

## **Home Credit Market Inquiry Summary of Provisional Findings**

1. On 20 December 2004, the Office of Fair Trading (OFT) referred to the Competition Commission (CC) for investigation and report the supply of home credit in the UK.<sup>1</sup> The OFT made the reference to the CC following receipt (on 14 June 2004) of a supercomplaint from the National Consumer Council (NCC<sup>2</sup>). The CC is required by section 137 of the Act to prepare and publish its report within a period of two years, that is, by 19 December 2006. This is a summary of our provisional findings.<sup>3</sup> We will reach a final decision after hearing further evidence and representations from the parties affected.
  
2. Home credit loans are mostly cash loans for small sums. We found that the mean value of a home credit loan is around £300, and that 70 per cent of home credit loans are for less than £500. Loans are repaid, generally over a period of a year or less, in weekly instalments which are collected from the customer's home. The vast majority of home credit lending is done by companies which engage agents to visit customers' homes to collect repayments, and sometimes assess customers' creditworthiness and make loans (though we also found over 200 sole traders or partnerships who perform all these functions themselves).
  
3. The home credit industry has been the subject of considerable research and public scrutiny for some time, and there are broader social and public policy issues which surround it, for example financial exclusion and consumer credit more generally. We have heard evidence on some of these wider issues, and they set the context for our

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<sup>1</sup>The reference was made under section 131 of the Enterprise Act 2002.

<sup>2</sup>Although the NCC was not at the time formally designated as a supercomplainant, the OFT decided to treat the NCC's submission as a super-complaint.

<sup>3</sup>Though in this summary and in the main report we have refrained from putting 'provisional' in front of every finding.

inquiry. Our terms of reference, however, require us to consider competition in the supply of home credit. It is not our function, nor are we equipped, to investigate more widely. We have therefore focused on the nature, extent and effect of competition in the supply of home credit and on the impact of competition on home credit customers.<sup>4</sup>

4. We found that home credit lenders lent about £1.5 billion to around 2.3 million customers in 2004, and collected around £1.9 billion in repayments. Since 1994, the levels of loan advances have increased and then declined again, and are now at approximately the same level as in 1999. We found that six large lenders (five of which are quoted companies) account for around 90 per cent of the market. Of these, one, Provident Financial plc (Provident), accounts for around 60 per cent of the market on most measures.
5. We found that home credit customers were more likely than the population as a whole to be female, to be under 35, to have young families, to fall into socio-economic groups D and E, to live in a low-income household and to live in housing rented from a local council or housing association. We did not find that these characteristics had changed much in recent years. The majority of home credit customers have at least one other credit option, though for some, home credit is the only available source of credit.
6. We found that assessing the price of a home credit loan was complicated by the absence of a single measure of price and by the weakness of the annual percentage rate (APR) as a measure of price for home credit loans. We considered the total charge for credit (TCC) to be a better price measure for home credit loans than the APR, especially for loans of less than a year. We found that the prices of home credit

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<sup>4</sup>In considering potential remedies these considerations will again become relevant.

loans, however measured, were high by comparison with the prices of other credit products (though, given the differences in the product offerings, that does not necessarily imply that a home credit loan represents worse value for money). We also found that prices were higher in the UK than in Ireland, where many market conditions appeared similar, though the regulatory regime was somewhat different. We found that the price paid by customers when they repay loans early, which nearly half do, was particularly high. This is because they still pay most of the charges on the loan, less a rebate, and the rebate payable (the minimum level of which is governed by statute) appears to us to be calculated in a way which, in the context of home credit, favours the lender.

7. We found that the provision of a home collection service involved high costs by comparison with other forms of credit. We considered whether the levels of profitability being earned in the industry suggested that prices might be higher than necessary to cover those costs (including the cost of capital) and hence above competitive levels. We looked carefully at this issue and held extensive discussions with Provident, in particular, about the correct way to measure profitability. These discussions have not finished, but on the basis of what we know so far, we concluded that Provident has, in the period from 1999 to 2004, been earning returns substantially and persistently in excess of the cost of capital. Provident disagreed with our conclusions in this area.
8. Among the other larger lenders, we also found that S&U plc (S&U) had also been earning returns substantially and persistently in excess of the cost of capital, and that Cattles plc (Cattles) had earned returns in excess of the cost of capital in all these years, though we did not consider the excess substantial in two of them. We also found that at least some small businesses are earning returns in excess of the cost of capital (though the results of this analysis are subject to quite wide margins for error).

9. Given that Provident alone represents around 60 per cent of the market on most measures, and that profits in excess of the cost of capital, while greatest in Provident's case, are not confined to Provident, we concluded that profits have been persistently and substantially in excess of the cost of capital for firms that represent a substantial part of the market.
10. Among other indicators of competitive intensity, we found modest levels of switching between lenders, and little variation in market shares over time, but we did find evidence that customers were generally satisfied with the service they received, and some evidence of innovation. Thus, while not all the evidence points the same way, on balance our findings led us to believe that, while home credit provides a service which is valued by its customers, the prices they pay are higher than they would need to be to reflect the costs of providing the service, and are higher than they would be in a competitive market.
11. We assessed the reasons for this by considering the possible constraints on prices from three possible sources—from other forms of lending, from the threat of entry or expansion and from competition among home credit lenders.
12. We found no evidence that any alternative credit products (those used disproportionately by low income consumers, such as agency mail order (AMO), pawnbroking, credit unions and the social fund) were good substitutes for home credit or posed a competitive threat to it. Moreover, while we found that the penetration of mainstream credit products (credit cards, personal loans etc) among home credit users had increased in recent years, this did not appear to have had any impact on home credit prices, nor had it led to customers switching away from home credit to these products in response to price rises. We concluded that no other form

of credit imposes a significant competitive constraint on home credit prices (and thus that home credit was the relevant economic market for investigation).

13. We found that although there are few barriers to small scale entry to home credit, there are significant barriers to large scale entry or to expansion. These included the risk of adverse selection (new customers represent a worse default risk than existing ones), the advantages enjoyed by incumbent lenders, and the need to build local density to operate efficiently. We found that there had been some recent history of entry and expansion, but that it had not significantly affected the behaviour or the profitability of existing home credit lenders.
14. We found that price competition among home credit lenders was weak. We found that demand was unresponsive to changes in price (though there had been almost no reductions in price in the last five years). We also found substantial and persistent price differentials between suppliers without evidence of significant shifts between them. And we found no evidence of selective price competition either in response to local market conditions or to attract and retain particular customers.
15. The absence of price competition is in part explained by customers' insensitivity to price. This appeared to derive from customers placing greater value on other product attributes and from the difficulties customers have in assessing and comparing the prices of home credit loans. Where customers are insensitive to price and competing for new customers increases the risk of default, there is only a limited incentive to compete on price. We found that lenders preferred to compete to make larger loans available to their best customers at the times when customers most needed them.
16. Since competition was focused on availability, we found that an incumbent lender (one who has a current relationship with the borrower) had considerable advantages,

in that he had a better understanding of the customer's circumstances, credit needs and creditworthiness than any other lender, a point of sale advantage from the presence of the agent in the customer's house, and an established relationship of trust between the agent and the customer. These advantages were reinforced by the fact that home credit lenders, unlike many other lenders, do not share data on customers' creditworthiness through credit reference bureaux or otherwise.

17. We found no other form of competition between lenders which could compensate for the weakness of price competition.
18. We concluded that the two features which contribute to the weakness of price competition (the insensitivity of customers to prices and the failure of lenders to compete in any significant way on price) are features which prevent, restrict or distort competition. We further concluded that the incumbency advantages for established lenders which exist where competition is focused on availability (the inability of customers to convey reliable information about their creditworthiness to lenders and incumbent lenders' knowledge of customers creditworthiness) are features which prevent, restrict or distort competition, as are three features which contribute to the preservation of these advantages (the lack of data sharing, customers' requirement for an agent they can trust and the regulatory prohibition on door to door canvassing of loans). These features give rise to an adverse effect on competition.
19. As a result of the adverse effect on competition we found that customers pay higher prices than could be expected in a competitive market. On the basis of our calculations, we concluded that the detriment to customers from high prices is substantial, and may be in excess of £500 million over the period 2000 to 2004, or over £100 million a year over that period. This implies that the price of an average loan was approximately £26 higher than could have been expected in a competitive

market. This equates to £9 per £100 loaned. The assessment of profitability on which these estimates are based has been a difficult and contentious area of our inquiry; not all lenders agreed with our approach or our conclusions, and we expect discussions on this to continue.