whether the profits derived from the use of information on store card holders for cross-selling activities should be regarded as part of the profitability of store card credit providers' store card operations, and ascribed a value in the profitability analysis; and whether consumers benefit from such activities;
- (e) how the profitability of a retailer's store card operations should be measured; and the overall level of retailers' profitability in respect of their store card operations;
- (f) whether retailers are able to save on the marketing expenditures they would otherwise need to incur to generate the loyalty purchases and the consumer information that they obtain through store cards, and, if so, whether such saved expenditures should be included in calculating the profitability of their store card operations;

- (g) whether the extra sales created by the discounts provided to store card holders by retailers more than compensate for the loss of revenue represented by the discounts, and whether such extra sales could and should be ascribed a value in the context of the store card profitability analysis and included as part of the retailers' returns in respect of their store card operations;
  - (h) the relative prices of store cards and credit cards (including not only the levels of APRs, fees and charges associated with each of these product types but also the circumstances under which those APRs etc are levied); and
  - (i) the trend over time of prices and charges, in particular relative to other sources of consumer credit.
- (xxxiii) Whether the structure of prices for store cards is consistent with that which might be expected in a competitive market. Among the factors the CC will consider are:
- (a) whether store card prices are cost reflective;
  - (b) whether there might be potential for alternative pricing models, for example incorporating risk-based pricing; or charges such as annual fees, which are not driven only by the level of balances;
  - (c) whether charges for ancillary products sold with store cards, including payment protection and card protection insurance, are cost reflective;
  - (d) whether the profits and benefits that store card credit providers and retailers obtain between them are adequately or fairly shared with store card holders; and
  - (e) whether the store card pricing model discriminates unduly against certain store card holders because it means that those card holders who take credit subsidize those who do not.

### ***G. The applicability of Articles 81 and 82 of the EC Treaty***

- (xxxiv) Whether Articles 81 or 82 of the EC Treaty are applicable to any agreements or conduct in the relevant market or markets such that, when applying national

competition law pursuant to Article 3(1) of the Modernisation Regulation, the OFT (or other competent authority) must also apply Articles 81 and 82.

(xxxv) What effect Article 3(2) of the Modernisation Regulation is likely to have on the issues in this inquiry.

(xxxvi) *Store card credit services to retailers and consumer credit through store cards:*

Whether, and if so to what extent, the provision of store card credit services, and related services such as payment or card insurance, to retailers and store card holders, involves an appreciable effect on trade between member states.<sup>8</sup> In particular:

- whether the services are, by their nature, easily traded across borders, or whether they are important for undertakings that want to enter or expand their activities in other member states;
- whether the services are of interest from the point of view of cross-border establishment (setting up a branch or subsidiary) or the expansion of economic activity from such place of establishment;
- whether any of the agreements entered into or practices carried out by store card credit providers and/or retailers foreclose the UK market, making it more difficult for undertakings from other member states to penetrate the UK market, either by means of export or establishment;
- whether the agreements between store card credit providers and retailers in this context are appreciable in terms of their effect on trade;
- whether the cumulative effect of similar agreements involving store card credit providers, retailers and consumers means that the agreements, taken as a whole, are capable of having an appreciable effect on trade between member states.

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<sup>8</sup>See EC Guidelines at <http://europa.eu.int/comm/competition/antitrust/legislation>; and OFT guidance at: <http://www.of.gov.uk/Business/Legal+Powers/Competition+Act+1998.htm>.

## ***H. Possible detrimental effects on consumers***

(xxxvii) Whether any effect on consumers in the form of higher prices, lower quality or less choice of goods or services, or less innovation has resulted from, or may be expected to result from, any adverse effect on competition in the relevant market or markets.

Competition Commission  
21 September 2004