

4. Competition from other forms of lending (product market definition)

Introduction

- 4.1. In this section, we examine the competitive constraint on home credit lenders from other forms of credit. This forms part of our overall competitive assessment and also enables us to define the relevant product market. The CC does not regard market definition as an end in itself, but rather as a framework within which to analyse the effects of market features.¹
- 4.2. A range of opinions were put to us about the extent to which other forms of credit constrained home credit, and hence whether they should be included in the definition of the relevant product market. The NCC argued that constraints from other products were weak and that therefore home credit was the relevant product market. Mutual also took the view that home credit was a distinct product market. The CCA and many of its members took the view that home credit lenders faced effective competition from a variety of small sum credit options, and that the competition took place in a broader market for small sum credit. In putting forward this view to us, Provident emphasized, in particular, a growing competitive threat from mainstream credit products. Other home credit lenders took an intermediate position. For example, one lender considered that the relevant product market included alternative but not mainstream credit options (paragraph 4.5 explains this distinction), while another identified AMO as the only other product which should be included in the relevant product market.
- 4.3. In seeking to evaluate these differing views, we have considered a wide range of evidence. Evidence considered relates to product characteristics and structure of supply; availability and use of alternatives by home credit customers; movements of prices in home credit and other products over time; responsiveness of demand to changes in home credit prices; survey evidence on the options considered by customers; and their stated response to hypothetical scenarios.
- 4.4. Home credit offers a unique combination of characteristics which helps to meet the expectations of its distinct customer base (see Section 2). The following characteristics are common to most home credit products:
 - a loan is made in cash and is unsecured;
 - collections are made at the customer's home, usually weekly;
 - there is no need for any interaction with a bank or other financial intermediary, either to receive the advance or make repayments; and
 - occasional missed repayments are tolerated by suppliers and do not result in additional charges.

¹CC3, paragraph 2.2.

4.5. Potential substitutes for home credit may be considered as falling into two categories:²

- *Alternative credit options.* These are credit products that are used disproportionately by low-income consumers, compared with the population as a whole. Examples include AMO, pawnbroking, credit unions and the Social Fund.
- *Mainstream credit options.* These are credit products that are commonly used by the majority of the population. Examples include credit cards, overdrafts and personal loans. Some home credit lenders have told us that mainstream credit options represent an increasing competitive threat.

Competition from alternative credit options

4.6. Like home credit, alternative credit options are available to some customers who do not have access to mainstream credit options. Alternative credit options comprise AMO; other commercially-provided options such as pawnbroking; the Social Fund; not-for-profit lenders such as credit unions; friends and family; as well as illegal lending.

4.7. Table 4.1 estimates the total scale of various alternative credit options along with home credit. AMO has more customers than home credit and (is also larger in scale in terms of gross) annual advances. The other alternative credit options are considerably smaller under either measure.

TABLE 4.1 Scale of home credit and alternative credit options*

	Estimated total size	
	Customers m	Gross annual advances £m
AMO†	5.7	2,900
Home credit	2.3	1,317
Social Fund	1.2	520
Credit unions	0.5	237‡
Pawnbrokers and buy-back shops	0.6	60
Rental purchase shops	N/A	N/A
Cheque cashing/payday advances	0.25	N/A

Source: CC estimates.

*Compared with access to banking or to credit card use there is less systematic large-scale data on users of alternative credit options and there are some discrepancies between sources.

†Based on agents and agents spend only, average annual spend of £500. (Source: the *March/GUS* report).

‡Loans made during 2005, source: the Financial Services Authority (FSA). *2005 Credit Union Statistics*.

Note: N/A = not applicable.

²See, for example, *Affordable Credit—the way forward*, Sharon Collard and Elaine Kempson, Joseph Rowntree Foundation (2005).

Description of alternative credit options and their use by home credit customers

Agency mail order

- 4.8. AMO is one of the most popular sources of credit for those on a low income.³ AMO uses agents (who are in direct contact with the company and who are credit scored) to place orders on behalf of themselves and their families and on behalf of others outside the home, in return for a commission. AMO companies do not keep extensive records of non-agent customers, and tend not to credit score them except in the event of a significant purchase. The ratio of customers to agents has dropped significantly over time and was approximately 2.5:1⁴ in 2002.
- 4.9. A single 'instalment offer' covers the costs of the goods ordered, commission, delivery, return within 14 days, and the facility to pay the catalogue price by instalments (often in weekly cash repayments to the agent). The length of repayment periods varies slightly from one AMO company to another, but is usually of 20 or 38 weeks depending on the product purchased.⁵ When purchasing larger items, the repayment period may be extended to 100 or 150 weeks. In the earlier case, AMO credit can be advertised as 'interest free'; however, explicit interest can be charged in the latter case. Although prices in catalogues are generally quoted as weekly instalments, most agents are required to remit payments to the AMO company either monthly or every four weeks.
- 4.10. AMO is the most widely-used alternative credit option among home credit customers. Qualitative research, including the AIA report⁶ for the CC, suggests that home credit customers perceive AMO as an accessible and available option. Estimates of the proportion of all home credit customers using AMO range between 14 per cent (NOP) and 21 per cent (MFS). Provident estimated that around one-third of its customers currently used mail order catalogues or had used mail order in the past year.⁷ However, AMO is a declining sector, and the proportion of home credit customers who use AMO has been falling over time (see Figure 4.1).⁸

³The CC has investigated AMO, most recently in the *March/GUS* report (*March UK Ltd and the home shopping and home delivery businesses of GUS plc: a report on the merger situation*, The Stationery Office, Cm 6102, January 2004). Also available on our website.

⁴Source: the *March/GUS* report.

⁵One AMO provider, [X], told us that this was now closer to 52 weeks as AMO no longer needed to be kept within the old hire purchase legislation.

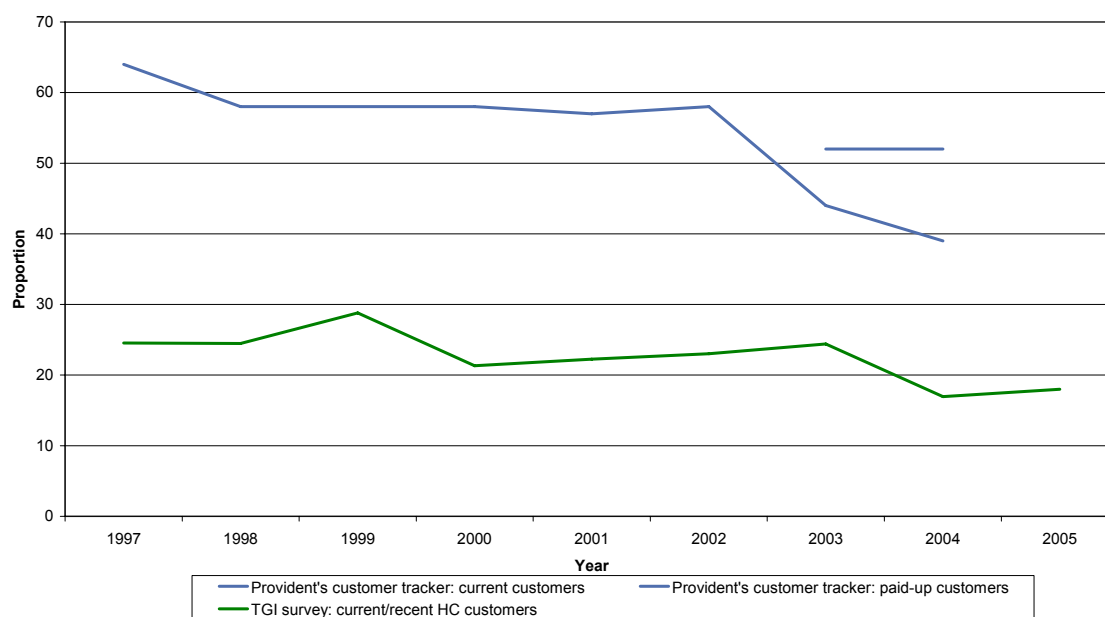
⁶AIA *Home credit market inquiry: research report for the Competition Commission* (April 2005), available on the CC website, pp11–12.

⁷Provident's customer tracker asks about customers' use of 'mail order catalogues'. This may include some catalogues which do not supply goods on credit. This may partially explain why this number is higher than the range of estimates from other surveys.

⁸It should be noted that the methodology for asking this question in Provident's customer tracker changed in 2003. Previously AMO was first on the list of products read out to customers. From 2003, pursuant to views on best practice in consumer research, the order of products was rotated. This is likely to have produced a decline in the proportion of respondents mentioning AMO.

FIGURE 4.1

Evolution of the proportion of home credit customers using mail order



Source: Provident customer tracker, TGI survey.

- 4.11. AMO is only an alternative to a home credit loan on those occasions where a customer's requirements may be adequately met by the goods available in the catalogue. The agency structure also operates in a significantly different way to home credit. As the cost of credit is not always separately identified in AMO agreements, it may be difficult for customers to make price comparisons between AMO and home credit.⁹ These factors reduce the extent to which AMO imposes a competitive constraint on home credit.

Other commercially-provided options

- 4.12. Other commercially-provided alternative credit options include pawnbroking, cheque cashing, sale and buy-back, and rental purchase. All are considerably smaller in scale than either home credit or AMO. Each is considered briefly below.
- 4.13. Pawnbrokers are used by about 600,000 customers a year.¹⁰ In 1999 the National Pawnbrokers Association estimated that there were 800 pawnbroking outlets in Great Britain. Most of these outlets were small local companies with only one shop; the largest company had 40 outlets. Pawnbrokers are subject to the Consumer Credit Act 1974 including provisions that apply specifically to pawnbroking. A customer can go to a pawnbroker for a loan, but will have to leave something valuable (the pawn) as security. The average size of a loan is around £100, and 85 per cent are for a six-month redemption period. In general, pawnbrokers charge 7 to 12 per cent a month, with the total principal and interest payable on redemption of the pawn. Hence a loan of £200 over four months would have a charge of around £56 and an APR of around

⁹Though we were told by home credit lenders that, where customers are borrowing to purchase a specific item (such as a washing machine), effective comparisons can be made between the weekly repayments on a home credit loan taken out to purchase the item from a retailer and the weekly instalments associated with buying the same item on AMO.

¹⁰Source: *Promoting financial inclusion* (HM Treasury, *Promoting financial inclusion*, December 2004).

110 per cent. Recent research estimates that 29 per cent of people using pawnbrokers fail to recover the pawn.¹¹

- 4.14. Some lenders (including some pawnbrokers) offer 'sale and buy-back' schemes. The customer sells an item to the lender and can then buy it back at a higher price within a short period of time. It is also possible to arrange with the lender to buy the item back in instalments (often called a 'set aside' or 'lay by' scheme). However, the customer has fewer rights and less protection under these schemes than they do with pawning. Cash Converters is currently the UK's leading sale and buy-back retailer with over 100 high street stores; however, it also cashes cheques, gives payday advances and has a pawnbroking service.
- 4.15. The NOP survey for the CC found that 1 per cent of home credit customers were currently using either a pawnbroker or a sale and buy-back shop.
- 4.16. There are around 400 cheque cashers operating in the UK with 1,500 high street outlets. This indicates a substantial growth rate as the industry only developed in the UK after the Cheques Act 1992 came into force in that year. The sector is fragmented and most firms belong to the British Cheque Cashers' Association (BCCA). In addition to cashing cheques for on-the-spot payment, cheque cashers may advance money against the borrower's cheque for a fee; exceptionally, debts can be rolled over for a further consideration. The cheque is made out for the day of the transaction, but the company does not cash it for 30 days. The facility is available if the customer can confirm his ability to pay (often with the production of a payslip) and provides suitable identification. Dominy and Kempson found that charges vary from £6 to £14 for a £100 cheque; and that customers seeking advances are mostly managing well financially, do not have dependents and have only modest credit commitments.¹² None of the home credit customers surveyed by NOP were currently using a cheque casher to borrow money.
- 4.17. Rental purchase shops allow customers to spread the cost of buying goods. Some of these shops offer financing for customers with no credit ratings. However, goods bought under such schemes can normally be repossessed when payments are missed. Loans are available as long as the customer can provide four names of local friends/relations. The advertised APR is normally around 30 per cent; however, as with AMO, the good is often more expensive than it would be on the high street and in addition customers are strongly encouraged to take out insurance which will again increase the cost of the loan. Rental purchase shops are relatively new in the UK and Brighthouse, which used to be called Crazy Georges, is the largest rental purchase shop with over 130 stores. In 2003, Brighthouse had a turnover of £[£]; however, Brighthouse also provides customers with cheque-cashing and insurance services. NOP found that 1 per cent of home credit customers were currently borrowing from a rental purchase shop.
- 4.18. Other commercial alternative credit options have been developed in recent years. For example, Telebank rents televisions, DVDs and videos and sells other products including furniture, kitchen appliances and shopping vouchers. All customers are required to rent a television in the first instance, the payment method for which is a meter attached to the television for which there is a £3.50 rental charge (this charge covers the home collection). When customers purchase other items they use the same meter but are charged an additional £5 to £10 administration fee depending on

¹¹Source: *Would you credit it?* (Paul Jones and Tina Barnes, *Would you credit it?* (2005), Liverpool John Moores University).

¹²Dominy, N and Kempson E, *Pay Day Advances—the companies and their customers* (2003), British Cheque Cashers Association.

the size of the purchase. Telebank has stated that there are many companies which provide this service for customers. A relatively recent specialization of pawnbroking is to be found in the form of Log Book Loans where a cash loan is given against deposit of the log book of the borrower's car. The borrower retains the use of the car but cannot sell it, the car thereby acting as security for the loan. Loans are available for £500 or more on cars generally eight years old or less. No data is available on the take-up of these options among home credit customers, but we would expect this to be less than 1 per cent.¹³

The Social Fund

- 4.19. The Social Fund is a government scheme to help people with basic needs which are difficult to meet from regular income. Since 1988, the Social Fund has included a discretionary fund which is administered by each Jobcentre Plus district. The discretionary Social Fund includes budgeting loans and crisis loans, as well as community care grants which do not need to be paid back. Budgeting loans are available to people who have been on income support, income-based job-seekers allowance or pension credit for 26 weeks. Crisis loans are available to all as long as the person has no other sources of money (eg savings or credit cards). Crisis loans are for people for whom the lack of the loan would mean that there was a serious risk to themselves or their family, for example people who have had their money stolen.
- 4.20. Budgeting loans are issued for sums of between £100 and £1,500 (the average in 2004/05 was £405). If a person has savings of over £1,000 (£2,000 for pensioners) then the potential loan will be reduced on a pound for pound basis. Budgeting loans are interest-free; however, the repayments are taken out of the persons' benefits at a rate of 5 to 12 per cent of the person's allowance (excluding housing costs) every week.¹⁴ Around one-quarter of applications are refused mostly because of outstanding Social Fund debt¹⁵ or because the applicant was not in receipt of a qualifying benefit for 26 weeks.¹⁶
- 4.21. Local job centres and social security offices have fixed amounts in their Social Fund budgets to give out as discretionary loans. The gross loans budget for 2004/05 was over £560 million;¹⁷ the net cost is estimated to be £20 million. In 2004/05 an estimated 1.2 million budgeting loans were awarded; around half of these were to one-parent families. Just under half of Income Support recipients are estimated to have applied for a loan in the last 12 months or to be currently paying off a loan.¹⁸ Table 4.2 provides a breakdown of Social Fund expenditure by category.

¹³The NOP survey found that less than 1 per cent of customers were currently using a form of borrowing other than those on the list read out to respondents.

¹⁴Source: *The Use of the Social Fund by Families with Children* (Kemp, P and Finch, N (2004), *The Use of the Social Fund by Families with Children* DWP In-house Report 139, Social Research Division, Department for Work and Pensions, London).

¹⁵The DWP told us that the way existing debt was taken into account had changed, hence the number of applicants refused for this reason would reduce.

¹⁶Source: *The Use of the Social Fund by Families with Children*.

¹⁷www.dwp.gov.uk/news/archive/english/2004/30_03_04.asp.

¹⁸Source: *The Use of the Social Fund by Families with Children*.

TABLE 4.2 Social Fund: gross expenditure in nominal terms

	£ million							
	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Budgeting loans	311	345	396	436	462	462	482	486
Community care grants	96	98	98	100	109	109	118	127
Crisis loans	<u>55</u>	<u>59</u>	<u>62</u>	<u>66</u>	<u>85</u>	<u>85</u>	<u>86</u>	<u>82</u>
Total discretionary Social Fund	463	502	556	601	656	656	686	696
Funeral expenses	38	39	38	36	41	41	47	46
Maternity expenses	20	18	17	44	111	111	120	118
Cold weather payments	<u>1</u>	<u><1</u>	<u>1</u>	<u>30</u>	<u>14</u>	<u>14</u>	<u>4</u>	<u>2</u>
Total regulated Social Fund	58	57	57	110	166	166	171	166
Total gross expenditure	521	559	613	711	823	823	857	826

Source: www.dwp.gov.uk/asd/asd4/Table9.xls.

4.22. Some studies have suggested that shortfalls in the Social Fund loan awarded can lead to customers topping up the loan with commercial credit, such as home credit.¹⁹ The Social Fund is used predominantly for household goods, for example beds (24 per cent), carpets (21 per cent) and bedding (20 per cent). Some applications are based on non-household items such as food (5 per cent) and clothes (13 per cent). However, unlike home credit loans, Social Fund loans are unlikely to be spent on Christmas presents or holidays.²⁰ The NOP survey found that 9 per cent of home credit customers were currently borrowing from the Social Fund. Provident's customer tracker suggests that 15 per cent of the company's current customers had a loan from the Social Fund in 2004.

Not-for-profit lenders

4.23. People on lower incomes may be able to obtain loans for small amounts from not-for-profit lenders such as credit unions and Community Development Finance Institutions (CDFIs). Such loans are typically available at lower APRs than home credit. However, the geographic spread of credit unions in the UK is incomplete²¹ and customers' awareness of and ability to access finance from these sources can be constrained.

4.24. Credit unions are mutual owned financial organizations which offer saving and credit products to their shareholder members. Many credit unions in the UK are run by volunteers. Credit unions are regulated by the FSA and are legally obliged to define a group of people who share a 'common bond' from which they can recruit their membership; common bonds are generally based on employment or residence. In June 2005 there were 492,000 members of credit unions, compared with 255,596 in December 1998. The same period saw a reduction in the total number of credit unions from 630 to 567 and a large increase in the average size of each credit union; some of this reduction in number is due to the merger of credit unions.

4.25. Credit unions normally lend money to members after a period of saving of around three months. Typically the amount of credit a person can get is related to their level of savings. The Association of British Credit Unions Limited (ABCUL) has stated that many credit unions are reforming their credit practices to allow them to lend to members who have no history of borrowing from them and that this was a

¹⁹Source: *The Use of the Social Fund by Families with Children*.

²⁰Source: *The Use of the Social Fund by Families with Children*.

²¹See the *Treasury Mapping of Credit Unions and CDFIs* available on the HM Treasury website.

precondition of much the recent government funding. To this end ABCUL has signed an exclusive deal with Callcredit to enable their members to carry out anti-money-laundering customer ID verification and a deal with Equifax regarding costs for using its INSIGHT database; however, it is unclear how many ABCUL members take advantage of these deals. The limits on the amount of lending and the loan term have increased recently. The majority of credit unions can now lend for up to five years for unsecured loans and up to ten years for secured loans, and the amount over and above savings held in the credit union which members can borrow has increased to between £7,500 and £15,000, depending on the status of the credit union.²²

4.26. The interest rate that credit unions may charge to their members is subject to a cap. It was announced in the 2005 Pre-Budget report that the maximum rate of interest will be increased from 1 to 2 per cent a month. This is equivalent to an increase in the maximum APR from 12.7 to 26.8 per cent.

4.27. In qualitative research for the CC, AIA found that:

a minority of respondents have discovered the credit union option and were enthusiastic about this new source of low cost loans. However, most were unaware of it and, for some, having to put money in first was a hurdle. There were indications that for some users it had become another line of credit in addition to home credit and other means of borrowing.²³

According to the NOP survey, 2 per cent of home credit customers are currently borrowing from a credit union. 2 per cent of Provident customers have savings with a credit union and 3 per cent have borrowed from a credit union. ABCUL recently conducted a survey of its member credit unions, and reported that nearly 50 per cent of loans issued were for less than £500 and that 30 per cent of credit union members used to have home credit loans.²⁴

4.28. CDFIs are not-for-profit organizations that provide lending and investment facilities in disadvantaged communities. The majority of CDFI activity is focused on lending to small businesses, including social enterprises. However, in recent years there has been a rise in the levels of personal lending by CDFIs. CDFIs offering personal loans typically do so at interest rates of between 15 and 30 per cent, although many operate a risk-based lending approach, charging higher rates for riskier clients. In addition, CDFIs can help clients to obtain advice in the course of providing a loan.²⁵ While the sector is growing rapidly, the scale of CDFI lending to individuals is small compared with home credit. For example, in 2004, total CDFI lending was around £150 million, of which more than three-quarters comprised loans to social and micro-enterprises.²⁶

Friends and family

4.29. 4 per cent of home credit customers said that they were currently borrowing from friends or family.²⁷ The AIA report found that this was most likely to occur for short-

²²Source: FSA Handbook Notice 49.

²³Source: the AIA report, page iv.

²⁴ABCUL press release, 17 February 2006—Financial inclusion survey shows ways credit unions meet the needs of communities.

²⁵Source: *Promoting Financial Inclusion*.

²⁶Source: *Inside Out—The State of Community Development Finance*, Sarah McGeehan, Community Development Finance Association, April 2005.

²⁷Source: the NOP survey for the CC.

term crisis borrowing, rather than for regular borrowing or to fund discretionary spending. This may not be an option, if an individual's family and friends are in a similar financial situation.²⁸

Illegal lending

- 4.30. A person or organization which carries on a consumer credit business without a consumer credit licence is an illegal lender (see paragraph 2.38). Though the stereotype of an illegal lender is a violent and threatening man, some illegal money lenders are local women who lend small amounts.²⁹ However, intimidation and violence in debt recovery is a feature of illegal lending.³⁰
- 4.31. The overall scale of illegal lending is difficult to determine (see Appendix 1.2). From the limited sources of evidence that are available to us, illegal lending appears to be most prevalent in areas that are avoided by other lenders, for example high crime areas.³¹ Illegal loans are generally made to people who are in substantial need and are typically made on a weekly or fortnightly basis. There are reports that pension/allowance books are collected to encourage repayment.³²
- 4.32. Research among customers suggests that illegal money lenders tend to be at the bottom of any hierarchy of borrowing options, to be used where no other source of credit is available.³³ Less than 1 per cent of home credit customers interviewed by NOP said that they were currently using an illegal lender.

Survey evidence on substitutability of alternative credit options for home credit

The NOP and Quaestor surveys

- 4.33. Survey evidence can provide useful information about customers' perception of the substitutability of different products.
- 4.34. In this inquiry, we examined the results of two quantitative surveys of home credit customers, one conducted by Quaestor for Provident and the other commissioned by us from NOP for this inquiry. Both of these surveys were designed to explore the extent to which customers perceive different forms of credit as an alternative to home credit.³⁴

²⁸Source: the AIA report, pages 14–15.

²⁹Source: *Access to credit on a low income*.

³⁰Source: *Promoting Financial Inclusion*.

³¹*Promoting Financial Inclusion (2004)*—HMT.

³²*Loan Sharks in the Borough (2002)*—Wigan Council and *Access to credit on a Low Income*.

³³Whyley C, Collard S and Kempson E, *Use of Social Fund Budgeting Loans and Community Credit Unions (2000)*. See also the AIA report, pp17–18.

³⁴The NOP survey has an effective sample size of 787, taken from customer lists provided by home credit suppliers. All respondents were either currently paying off a home credit loan or had recently paid off a home credit loan (14 per cent of the sample). The NOP's report is published on the CC's website. The Quaestor survey (also known as 'Project Space') was based on interviews with a mixed sample of 556, half of whom were current Provident customers and an equal number of paid-up customers (paid-up customers were defined as customers who have paid up outstanding home credit with Provident in the past 3 to 40 weeks and who have not been selected for research in the past two years).

Options considered on last borrowing occasion

- 4.35. Both surveys explored the options considered by home credit customers on a previous borrowing occasion. There were some differences in methodology between the surveys.
- 4.36. Our NOP survey asked customers which alternatives they had seriously considered when taking out their last home credit loan. NOP first asked customers for their unprompted response, to which 85 per cent of customers responded that they had not considered any other form of credit; 15 per cent said that they had. Customers were then prompted with a list of possible answers. This stimulated more responses, though 37 per cent of customers still responded that they had not considered any other form of credit; 63 per cent of customers responded that they had considered at least one of the prompted answers.
- 4.37. NOP also asked customers whether they had found out the cost of borrowing using any other form of credit. Of the 64 per cent of customers who recalled considering other forms of credit when prompted, 22 per cent—13 per cent of all customers—said that they had found out how much it had cost to borrow using another form of credit. Customers who recalled alternatives when prompted were significantly less likely to have compared prices than those who recalled alternatives unprompted.³⁵ Provident pointed out that some customers may have known how much it cost to borrow from alternative sources, without having to find it out.
- 4.38. Finally, the NOP survey asked customers which of a list of products they would certainly not use if they needed money now. Provident noted, and we agree, that this is a different question to whether a customer would never use a particular credit product. Provident submitted further that ‘it is this latter question which is more relevant to the issue of self-exclusion, as the actual question asked may relate to particular reasons why a customer might not use a credit product today but could well do so in future’. We consider that this argument has been overstated. If a customer would certainly not use a different product if they needed money now, we consider this to be evidence that they do not perceive this product as a close substitute for home credit, even if there might be circumstances in which they could conceive of using the product at some stage in the future.
- 4.39. The Quaestor survey focused on options considered on the customer’s last borrowing occasion (whether this resulted in a home credit loan or not) and did not use the word ‘seriously’ in the relevant question. For 77 per cent of current Provident customers and 55 per cent of paid-up customers, the last credit product used was a home credit loan. Of the other credit products used on the last borrowing occasion, personal loans were cited most frequently by both current customers (15 per cent) and by paid-up customers (21 per cent). The next most frequently used credit product were credit cards (2 per cent of current home credit users and 10 per cent of paid-up customers).³⁶ Quaestor found that 72 per cent of those who took a credit product other than home credit on the last borrowing occasion also considered a home credit product. Of those customers who took home credit on the last occasion, 57 per cent had not considered another form of credit, while 13 per cent of those who took another credit product had also considered another non-home-credit alternative.

³⁵30 per cent of customers who recalled considering alternatives unprompted compared prices, compared with 20 per cent of customers who recalled alternatives when prompted.

³⁶Source: Project Space, slide 7.

Alternative credit options considered when taking out last home credit loan

4.40. Table 4.3 summarizes evidence from the NOP and Quaestor surveys on the extent to which home credit customers considered alternative credit options, when taking out a home credit loan and on their last borrowing occasion.

TABLE 4.3 Alternative credit options considered when taking out last home credit loan

Survey	per cent				
	NOP	NOP		Quaestor	
Question	Would certainly NOT use if you needed money now	Alternatives seriously considered to your last home credit loan		Alternatives considered on your last borrowing occasion	
Sample	All home credit customers	All home credit customers		Took home credit last time	Did not take home credit last time
Prompted/unprompted	Prompted	Unprompted	Prompted	Prompted	Prompted
Loan from friend or relative	50	4	22	N/A	N/A
Home shopping (AMO)	65	0	16	14	35
Social Fund	70	0	17	N/A	N/A
Credit union	85	0	4	N/A	N/A
Payday advance	87	0	4	1	4
Unlicensed lender	87	0	3	N/A	N/A
Rent-to-own	88	0	5	2	7
Pawnbrokers	91	1	5	4	4
Buy-back shop		Included with pawnbrokers		1	4

Source: NOP, Project Space.

Note: N/A means that the options were not offered to customers as possible responses in the Quaestor survey.

4.41. The NOP survey found that home credit customers were more likely to have considered a loan from a friend or a family member than any of the other alternative credit options when taking out their last home credit loan. The two next highest-ranked options were AMO and the Social Fund. Less than 1 per cent of customers recalled considering either option unprompted. NOP found that 14 per cent of customers recalled seriously considering AMO and Quaestor reported 16 per cent of customers who took a home credit loan on their last borrowing occasion recalled having considered AMO. 17 per cent of respondents to the NOP survey recalled having seriously considered a Social Fund loan as an alternative to their last home credit loan.

4.42. Both surveys showed extremely low levels of consideration for credit unions, payday advances, unlicensed lenders, rent-to-own, pawnbrokers and buy-back shops. 85 per cent or more of home credit customers said that they definitely would not consider each of these options if they needed money now. When prompted, 5 per cent or less of customers recall considering one of these options when they took out their last home credit loan.

Stated responses to hypothetical scenarios

4.43. The NOP and Quaestor surveys also both explored how customers said they would respond to hypothetical situations. This type of question can provide insight into how customers would actually behave, if faced with such a scenario. However, questions need to be asked carefully and responses interpreted in the context of other evidence, including responses to other questions in the survey and customers' actual behaviour. One risk associated with hypothetical questions is that customers may not have a detailed understanding of the scenario that has been proposed or how they

would react in this situation. Another risk is of positive response bias, where respondents perceive one particular answer to be more virtuous than another.

- 4.44. The NOP survey asked what home credit customers would have done if agents of their current lender had stopped calling in their area when they took out their most recent home credit loan. In response to this question, 32 per cent of home credit customers said that they would not have borrowed money at all if their current lender had stopped calling. A similar proportion (29 per cent) would have used another home credit supplier. Just over one-fifth (21 per cent) said that they would have borrowed from family or friends instead. 13 per cent said that they would have used a different form of credit.
- 4.45. Provident argued that it was counter-intuitive to think that 32 per cent would not have borrowed the money at all because they would have needed credit at some time. This would be consistent with the view that borrowing is a necessity for these respondents and that a supplier of home credit or of another form of credit will eventually meet that need. If that were the case, those saying that they would not borrow at all would not be accurate in giving their second choices, and should be treated in the same way as those saying 'Don't know'. We note that this would not alter the relative ranking of home credit versus the alternatives.
- 4.46. Provident also told us that the methodology used by NOP prejudiced the result by focusing exclusively on the last time home credit was chosen, rather than the last borrowing occasion (as in Project Space).³⁷ We do not accept this criticism. We consider that the question asked by NOP provides useful evidence about what home credit customers would do if faced with a particular scenario, and that this evidence is relevant to our understanding of customers' perceptions of switching possibilities. Given the risks associated with asking hypothetical questions in customer surveys (see paragraph 4.43), we considered that the question posed by NOP was more likely than other types of hypothetical questions to generate a meaningful response. Nor was it inevitable that customers would respond in the way that they did to this question. We note, for example, that when the CC has commissioned similar questions to consumers of groceries or public transport, typically less than 10 per cent of respondents said that they would not shop or not travel.³⁸
- 4.47. Quaestor asked customers how they would have responded to a hypothetical price rise of 5 or 10 per cent.³⁹ Of those respondents who took out home credit as their last credit product, 44 per cent stated that they would have made a different choice in response to a 5 per cent price rise.⁴⁰ Of those who said that they would make a different choice, 26 per cent said they would have chosen a different home credit product, 32 per cent mentioned a non-home-credit product and 41 per cent did not specify a product at all. The most commonly mentioned non-home-collected products

³⁷Provident argued that the NOP question did not test the issue of which products were substitutable for home credit because it only asked about a situation where the customer chose home credit when they were looking for a source of credit. The question did not address what the consumer might have considered or chosen in instances where home credit was not the ultimate choice nor what they would do if other products were not available. In Provident's view, it was therefore a mistake for the CC to link responses to this question to the issue of which products were substitutable to home credit.

³⁸See, for example, the customer surveys conducted for the following CC merger inquiries: Greater Western Passenger Franchise (2006), First Group plc/InterCity East Coast Franchise (2005), Somerfield plc/Wm Morrison Supermarkets plc (2005). All of these surveys are available on the CC website.

³⁹Source: Project Space. The relevant question reads: 'When you borrow money from a credit of finance company, you pay a percentage of that money as payment for borrowing the money. Thinking about the money that you borrowed, if you had been charged 5 per cent MORE interest for the money then you were actually charged, would this have affected your choice of credit?' Customers who answered 'Yes' were then asked about the choice that they would have made instead.

⁴⁰Source: Project Space, slide 27. For a 5 or 10 per cent price rise the corresponding figure is 64 per cent. Customers whose last credit product had not been home credit reported significantly higher levels of price sensitivity with respect to this purchase than customers who had taken a home credit loan.

were personal loans, overdrafts, AMO and credit cards. Based on the responses to this question, Provident estimated a range of elasticities of demand for home credit of between -2.9 and -4.8 for a 5 per cent price rise and of between -2.1 and -3.5 for a 10 per cent rise in price.⁴¹

- 4.48. Provident submitted that the results from this survey demonstrated that customers were highly sensitive to price.
- 4.49. We note that the question that customers were asked was phrased in a way that made it difficult for customers to understand what was meant by '5 per cent more expensive' in the context of their own experience. The question itself was ambiguous⁴² and, moreover, the 5 per cent price rise was not clearly defined or articulated in cash terms that might have been more readily understandable to customers.^{43,44} Other questions in this survey do not provide any evidence about the interpretation that customers placed on this question. Given this lack of clarity, there may also be a risk of positive response bias. In light of these issues, it is difficult to place much weight on the elasticities calculated using this survey, which are likely to over-estimate the sensitivity of home credit customers to changes in price. Nonetheless, the responses may be interesting as an indicator of customers' relative feeling about price changes and the options available to them, rather than as an accurate prediction of how they would respond faced with a particular event.
- 4.50. Paid-up customers are heavily represented in the Quaestor report; over-representing paid-up customers might bias upwards estimates of price sensitivity. Provident presented evidence, which suggested that this sampling issue had relatively little effect on estimated elasticities.

Likelihood of switching to alternative credit options in hypothetical scenarios

- 4.51. Table 4.4 summarizes the proportion of home credit customers who said that they would switch to particular alternative credit options in the hypothetical scenarios described in paragraphs 4.43 to 4.49. In the Quaestor research, customers were prompted with a list of other products to which they might switch whereas, in the NOP survey, customers were asked for their unprompted responses. Some of the products identified in response to the NOP survey, such as credit unions and the Social Fund, were not on Quaestor's list of prompted options. It is therefore not possible to use the Quaestor survey to estimate customers' likelihood of switching to these options.

⁴¹Source: Project Space.

⁴²In the context of a home credit product, '5 per cent more interest' could be interpreted to mean (a) an increase in the APR by five percentage points; (b) an increase in the APR by 5 per cent (eg an increase from 200 to 220 per cent); or (c) an increase in the TCC by 5 per cent. Customers may also have thought in terms of a 5 per cent rise in weekly repayments or have had a vaguer, unquantified concept of a price rise in mind.

⁴³FSA and other research have indicated that a significant minority of adults are unable correctly to calculate percentages.

⁴⁴Provident told us that the question was not in any way misleading or complex. In Provident's view the format of the question was entirely appropriate and was dictated by the desire to ask customers about their last credit need rather than just their last home credit experience.

TABLE 4.4 Proportion of customers who say they would switch to alternative credit products in hypothetical scenarios

Survey	NOP		Quaestor	
	Would have used if agent stopped calling	Would use in response to 5% or 10% price rise	Would use in response to 5% or 10% price rise	Would use in response to 5% or 10% price rise
Question				
Sample	All home credit customers	Took home credit last time	Did not take home credit last time	
Prompted/unprompted	Unprompted	Prompted	Prompted	
Home shopping (AMO)	1	3	5	
Social Fund	1	N/A	N/A	
Credit union	<1	N/A	N/A	
Payday advance	<1	<1	<1	
Unlicensed lender	<1	N/A	N/A	
Rent-to-own	<1	<1	<1	
Pawnbrokers	<1	<1	<1	
Buy-back shop	<1	<1	<1	
Loan from friend or relative	1	N/A	N/A	

Source: NOP, Project Space.

Note: N/A means that the options were not offered to customers as possible responses in the Quaestor survey. In the Quaestor survey, respondents were allowed to choose only one option.

4.52. The NOP survey found that only 1 per cent or fewer customers would have switched to any of the alternative credit products if their home credit agent had stopped calling. Quaestor found that 3 per cent of customers who used home credit on their last borrowing occasion would have switched to AMO if they had been charged 5 or 10 per cent more interest, but that the percentage switching to other alternative credit options was less than 1 per cent. Customers who had chosen a credit option other than home credit on their last borrowing occasion were more likely to say that they would switch to an alternative credit option in response to a 5 or 10 per cent price increase than those who had chosen home credit.

Conclusion on competition from alternative credit options

4.53. We have considered the constraint imposed on home credit lenders by a variety of alternative credit options. Having considered a wide range of evidence, we conclude that these options pose only a limited competitive threat to home credit.

4.54. AMO is the most widespread alternative credit option and, although the sector is in decline, AMO is used by a substantial proportion of home credit customers. However, differences in product characteristics and the structure of supply limit the extent of substitutability for home credit. Survey results suggest that AMO is considered as an alternative to home credit on a relatively small proportion of occasions. Customers' responses to hypothetical scenarios posed both by NOP and Quaestor (on the latter of which we think we can place only limited weight for the reasons given in paragraph 4.49) suggest that few customers would switch to AMO in response to an increase in the price or a reduction in the availability of home credit. And, as is shown in paragraphs 4.94 to 4.105, we saw no evidence of them actually doing so in response to a rise in the price of home credit.

4.55. The Social Fund is the next most widespread alternative credit option. However, its availability is limited to a subset of home credit customers and has until recently been limited to a subset of their borrowing requirements. Credit availability is rationed. On the basis of the evidence we have seen, the Social Fund appears to be used in

parallel to home credit, rather than as a competitive constraint. Similar considerations apply to loans from credit unions and from friends and family.

- 4.56. Other commercial alternative credit options are much smaller in scale than home credit. A high proportion of customers said that they would not use them if they needed money now. These options hardly figure in customers' recollection of alternatives considered and few customers said that they would switch to them in hypothetical situations.
- 4.57. Illegal lending does not appear to pose a competitive constraint on home credit. It is perceived as a last resort, unlikely to be embarked upon as a result of a small change in home credit prices. This is supported by the survey evidence that we have seen.

Competition from mainstream credit options

- 4.58. In the following paragraphs, we evaluate the competitive constraint on home credit from those credit options that are commonly used by the majority of the population (mainstream credit options). Mainstream credit options used by home credit customers include overdrafts, credit cards, store cards, personal loans, hire purchase and car loans.⁴⁵ Lending decisions for mainstream credit options are usually made remotely and repayments may be made in a variety of ways, though not through home collection. Mainstream credit options are offered at a lower APR than home credit, but customers may face other charges for missed payments or unauthorized borrowing. This can reduce the difference between effective interest rates for mainstream credit options and home credit, compared with the difference in APRs (see paragraphs 3.18 to 3.31).
- 4.59. Some home credit lenders argued that this constraint is substantial and growing. They have noted the increased availability of mainstream credit options to what have historically been their lowest risk and most profitable customers, and argued that this had increased their costs (by mechanisms described in more detail in paragraph 4.121). Home credit suppliers, they have argued, have not been able to increase prices to reflect these cost increases, as this would cause them to lose more of their best customers to mainstream credit options. As home credit prices do not vary by customer, it has been argued that competition with mainstream credit options to attract lower-risk customers has constrained the price of home credit to all customers.

Use of mainstream credit options among home credit customer base

- 4.60. The most widely held mainstream credit options among home credit customers are credit cards, personal loans and overdrafts.

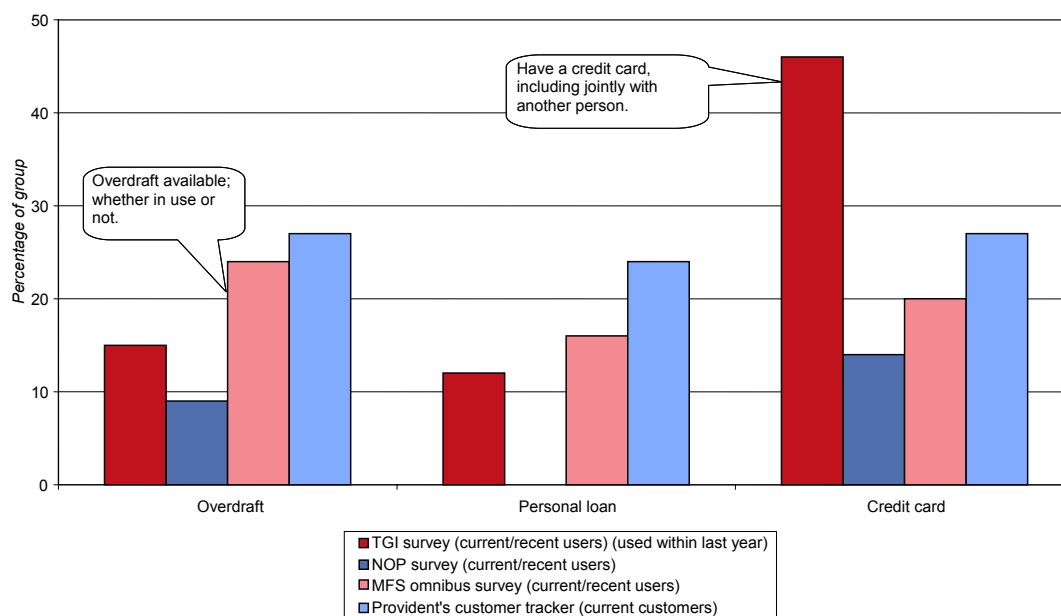
Results of customer surveys

- 4.61. Figure 4.2 summarizes the findings of four large-scale quantitative surveys relating to the extent to which home credit customers use or have access to these mainstream credit options.

⁴⁵A small proportion of home credit customers also have a mortgage. However, mortgages are secured on property and are for much larger sums than a typical home credit loan. It has not been suggested to us that mortgages constitute a competitive constraint on home credit. We do not therefore consider mortgages further.

FIGURE 4.2

Use of mainstream credit options among home credit customers



Source: TGI, NOP, MFS surveys, Provident.

4.62. Estimates of the use of mainstream credit options differ between these surveys over and above the normal statistical variation that would be expected between survey results. This is primarily because of differences in definitions used between the various surveys. In particular, we note that:

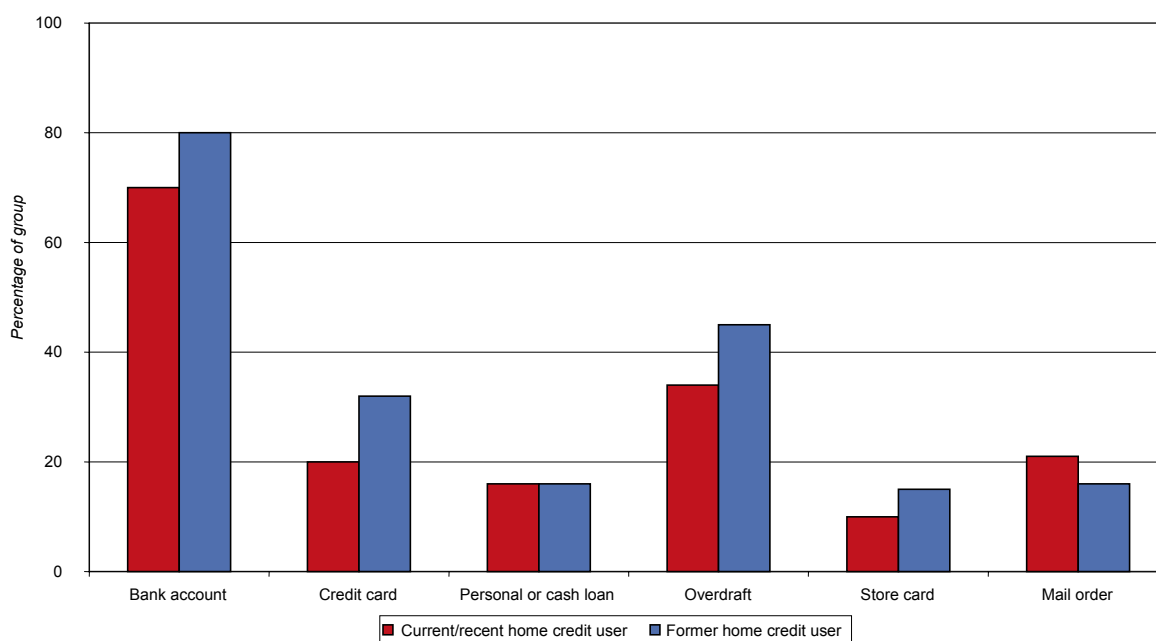
- The proportion of customers who have the potential to access a form of credit tends to be higher than the proportion of customers who actually use it. For example, MFS asked about whether customers have overdraft facilities available, whereas NOP and TGI asked about whether a customer is currently borrowing (or has borrowed) on overdraft. Similarly, the TGI survey found that 45 per cent of current/recent customers hold a credit or a charge card (much higher than other surveys), but that of these, only 44 per cent (about 20 per cent of the total sample) used it once every three months or more.
- Some TGI questions ask whether customers have used a credit product to purchase a single item costing more than £200. This is likely to reduce estimates of penetration.
- The proportion of customers who are currently borrowing on a form of credit tends to be lower than the share of customers who have used that form of credit in the past year. TGI and MFS asked about the use of products in the past year whereas NOP asked about current behaviour.⁴⁶ The NOP survey for the CC tended to find lower levels of other forms of credit compared with the TGI and MFS omnibus surveys. This is because not all customers will be using the credit facilities to which they have access.

⁴⁶In addition, TGI only takes overdrafts into account that exceed £200 and were used for purchasing goods. NOP or MFS do not apply such restrictions and consequently produce higher results in this particular case.

- 4.63. There is some overlap between customers' use of mainstream credit options. For example, in 2004, 27 per cent of Provident's current home credit customers had a credit card, 24 per cent held a personal loan and 27 per cent had overdraft facilities. Overall, 49 per cent of Provident's current home credit customers had one or more of these three mainstream credit options; 16 per cent had two; and 7 per cent had all three.⁴⁷
- 4.64. Former home credit customers and customers who have paid up their most recent home credit loan are more likely than current customers to have or use mainstream credit options. Figure 4.3, taken from the MFS survey of paid-up customers, compares the use of other credit options by current and former home credit users. Former home credit users are more likely to use storecards, credit cards and overdrafts than current users. However, the MFS survey does not find a difference in the usage of personal loans between the two groups. Provident's customer tracker compares its current customers with those customers who have paid off a home credit loan between 3 and 40 weeks ago. This finds that paid-up Provident customers are more likely to have a bank account and to use other forms of credit than their current customers.

FIGURE 4.3

Use of other credit options by current and former home credit users



Source: MFS survey of paid-up customers.

Developments in use of mainstream credit options since 1997

- 4.65. Access to mainstream credit options, and in particular credit cards, by home credit customers has increased since the late 1990s. For example, the proportion of Provident customers holding a credit card increased from 17 per cent in 1997 to 27 per cent in 2004. Reasons for this development include sustained low levels of unemployment, mainstream suppliers' perception of saturation among low-risk cus-

⁴⁷Source: Provident customer tracker.

tomers and entry by new suppliers, such as Capital One, focusing on the sub-prime or near prime segments.⁴⁸

4.66. However, based on our analysis of the Provident customer tracker and the TGI survey, this trend of increased penetration of mainstream credit options among home credit customers appears to have slowed or even stopped since around 2004.

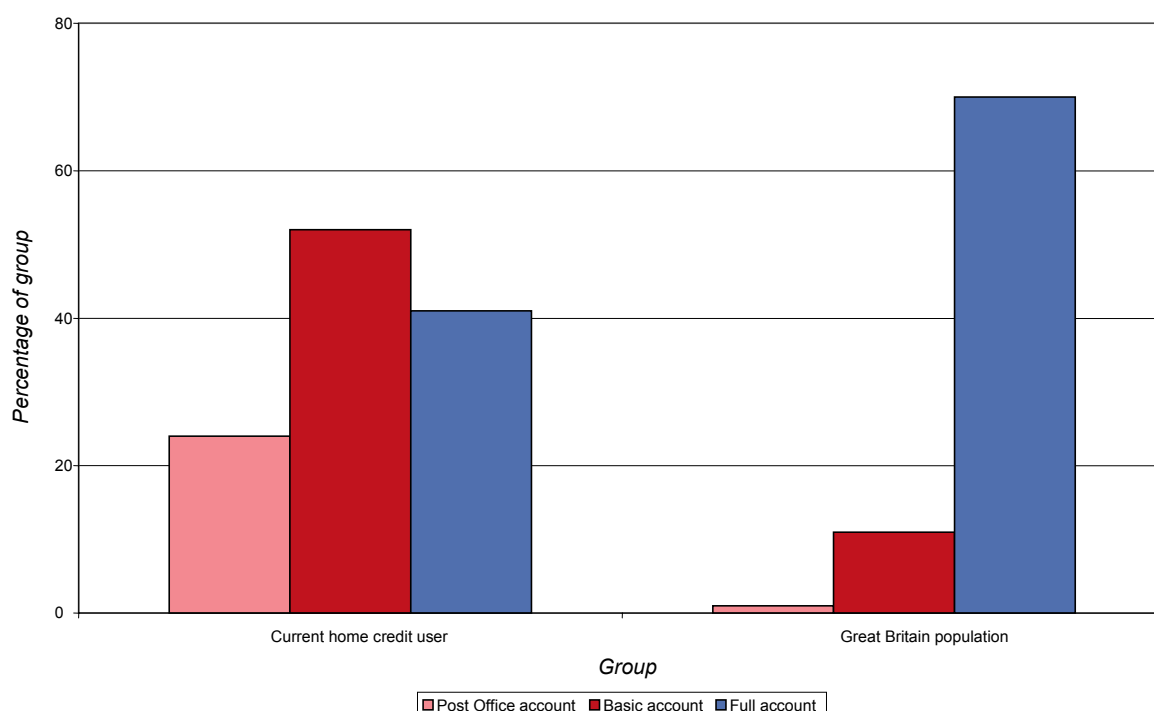
Current account ownership

4.67. A current account can act as a gateway to mainstream credit options. An overdraft is only available to customers with a full current account. In addition, current account providers are more likely to grant further credit (eg personal loans and credit cards) to customers who have proved themselves able to manage their current account. The proportion of home credit customers holding a current account has increased since 1997. The Provident customer tracker showed an increase in the proportion of current Provident customers with a current account from 54 per cent in 1997 to 66 per cent in 2004. The TGI survey showed an increase in current account holdings from 62 per cent in 1997 to 88 per cent in 2005.

4.68. This increase in current account holding is due, in part, to the development of basic bank accounts, of which over 5 million have now been opened.⁴⁹ Basic bank accounts—and also Post Office card accounts—are more widely held among the home credit customer base than in the population as a whole (see Figure 4.4).

FIGURE 4.4

Current account holdings by type



Source: NOP survey.

⁴⁸See Datamonitor *UK non-standard and sub-prime consumer credit 2005* for discussion of the factors driving the development sub-prime lending.

⁴⁹Source: 'Financial inclusion—access to advice, banking & credit', APACS & BBA 2005.

- 4.69. Basic bank accounts do not themselves have borrowing facilities, but they may act as a gateway to other credit options. For example, between 125,000 basic bank accounts were upgraded to accounts with more features since April 2003 and November 2001.⁵⁰ However, we were also told that the linkage between current account and mainstream credit use is considerably less pronounced for basic bank accounts and Post Office card accounts than for full service bank accounts, as customers have a more limited opportunity to demonstrate their creditworthiness. This view appears to be supported by the NOP survey, which found that 12 per cent of home credit customers with a basic bank account were currently borrowing on a credit card, as compared with 23 per cent of those who had a full service bank account.⁵¹

Factors limiting competition from mainstream credit options

- 4.70. While there has been an extension of mainstream credit to home credit customers and other groups who had previously been considered to represent a higher credit risk, there are some factors which limit the competitive threat posed by this development to home credit lenders, both now and in the future.

Attitudes of mainstream credit providers

- 4.71. None of the providers of mainstream credit that we spoke to knew how many of their customers had home credit loans. None told us that they targeted the demographic groups most strongly represented among home credit customers. However, most said that they would lend to people in these groups if they demonstrably met the lenders' normal lending criteria.
- 4.72. Data from CRAs forms a major input into mainstream credit providers' assessment of customers' creditworthiness and hence into their lending decisions. Many home credit customers have a poor credit record; some have no record at all (for example, [X] of Provident's customers—see paragraph 4.82). Providers of mainstream credit would be unlikely to lend to these groups. Lenders told us that a good record of payment on a home credit loan might be predictive of creditworthiness (though they would need to test that contention statistically). However, with few exceptions, home credit lenders do not share data on customers' repayment performance with CRAs. Some providers of mainstream credit told us that the absence of this information inhibited their ability to assess, and hence to lend to, any potential customer (whether a home credit customer or not). They also told us that if this information were available in an electronic format, it would enable them to form a more accurate assessment of default risk of some home credit customers. This could increase access to mainstream credit by home credit customers with a good repayment history. We have also been told that hard copies of customers' payment books would be much less useful to mainstream lenders as they would be unable to authenticate the accuracy of the book as a protection against fraud, they would have difficulty interpreting the data and it would be costly to integrate data held only in this form into automated credit-scoring processes.
- 4.73. All the providers of mainstream credit we spoke to told us that they had recently tightened their lending criteria in response to industry-wide increases in bad debt. Most told us that this made it less likely that customers perceived as presenting a higher-than-average credit risk would be able to secure credit from them.

⁵⁰Source: *Financial inclusion—access to advice, banking & credit*, APACS & BBA 2005.

⁵¹Source: NOP survey, Chart 15.

- 4.74. No lender told us that it was actively increasing its efforts to lend to higher-risk customers. Most of the providers of mainstream credit products told us that their current lending models and credit risk assessment methods were not designed to deal with higher-risk customers. They did not consider that they had the skills or capability to serve higher-risk groups than they currently did. Most also told us that they would not consider it consistent with their current brand positioning to charge an APR in excess of 30 per cent, which they considered might be necessary to serve higher-risk customers profitably. None told us that it was interested in developing new products (home collected or otherwise) for higher-risk groups.

Attitudes of customers

- 4.75. Even where customers use or are able to access mainstream credit options, it cannot be assumed that these options are a close substitute for home credit. The unique combination of features of home credit, such as the ability to miss repayments and the home collection service, may reduce customers' willingness to switch to mainstream credit options, even where mainstream credit providers are prepared to lend to them.
- 4.76. We commissioned qualitative research from AIA to explore characteristics and motivations of home credit customers. AIA's interviews with home credit customers who also had access to mainstream credit identified a range of motives for using home credit alongside other forms of credit. Some customers reported having used up other lines of credit. Others took out a home credit loan on impulse⁵² or in an emergency. NOP found that 60 per cent of home credit customers identified an 'urgent need for money' as an important reason for getting a home credit loan. This was the second most popular reason overall and was no less likely to be given by users of multiple sources of credit than by other home credit customers.⁵³ A third group used home credit out of habit and a further group concealed the home credit loans that they took out from their family/partners.
- 4.77. AIA's findings that some customers use home credit to supplement borrowing on other forms of credit are consistent with hearing evidence from LSB that some customers use multiple sources of credit in order to maintain access to several different lines of credit. This was also suggested by Cattles' presentation to the Open Meeting in May 2005.

Impact on home credit lenders

- 4.78. Home credit lenders have argued that competition from mainstream credit is an effective and increasing competitive constraint. If this were the case, we would expect such a constraint to impose downward pressure on home credit lenders' profitability and prices. We have therefore examined the impact of increased penetration of mainstream credit options on home credit lenders' costs, profits and prices.

⁵²The TGI survey found that home credit customers who also use other forms of credit display some characteristics of impulse buyers and agree disproportionately frequently with statements like 'With a credit card I can buy the sort of things I couldn't normally afford' and 'I tend to spend money without thinking'.

⁵³Source: the NOP survey, p12. The most popular reason for taking out a loan was for a special occasion such as Christmas or a birthday. NOP also found that users of multiple sources of credit were more likely to take out a loan for a special occasion, for shopping in general or to pay off another loan.

Impact on costs and profitability

- 4.79. It was put to us that competition from mainstream credit options had increased home credit lenders' costs, principally by increasing bad debts. In principle, there are two mechanisms by which this might have happened.
- 4.80. First, there might have been a change in the mix of customers towards higher-risk customers, as lower-risk customers switched away from home credit. We have not seen any evidence that the profile of home credit customers has shifted appreciably towards higher-risk groups. Paragraph 2.109 and Appendix 2.5 show a pattern of relative stability of the demographic characteristics of the home credit customer base.
- 4.81. Second, there might have been a reduction of the profitability of previously low-risk customers who have continued to use home credit alongside mainstream credit options. They might, for example, prioritize a credit card bill over a home credit repayment since missing the home credit payment would not result in a default charge.
- 4.82. On this issue, Provident submitted an analysis (bureau-based churn analysis) of the profitability and repayment performance over time of a cohort of its customers segmented according to their Delphi for Mailing score (DFM score), which is an indicator of the likely credit score that they would receive on the basis of data available from the Experian credit bureau. The bureau-based churn analysis showed that around a quarter ([redacted] per cent) of Provident's customers did not feature on the Experian database in 2004. A further substantial proportion ([redacted] per cent) fall into the next two highest-risk categories; [redacted] per cent are classified as medium risk; and [redacted] per cent of customers are classified as low risk ('prime or near prime'). This suggests that a significant proportion of Provident's customers (at least some of which have a good home credit repayment record) currently have very limited access to mainstream credit options.
- 4.83. The analysis then tracked the profitability of customers with different DFM scores over time. Some groups showed evidence of deterioration in performance across a number of measures. Comparing [redacted]. In Provident's view, this analysis provides clear evidence of the actual behaviour of customers over a short period casting light on a longer-term and more dramatic trend of declining profitability from particular customer groups. In Provident's view, this evidence demonstrates that other small sum credit products have an impact on Provident's profits and are therefore providing a real competitive constraint.
- 4.84. Despite Provident's view, this analysis does not appear to be compelling evidence of a strong competitive constraint. The analysis of DFM scores suggests that a large proportion of Provident's customers would have difficulty in obtaining mainstream credit. The effects identified on profitability and payment performance are small. Furthermore, as this approach tracks the credit performance of particular customers rather than tracking the Provident customer base over time, there may also be a natural tendency towards equalization of payment performance between categories, as some good credit risks become worse credit risks over time, and vice versa.
- 4.85. To the extent that bad debts may have increased among home credit lenders' better customers, it is unclear whether this should be attributed to competition from mainstream credit or to other factors. We were told by mainstream lenders that bad debts have risen in other credit markets in the last two years, mainly as a result of macro-economic factors. In addition, the trend of increasing bad debts among home credit suppliers predates the expansion of mainstream credit options among low-income groups.

4.86. In summary on this point, we have seen no evidence of a worsening of the home credit customer base. Nor have we seen persuasive evidence of a direct competitive impact from mainstream credit options on home credit lenders' costs or profits.

Impact on prices

4.87. If increased penetration of mainstream credit options among home credit customers was resulting in a strengthening competitive constraint, we might expect this to have led to a reduction in the price of home credit, as home credit lenders sought to respond to this competitive threat.

4.88. Our analysis of the history of prices charged by the medium-sized and largest suppliers between 1999 and 2004 is in Section 6. The analysis shows that there have been few price changes by the six largest home credit lenders in recent years, and that almost all price changes that have occurred have been to increase rather than decrease prices.

4.89. Some large home credit lenders told us that, although they had not cut any of the prices of their individual products, there had been a trend towards longer-term loans. This trend is shown in Table 4.5, which shows the proportion of loans of different lengths issued by large suppliers. In 1999, 63 per cent of loans issued by large suppliers had a term of 40 weeks or less. In 2005, this proportion had fallen to 43 per cent. The proportion of short-term loans by value has also fallen over this period from 44 to 27 per cent. The proportion of medium-length loans has risen over this period as has the proportion of loans of more than 60 weeks, albeit from a low base.

TABLE 4.5 Trends in length of loans issued by term

	1999	2000	2001	2002	2003	2004	2005
	<i>per cent</i>						
<i>Proportion of number of loans issued</i>							
40 weeks or less	63	62	61	55	51	46	43
41–60 weeks	35	36	36	42	45	51	52
More than 60 weeks	2	2	2	3	3	3	5
<i>Proportion of value of loans issued</i>							
40 weeks or less	44	43	44	37	33	29	27
41 to 60 weeks	48	49	49	54	57	61	58
More than 60 weeks	8	7	8	9	10	10	15

Source: CC analysis of data provided by Provident, Cattles, LSB, S&U and Park.

Note: 2005 data excludes Park.

4.90. Provident told us that it had developed a strategy of offering 'longer, larger loans' to existing customers, where it considered these customers to be lower credit risks. These typically have a lower APR than shorter-term loans, but a higher TCC.⁵⁴ The proportion of Provident's sales accounted for by longer loans has roughly trebled from a low base in 2004. In 2005, [redacted] per cent of Provident's loans by volume and [redacted] per cent by value were accounted for by loans of 60 weeks or longer—the corresponding figures in 2004 were [redacted] per cent by volume and [redacted] per cent by value. Provident told us that this was, in part, a competitive response to mainstream credit options, targeted at retaining those customers most likely to defect to

⁵⁴For example, Provident's 80-week PPC cash loan has a TCC of £80 per £100 lent and an APR of 132.5 per cent. By contrast, Provident's 55-week PPC cash loan has a TCC of £65 and an APR of 177.0 per cent. Provident's 31-week PPC cash loan has a TCC of £50 and an APR of 365.1 per cent.

mainstream products by offering larger loans at affordable weekly repayments. It also told us that this development had been enabled by its relatively new System Enhanced Lending (SEL) IT system, and had not been possible prior to its development.

- 4.91. It is not clear whether this constitutes a price increase or decrease. When offering a longer, larger loan Provident is, in effect, charging a higher TCC to its lowest-risk customers. [X] This development has not affected charges paid by the majority of Provident's customers to whom these products are not offered.
- 4.92. Our analysis of data provided confidentially to the CCA by its members showed that the proportion of longer-term loans in total increased between 1994 and 2004. In 1994, 21 per cent of products offered by CCA members were for terms longer than 30 weeks; by 2004 this proportion had increased to 32 per cent. In general, longer-term products have lower APRs, so we might expect an increase in the average length of loan offered to give rise to a decline in average APRs. The static or rising average APRs we observed over the period suggest that TCCs may have been rising over the period.
- 4.93. We are not persuaded that the increase in the average length and amount of loans offered by some home credit lenders is strong evidence of a reduction in price in response to competitive pressure from other products. It is not clear to us that this constitutes a reduction in price.⁵⁵ Nor is it clear to us that this development was primarily driven by competitive pressure, rather than other factors, such as improvements in credit-scoring techniques which made it possible to make longer loans without increasing bad debts unacceptably.

Impact of increases in prices of home credit products on customer demand

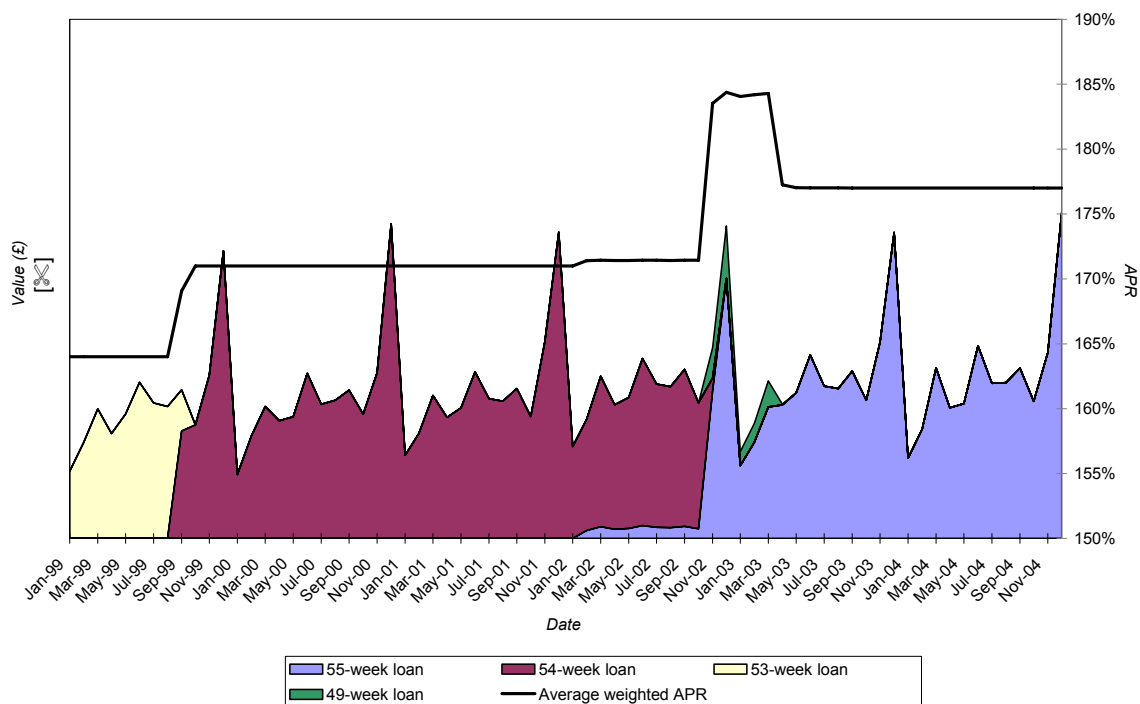
- 4.94. The price increases that have occurred since 1999 (see paragraphs 6.11 to 6.15 and Figures 6.1 to 6.4) offer an opportunity for us to observe customers' responses to changes in the price of home credit. If customers were sensitive to the price of home credit relative to other forms of credit, we might expect price increases of this size to lead to a sharp fall in the sales of the products whose price has increased.
- 4.95. We therefore examined sales of home credit loans before and after increases in the price of home credit products offered by large home credit lenders. Monthly sales and prices of the three home credit products with largest sales in 2004 are shown in Figure 4.5.

⁵⁵An increase in the length of a loan with unchanged weekly repayments would be likely to reduce the APR but increase the TCC (our preferred measure of price).

FIGURE 4.5

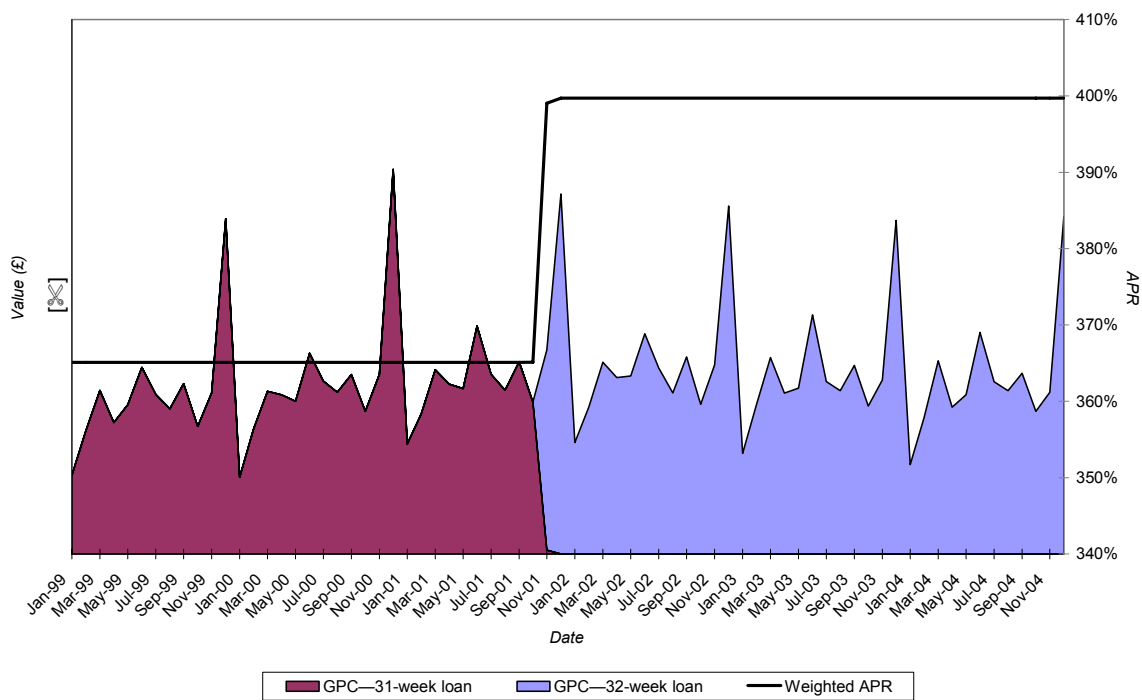
Impact of increases in price on sales of top three home credit products

Provident's PPC year-long product



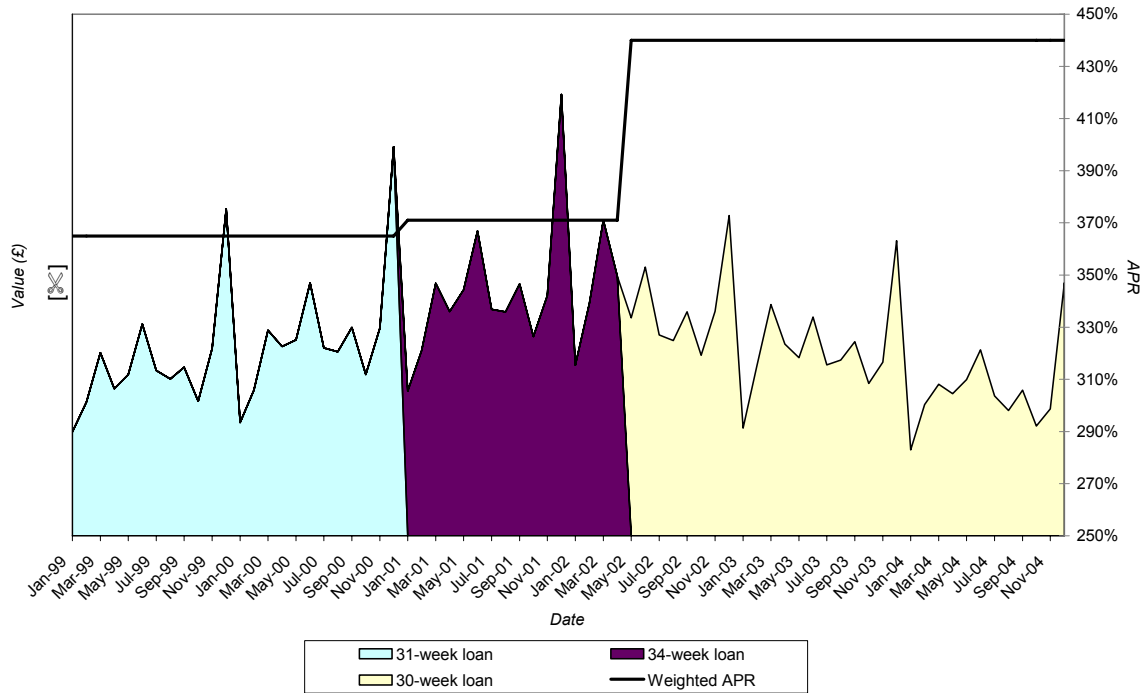
Source: Provident, CC analysis.

Provident's GPC half-year product



Source: Provident, CC analysis.

Cattles' half-year product



Source: Cattles, CC analysis.

- 4.96. Sales of some products (though not the most popular) appeared to show some decline in response to a rise in price. Lenders told us that we should not draw conclusions based simply on observation of the data. We therefore sought to apply econometric analysis to the limited price data we had, in order to estimate the magnitude of this effect. See Appendix 4.1 for details of the methodology used in this exercise.
- 4.97. We calculated price elasticities of demand for five individual home credit products (the two illustrated in Figure 4.5, Provident (PPC) and S&U half-year products). These elasticities summarize the overall sensitivity of demand for an individual home credit product to changes in its own price. As such, they encapsulate all demand responses to a price change, including switching to other home credit products offered by the same lender, to home credit products offered by other lenders and to other forms of credit. Elasticities of demand for individual home credit products are therefore likely to be larger (ie more negative) than the elasticity of demand facing an individual supplier, which is itself likely to be larger than the elasticity of demand for home credit as a whole. If product elasticities of demand are small the elasticity of demand for home credit as a whole will be smaller still. Table 4.6 sets out the summary results from this analysis.⁵⁶

⁵⁶The elasticities presented in Table 4.6 are based on regressions using deseasonalized data and using APRs to measure price. The results do not vary substantially using other methods (see Appendix 4.1 for further details).

TABLE 4.6 Summary of econometric analysis of price elasticity

	'Short-run' price elasticity	'Long-run' price elasticity
Provident one-year product	Positive	Positive*
Greenwood half-year product	Positive*	Positive
Cattles half-year product	-1.0*	-0.8*
S&U half-year product	-1.6†	-4.6†
Provident half-year product	-1.2*	-5.0*

Source: Cattles, Provident, S&U, CC analysis.

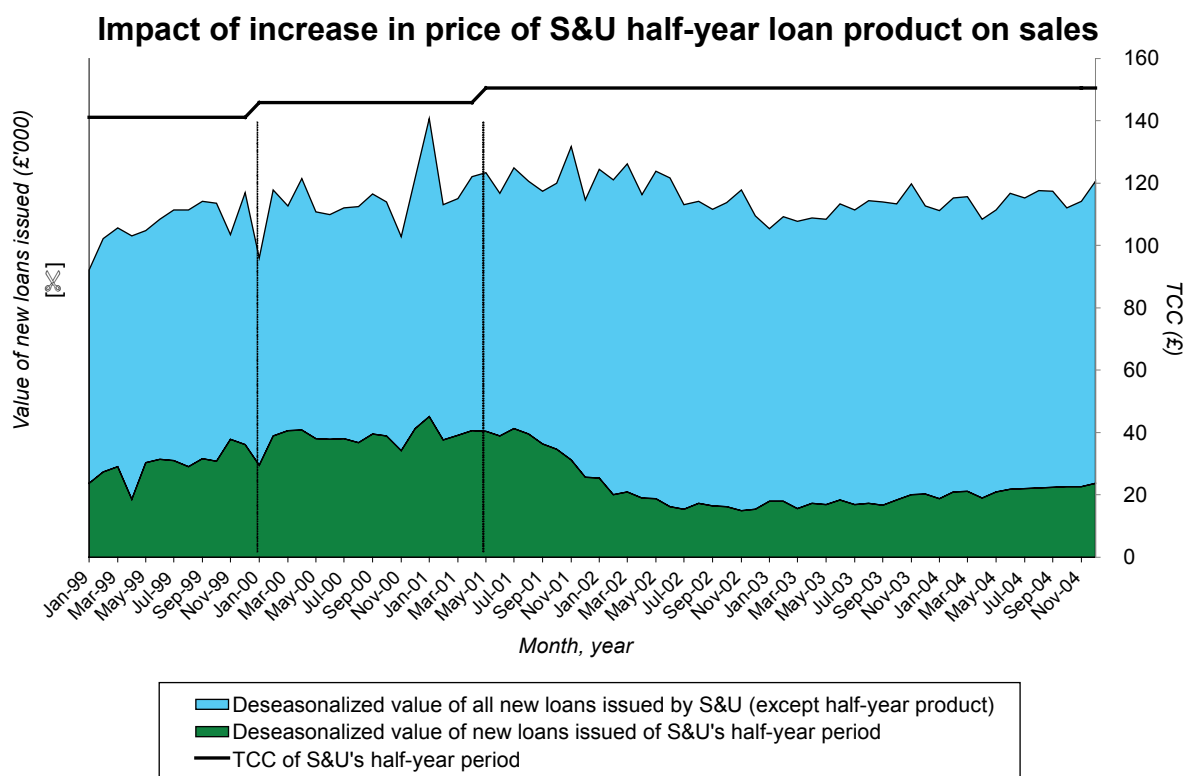
*Indicates that a coefficient is significantly different from zero at the 5 per cent level of significance.
 †Indicates that a coefficient is significantly different from zero at the 10 per cent level of significance.

4.98. The data did not permit us to draw any very firm conclusions from this analysis. In particular, the small number of price changes meant that we could place little faith in the precision of these estimates. However, the econometric results broadly confirmed our observations from the underlying data presented in Figure 4.4, that there was no adverse impact of price rises on product sales for the top two products in the market (the Provident one-year and Greenwoods half-year products). These results also confirmed the impression from Figure 4.5 that the demand for Cattles' half-year loan is also relatively inelastic.

4.99. In the remaining two cases (the Provident (PPC) and S&U half-year products), estimated product elasticities are reasonably substantial. In both cases we were told by the lenders involved that the decline in sales of the product we analysed coincided with an increase in sales of a longer-term product from the same lender.

4.100. This is illustrated by Figure 4.6, which shows sales of S&U's half-year product and its total home credit sales (adjusted for seasonal variation).

FIGURE 4.6



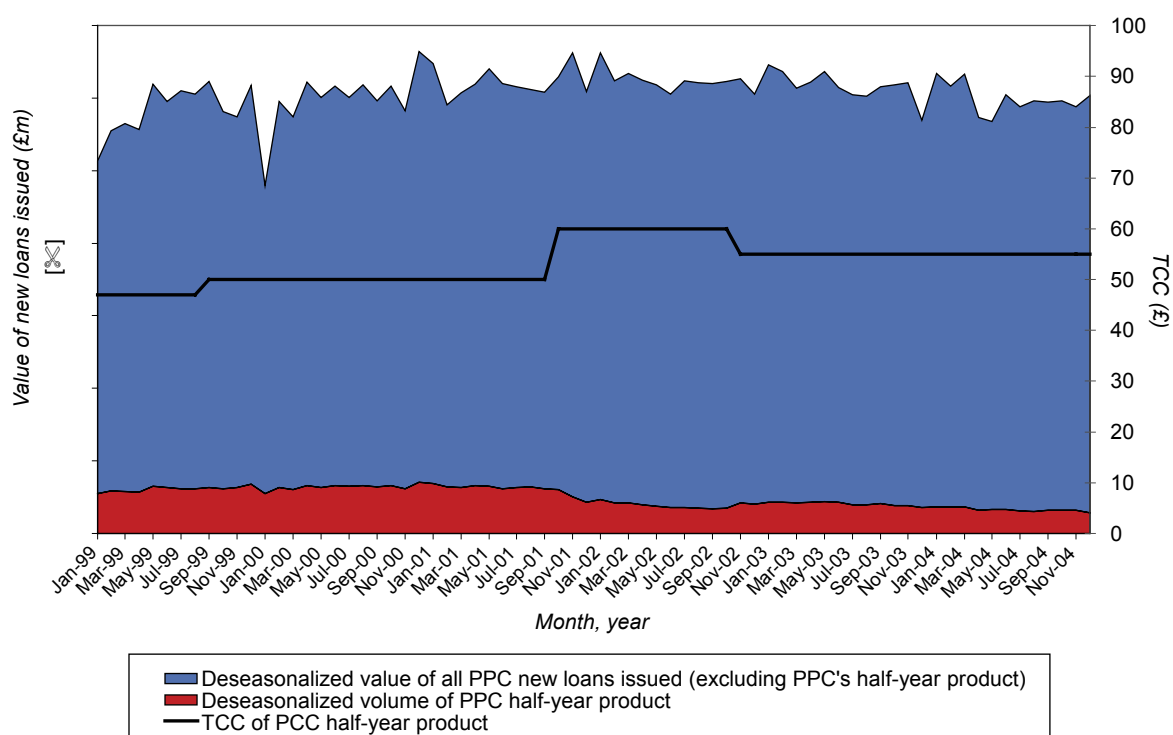
Source: S&U, CC analysis.

4.101. In May 2001, S&U increased the price of its half-year product. This was followed by a clear decline in sales of that product. However, S&U's sales of other products increased following the price increase and its total sales in this period were flat. S&U told us that, over this period, its strategy had been to migrate its customers towards its longer-term products.

4.102. A similar pattern can be observed with respect to sales of Provident's half-year PPC product (see Figure 4.7).

FIGURE 4.7

Impact of increase in price of PPC half-year loan product on sales



Source: Provident, CC analysis.

4.103. This further analysis suggests that much of the observed price elasticity of demand for these two products is explained by customers moving from one product to another product offered by the same lender. It is therefore not indicative of high levels of price sensitivity either between home credit lenders or between home credit and other credit options. This analysis is discussed in more detail in Appendix 4.2.

4.104. In January 2005 the headline prices of S&U's four most popular home credit products (which together accounted for 97 per cent of its home collected business) increased by around 8 per cent. S&U told us that this change simply represented the incorporation of what had previously been a charge for insurance into the price of the loan, so what had previously been insurance revenue became interest income. There was no material change to S&U's revenue as a result.

4.105. Taking together our observation of the changes to prices and values of new loans issued and the econometric analysis, we concluded that the sensitivity of demand to the price of particular home credit lenders' loans is very low. This implies further that the sensitivity of the demand for home credit as a whole to changes in its price is lower still.

Comparison of price levels

- 4.106. Provident submitted that its 'effective APR' analysis (discussed in Section 3 and in more detail in Appendix 3.2) supported its view that home credit was in the same market as other forms of credit. Provident argued that, when other charges were taken into account, the difference in price between home credit and mainstream credit products was much smaller than would be apparent from comparing APRs. Provident added that this showed that customers were making a rational choice between home credit and mainstream credit options and were weighing up price against other factors. We accept that the difference between headline APRs can overstate the difference in prices between home credit and mainstream credit products.
- 4.107. However, this analysis says little about customers' sensitivity to the price of home credit relative to mainstream credit options. Moreover, we noted in Section 3 that even in Provident's 'effective APR' analysis, home credit charges were still higher than those for mainstream credit products. We do not consider that this analysis provides much support for the argument that mainstream products constrain home credit.

Comparison of price movements

- 4.108. We also examined the extent to which the price of home credit loans moved together with the prices of mainstream credit products (see Appendix 4.3 for further details). We would often expect the prices of products, which imposed a competitive constraint on each other, to move closely together over time.
- 4.109. We examined first the correlation between the average price of Provident's home credit loans (measured both by the TCC and APR) with the average APRs of all credit cards, personal loans and overdrafts. This analysis showed that over this period, home credit prices had increased and APRs on mainstream products had fallen. This implied a negative relationship between home credit prices and the interest rates on mainstream credit products, as measured by the APR. This is the exact opposite of what one would expect if there were a pricing constraint between interest rates on mainstream credit products and home credit prices.
- 4.110. This is, however, a simplified analysis. First, it measures the price of mainstream credit products, using the APR. Users of mainstream credit products may also face other charges, for example if they miss repayments or exceed agreed borrowing limits without prior authorization. There is some evidence that these non-APR charges have increased since 2000.⁵⁷ Second, the average interest rates for mainstream products, such as credit cards, are calculated by reference to all products in that category. However, in practice, certain mainstream credit products will be much more widespread among home credit customers than others.
- 4.111. We therefore conducted some further analysis of price movements over time. This looked in more detail at the movement of prices of [X] credit card product and looked at the changes to the total cost of borrowing using this product, when charges other than the APR are taken into account. This further analysis showed that, under a range of scenarios, the cost of borrowing using [X] credit card product also rose

⁵⁷For example, the report *Credit Cards in the UK* by the market research group Defaqto found that the average late payment charge increased from £16.42 in October 2002 to £22.68 in October 2005. Over the same period, the average charge for a returned payment increased from £15.29 to £20.93 and the average charge for exceeding an agreed credit limit increased from £16.27 to £22.79.

over this period. As the price of this product and Provident's loans were both increasing over this period, we observed a positive price correlation. Such a positive correlation might suggest that the two products are in the same market; however, it is also possible that the common upward trend in both prices can be explained by other factors, such as increases in bad debt rates. Both home credit and other lenders have told us that these have risen in recent years.

4.112. Thus we found that, when aspects of price other than the APR are considered, there is a positive correlation between the price of [X] credit card and the price of Provident's one-year PPC loan. However, the extent of this correlation is neither so large as to imply that the two products are definitely in the same market, nor so small as to imply that they are definitely in separate markets. The observed correlation may be explained by other factors, such as common cost trends. Given these factors, we do not consider this finding of a positive correlation between the two products as strong evidence that credit cards pose a competitive constraint on home credit loans.

Survey evidence on substitutability of mainstream credit options for home credit

Mainstream credit options considered

4.113. Table 4.7 summarizes evidence from the NOP and Quaestor surveys on the extent to which home credit customers considered mainstream credit options, when taking out a home credit loan and on their last borrowing occasion (see paragraphs 4.34 to 4.39 for a discussion of the methodology).

TABLE 4.7 Mainstream credit options considered when taking out last home credit loan

Survey	Alternatives considered NOP	NOP		Quaestor	
		Unprompted	Prompted	Took home credit last time Took home credit—prompted	Did not take home credit last time Did not take home credit—prompted
Question	Would certainly NOT use if you needed money now	Alternatives seriously considered—last home credit loan		Alternatives considered—last borrowing occasion	
Sample	All home credit customers	All home credit customers		Took home credit last time	Did not take home credit last time
Prompted/unprompted	Prompted	Unprompted	Prompted	Took home credit—prompted	Did not take home credit—prompted
Overdraft	67	3	16	13	37
Credit card	69	1	12	13	42
Personal loan	70	7	14	18	60
Hire purchase	73	0	13	N/A	N/A
Store card	77	0	5	7	14
Secured loan	87	0	3	N/A	N/A

Source: NOP, Project Space.

Note: N/A means that the options were not offered to customers as possible responses in the Quaestor survey.

4.114. Overdrafts, credit cards and personal loans feature more highly than other mainstream credit products in customers' considerations when taking out a home credit loan. Over two-thirds of customers said that they would definitely not consider each of these mainstream credit options if they needed money now. Unprompted customers were most likely to recall considering a personal loan (7 per cent of customers) compared with other mainstream products. When prompted, customers are more likely to recall considering a mainstream credit product, with the NOP and Quaestor surveys producing similar results. Quaestor found that customers who had

not taken home credit on their last borrowing occasion were much more likely to have also considered another mainstream credit product.

4.115. Comparing these results with those relating to alternative credit options (see paragraphs 4.33 to 4.51), the results for each of these three mainstream options are broadly similar to those for AMO. The NOP survey found that home credit customers were more likely to have considered a loan from a friend or a family member than any single mainstream credit option when taking out their last home credit loan.

Likelihood of switching to mainstream credit options in hypothetical scenarios

4.116. Table 4.8 summarizes home credit customers' stated likelihood of switching to mainstream credit options in the hypothetical scenarios set out in the NOP and Quaestor surveys (see paragraphs 4.43 to 4.50 for discussion of the methodology).

TABLE 4.8 Proportion of customers who say they would switch to mainstream credit products in hypothetical scenarios

Survey	NOP		Quaestor	
	Would have used if agent stopped calling		Would use in response to 5% or 10% price rise	Would use in response to 5% or 10% price rise
Sample	All home credit customers		Took home credit last time	Did not take home credit last time
Prompted/unprompted	Unprompted		Took home credit—prompted	Did not take home credit—prompted
Overdraft	2		5	3
Credit card	3		3	8
Personal loan	5		11	21
Hire purchase	<1		1	<1
Storecard	<1		<1	1
Secured loan	<1		N/A	N/A

Source: NOP, Project Space.

Note: N/A means that the options were not offered to customers as possible responses in the Quaestor survey. In the Quaestor survey, respondents were only allowed to choose one option.

4.117. The NOP survey found that 5 per cent or fewer customers would have switched to any of the mainstream credit products, if their home credit agent had stopped calling. Personal loans were mentioned most frequently. Quaestor also found personal loans (11 per cent) to be the mainstream credit option to which home credit customers said they were likely to switch if they had been charged 5 or 10 per cent more interest, followed by overdrafts (5 per cent) and credit cards (3 per cent). Customers who had chosen a credit option other than home credit on their last borrowing occasion were more likely to say that they would switch to personal loans or credit cards in response to a 5 or 10 per cent increase in the interest charged on their last credit option than those who had chosen home credit.

4.118. Interpretation of these figures is subject to the same considerations as we expressed in paragraphs 4.43 to 4.50. While the proportion of customers who say they would switch to a mainstream credit product is relatively small, it was put to us that even a small number of marginal customers likely to switch in the face of a price rise might be enough to constrain the behaviour of home credit lenders. We acknowledge that this is a possibility in theory. In assessing whether marginal customers are having such an impact on home credit suppliers in practice, we considered the evidence from customer surveys alongside the rest of the evidence on competition from mainstream credit products set out in this section. In assessing the sensitivity of cus-

tomers to price increases, we place most weight on the observed response to price increases described in paragraphs 4.94 to 4.105.

Assessment of competitive constraint from mainstream credit

- 4.119. Taking all of the above evidence together, mainstream credit products do not appear in practice to constrain the price of home credit.
- 4.120. While the penetration of mainstream credit products among home credit users has increased over the past decade, there remain a substantial proportion of customers who do not have access to these products and there are barriers to further penetration. For that substantial group of customers, mainstream credit products pose no competitive threat. We might still have expected home credit lenders to have responded to a threat to the proportion of their customers who do have other credit options (which they told us they perceived). But home credit lenders have not reduced their prices (expressed in TCC terms) in response to an increased competitive threat from mainstream credit products, although there has been a movement towards loans with a longer term. Significantly, when the price of particular home credit products rose, we were unable to detect substantial falls in the suppliers' home credit sales, which would be expected if mainstream credit products represented a significant competitive constraint.
- 4.121. We were told that competition from other providers of mainstream credit products had increased bad debt costs. Two mechanisms were cited by which this could have happened. First, the most creditworthy customers (those least likely to default) would be most likely to have abandoned home credit for other sources of credit, reducing the average payment performance of the remaining customers. Second, where customers were using more than one credit source their payment performance on the home credit loans was likely to decline.
- 4.122. Further, we were told that competition from providers of mainstream credit products had prevented home credit suppliers from passing on, in the form of higher prices, costs that had increased as a result of competition. This was not convincing. First, there does not appear to have been a substantial reduction in the profitability of low-risk customers, nor does the mix of home credit customers appear to have shifted towards higher-risk groups. To the extent that the costs of home credit suppliers have risen, this appears to be the result of general factors affecting all credit providers rather than a specific impact of increased competition from mainstream credit options. We also note that large home credit lenders made a number of price increases between 1999 and 2002, during which period penetration of mainstream credit options was increasing.
- 4.123. We note the survey evidence submitted by Provident, which it suggested demonstrated that a substantial proportion of customers would switch to another form of credit in response to a small change in the price of home credit.⁵⁸ However, we consider that the balance of evidence suggests that the demand for home credit is insensitive to its price and that mainstream credit options do not constrain home credit.
- 4.124. We were also told that some of the product and process innovations introduced by home credit companies in recent years (see paragraphs 3.153, 3.154 and 3.175 to

⁵⁸We note that if prices are in excess of competitive levels (as Section 3 suggests), then survey or other evidence on substitution would (incorrectly) indicate a broader market than is justified. This is a manifestation of the so-called 'cellophane fallacy' (see our Guidance—CC3, paragraph 2.9).

3.181), both in the delivery of home credit itself and in the development of other products which might appeal to current or former home credit customers, were evidence of competitive pressure. We accept that this may be the case, but do not consider this as important as the apparent lack of impact on home credit prices.

Supply-side substitution

- 4.125. We considered the possibility of supply-side substitution from suppliers of credit products that are not home collected and from suppliers of other products where collectors or sales representatives already call at customers' homes (such as AMO, hamper suppliers or debt collectors).
- 4.126. Both of these are sources of potential entry to home credit. However, neither can be considered as supply-side substitutes. Suppliers of other credit products operate a fundamentally different business model from home credit suppliers and show no appetite for setting up a home-collected credit business.⁵⁹ To do so, they would need to develop a reliable network of agents/collectors and to build up a customer base. This could not be done within a year without significant investment.
- 4.127. Suppliers with an existing collection network might be able to use this network to offer home credit loans alongside other products and services. However, these suppliers would still need to build a customer base for home credit and would need to learn new skills, for example in managing credit risk. They may also face resistance from their existing staff and customers to operating in a different role.

Conclusion on competition from other forms of lending

- 4.128. We have examined the competitive constraint on home credit prices from alternative and mainstream credit products. In both cases, our assessment of the evidence is that this constraint is weak on both the demand and the supply side. This also leads us to conclude that home credit may be considered to be the relevant product market for the purpose of analysing market features.

⁵⁹Source: questionnaires to mainstream financial services providers.