

5. Constraint imposed by entry and expansion

Introduction

- 5.1. In this section we evaluate the competitive constraint imposed on home credit lenders by new entry, the threat of entry, and expansion by existing lenders.
- 5.2. We received conflicting views on this issue. The NCC told us that barriers to entry were high, which reduced the extent to which the threat of entry constrained incumbent lenders. By contrast, home credit lenders told us that entry by efficient firms was straightforward and could be expected to act as an effective competitive constraint.
- 5.3. To assess this issue, we looked first at the recent history of entry and expansion. We then evaluated the significance of various barriers to entry, expansion and exit. Finally, we considered the impact of entry and expansion on the intensity of competition between home credit lenders.

Recent history of entry, expansion and exit

- 5.4. While many home credit lenders are long established, there have been several examples of entry and expansion in the past five years. In the five years between 1 January 2000 and 31 December 2004, 93 new member businesses (comprising 21 per cent of current membership) joined the CCA.¹ Of these 93, 39 were sole traders and 46 were businesses with up to ten agents. The Chief Executive of CCA said at our Open Meeting that 'although not all of those will have been new business start-ups, a great number of them were'. In addition, some firms already active in home credit have expanded their operations. A number of such episodes are discussed below.

Your Finance—an example of small-scale entry

- 5.5. The evidence from the CCA on the history of entry suggests that entry on a small scale is possible and has occurred. We heard from one such new entrant, Your Finance, at our Open Meeting. Your Finance started in 2003 in the Nottingham area. The company used focus groups to develop its customer offering. This comprised a programme of loans, retail products such as life insurance and hampers with loans that offered a higher weekly repayment rate than the competition focusing on lower overall cost (as measured by TCC). In its first six months in Nottingham, Your Finance signed up 500 customers, of which 300 had previously had an account with another home credit lender. By the time of the Open Meeting in March 2005, Your Finance had 1,500 customers in Nottingham, representing, on our calculations, a local share of supply of 3 to 4 per cent.
- 5.6. Your Finance did not, however, succeed and, in 2006, ceased trading. At the time it ceased business, Your Finance had 671 customers of which 462 were in Nottingham. Of the customers in Nottingham, Mutual (who had been asked to collect the debts) considered that only 219 were paying in an acceptable fashion.

¹In the same period there were 235 resignations from the CCA.

Park—the large-scale entrant

- 5.7. The one example of large-scale entry over the past decade has been Park. Park entered home credit in 1998 and, at the time of our Open Meeting in May 2005, had 763 agents based in 42 branches, mainly in Scotland and the North of England. Park told us that it intended to expand its home credit business to other parts of the country [§]. In our provisional findings we estimated that Park's share of the UK market was around 3 per cent. Given its limited operating area, Park's local share of supply would have been higher than this in some locations.
- 5.8. Park's original business had been the supply of Christmas hampers, for which its customers saved throughout the year by means of weekly home-collected payments. Hampers were supplied to a similar demographic group to home credit, and hence Park was likely to have some brand recognition among this group. However, synergies were limited in practice, as the customers of the hamper business were savers rather than borrowers and, in operational terms, Park had kept the two businesses separate.
- 5.9. Park's pre-entry analysis indicated that barriers to entry in home credit were low. Only general office space was required, five established software houses were able to provide a home credit system and Park recruited a former senior Provident manager to advise on setting up the business. Park successfully trialled its home credit business in a tightly defined geographic area.
- 5.10. Park's expansion appears to have been more problematic. The company had sought to expand rapidly and this led to difficulties in recruiting experienced agents and controlling fraud and bad debt. Park told us that its bad debt rate peaked at [§] per cent. Park had to fund losses for five years. With the benefit of hindsight, the Managing Director of Park—who joined the company after this period—would have pursued a more controlled entry strategy, building up a business region by region. This would have enabled Park to develop local economies of density in one area before entering another, enabling more direct management focus on the control of bad debt.
- 5.11. In July 2006, Park ceased trading as a home credit provider and its loan book was acquired by Cattles. Cattles purchased £53.1 million worth of debt and about 80,000 customer accounts from Park Group for a consideration of £8 million. Cattles had initially been approached regarding the proposed sale of Park as a going concern. Cattles indicated that it would only be interested in a purchase of book debt, not as a going concern.

CLC—expansion by a medium-sized company

- 5.12. In response to our Emerging Thinking, CLC Finance wrote to us describing its recent history of expansion. CLC was incorporated in 1953 and until 1997 operated as a traditional credit drapery business, with its main operation being the retail of household goods on credit, although cash loans and vouchers were offered as an alternative. As at 31 December 1997, CLC had 35 full-time agents and book debt of £1.8 million.
- 5.13. Following a reorganization of the board and the strategic decision to no longer offer goods, CLC sought in 2001 to expand from its traditional geographical area of Leeds and West Yorkshire. CLC expanded eastwards into Doncaster, Scunthorpe, Grimsby and Hull and also identified an area in Pontefract and Castleford which would 'fill in its geographical circle'. CLC used canvassing of vouchers as its sole means of entry

into new areas. By 31 December 2005, CLC had 92 agent rounds and book debts of £12.8 million.

Cattles—expansion by a large company

- 5.14. In 1998 Cattles launched a five-year expansion plan of its home credit business. It sought to do so both by acquiring the book debts of small operators and by opening new branches. At the end of 1998, Cattles had 157 branches. Three years later at the end of 2001 it had 267 branches and had increased its turnover by 67 per cent.
- 5.15. However, this strategy appears to have been unsuccessful. Although customer numbers and turnover increased, expansion was accompanied by increased bad debt rates, higher overheads and a rise in customer turnover. These effects outweighed the increase in turnover and Cattles' profitability fell. The strategy was reversed in 2002.

Barriers to entry and expansion

- 5.16. We identified a number of factors that might be expected to deter entry or expansion. These include potential entrants' perception of the attractiveness of home credit; access to capital; regulatory issues; incumbency advantages related to the difficulty in building up a customer base; and barriers to exit.

Overall attractiveness of sector

- 5.17. We considered, first, whether the home credit sector was likely to be attractive to potential entrants.
- 5.18. The sector is widely considered to be 'ex growth'. Over recent years, the value of new home credit loans issued has been static or slightly declining (see paragraph 2.94). The number of customers and number of loans issued have fallen over this period, though the average loan size has increased. A new entrant would need to attract business from existing players, rather than acquiring a share of an expanding market. Against this, some existing home credit companies appear to have been able to make high returns on capital employed.² In the absence of barriers to entry, we might expect this to act as a signal to potential entrants from other sectors.
- 5.19. We asked providers of mainstream financial services whether they would be interested in setting up a home credit operation. None said that this was an attractive option. The main reasons included the need to develop a different business infrastructure and new skills to manage a home collection operation and to manage higher-risk borrowers. Some also expressed concerns about the impact on their corporate reputation of lending at the rates of interest which they believed they would need to charge to operate profitably (see paragraph 4.74). We recognize the force of these arguments and consider entry into home credit from this source highly unlikely.

²See paragraphs 3.138 to 3.144.

Access to capital

5.20. We heard some anecdotal evidence that some banks were reluctant to lend to small home credit businesses.³ However, other lenders told us that this had not proved a major barrier to entry or expansion. For example, CLC told us that, although it had difficulty with one bank (because it was not in one of its 'preferred sectors of lending') it had been able to obtain adequate funding for its expansion proposals from another bank. The large number of small and medium-sized home credit lenders also suggests that access to capital is not prohibitive. We therefore concluded that access to capital is not a significant barrier to entry.

Regulatory issues

5.21. The regulatory framework for home credit is described in Section 2. The objective of these regulations is generally to protect consumers. We considered carefully whether any aspects of regulation could have the unintended consequence of making it more difficult for legitimate operators to enter the market.

5.22. Consumer credit regulation (in particular, the requirements for various forms of documentation when entering into an agreement) imposes a burden on all home credit lenders, but one which falls disproportionately on smaller firms. In particular, most of the costs of compliance with, for example, requirements to provide pre-contract documentation (see paragraph 2.45) do not vary with the number of loans issued, so can readily be spread over a larger volume of business by larger lenders. The existence of an active trade association can mitigate these effects by providing model documentation and advice on compliance. The CCA is active in this area; it and some small lenders told us that the model documentation it provides significantly reduces the burden of regulation for smaller lenders, and hence reduces the barrier to entry. We concluded that the regulatory requirements relating to documentations were not a substantial barrier to entry.

5.23. Under the Consumer Credit Act 1974, home credit lenders are required to obtain written permission to call before offering customers a cash loan (see paragraph 2.41). The objective of this restriction is to prevent customers being pressurized into taking out cash loans that they do not require. This objective, and the existence of the restriction, were endorsed by independent commentators who have studied the industry, such as Professor Elaine Kempson and Sharon Collard.

5.24. However, it has been put to us that this requirement might prevent home credit lenders from reaching potential customers new to home credit or from seeking to attract customers from other lenders. This might represent a significant barrier to prospective new entrants. Some lenders agreed with the principle of obtaining permission to call, but suggested that the need to obtain this permission in writing was outdated and constituted an unnecessary impediment to competition. Other lenders were unconcerned about this requirement. Many of these lenders and some agents told us that indiscriminate canvassing is one of the least reliable ways of attracting good new customers.⁴ However, this may be partly because of the lack of information sharing (see paragraph 5.28).

³For example, at the Open Meeting, Lance Sessions of Your Finance said 'the banks ... do not want to serve our customers but they also do not want to support us to serve these people'.

⁴See, for example, p51 of the AIA report, which records some agents' views on the merits of canvassing as a means of attracting new home credit customers.

5.25. We have been told that home credit lenders have been able, legitimately, to circumvent the prohibition, for example by canvassing directly to potential customers with offers of vouchers or goods.⁵ We consider that the prohibition represents a barrier to entry, but in the light of the evidence we have heard, we do not consider that it is likely to have a major effect. We consider its impact on competition among existing home credit lenders in paragraphs 6.100 to 6.102.

Advantages enjoyed by established lenders

5.26. A new home credit supplier needs to build up a base of creditworthy customers. Established home credit lenders enjoy the following advantages over new entrants or firms seeking to expand:

- information asymmetries; and
- economies of local density; and
- existence of an agent network.

Information asymmetries

5.27. New entrants and rapidly expanding home credit companies tend to have higher than average levels of customer turnover and write-offs. For example, Park experienced very high debt rates in its early years and Cattles experienced higher rates of customer write-offs during its expansionary phase, compared with subsequent years. Provident appears to have had a similar experience following its attempt to grow its business in Ireland in 2003, which resulted in an increase in customer numbers and in revenues, but also in bad debt, and subsequently in direct costs as Provident reduced spans of management control in order better to control bad debt.

5.28. One reason for this is that new entrants and rapidly expanding lenders face greater risks of adverse selection. A well-documented feature of credit markets is that entrants tend to attract a higher proportion of customers who have already been turned down by other lenders or who are already borrowing from other lenders.^{6,7} Both of these groups represent a higher than average credit risk. This effect is likely to be particularly pronounced in mature markets, such as home credit—in which potential customers are more likely to have had some contact with existing lenders⁸—compared with fast-growing markets. Lenders told us that the default rate on first loans to a customer (where the lender may be assumed to know less about the customer) was substantially higher than that on subsequent loans.

5.29. Established lenders have better information about their current customers' credit-worthiness and ability to repay future loans than would a new entrant (or even an existing supplier seeking to lend to the same customers for the first time—we

⁵This was, for example, the entry strategy used by CLC into new geographic areas. Vouchers account for less than 10 per cent of home credit sales, though some sales of voucher products will be to existing customers.

⁶For example, a survey carried out in 2002 by Prospektus for Provident Financial found a higher incidence of county court judgements and sanctions among potential new home credit customers than for current customers. However, the same survey found a lower incidence of late and missed payments among potential new customers than for current customers. Source: Provident.

⁷This effect has been explored theoretically and empirically in the economic literature on banking. See, for example, Sherrill Schaffer, *The Winner's Curse in Banking*, *Journal of Financial Intermediation* 7, pp359–392 (1998). The effect is also called the 'winner's curse' because a company's 'success' in attracting a customer may turn out to be a mixed blessing. Appendix 2.1 on Credit Scoring contains further relevant academic references.

⁸The NOP survey found that 89 per cent of current customers had used home credit before; 79 per cent had used the same lender before.

consider this case in more detail in paragraphs 6.103 to 6.114). In particular, established lenders are able to base lending decisions to existing customers on their past repayment performance with them. We were told that a customer's past repayment performance was a very powerful predictor of his or her future behaviour.

- 5.30. Unlike in other consumer credit markets, few home credit lenders share repayment information with each other, either directly or via CRAs.⁹ This increases the extent to which new entrants face the risk of adverse selection and the magnitude of the advantages enjoyed by established lenders. We were told by the Managing Director of Park that the costs of entry would have been much lower if home credit lenders shared repayment information.
- 5.31. We were told that lenders were able, in some cases, to inspect customers' payment books from other lenders. Some lenders, including Park, told us that they did this. Most, though not all, customers surveyed by NOP had payment books to hand. However, we were also told that customers were unlikely to volunteer to prospective lenders information about loans which they had not paid back. Even where a customer was able to show a payment book in which she had successfully paid back a loan, this might only be one of several loans and her performance on the other loans could be considerably worse.¹⁰ We observed in our Emerging Thinking that a borrower in need of credit may have a powerful incentive to conceal imperfections in her repayment record. While we recognize that payment books can be a useful indicator for lenders, we do not think that they can be relied upon to provide a wholly accurate picture of customers' creditworthiness.
- 5.32. Lenders may be able to form a judgement of a prospective new customer's ability to pay from a visit by an agent or manager. However, the impressions gained from such a visit are likely to be of limited predictive value compared with robust data about a customer's repayment history. Appendix 2.1 discusses the value of customer data in assessing creditworthiness.
- 5.33. There are two main consequences of this information asymmetry for new entrants and firms wishing to expand. First, initial bad debt rates can be high (as Park's experience shows). Second, to manage these bad debt risks, home credit lenders typically offer smaller initial loans to new customers. Both of these consequences mean that new entrants will initially incur losses (and that geographic expansion or attempts at rapid expansion in the same geographic area will lead to a fall in profits), until the entrant has developed a critical mass of good customers. In addition, the ability to offer larger loans to their better customers is a strong advantage to incumbents that new entrants are unable to match.
- 5.34. Established lenders have other informational advantages over new entrants:
- Where an agent has developed a good relationship with a customer, the lender may know more about the customers' circumstances and credit needs. This could help inform judgement of credit risks and enable the lender to make credit available in a timely manner.

⁹The nature and pattern of data sharing by home credit lenders is described in Appendix 2.1.

¹⁰One home credit lender put it this way:

If I was dealing with Provident and London & Scottish and I had some financial problems, I would always make sure that I paid one of those companies well and the other one possibly not at all. It could be that that customer has one payment book from Provident that is very good, could have a very poor record with another company, or possibly has got six loans with Provident, five of which are terrible and the one that they show you is the good one. So there is a risk to that. You don't know for certain but it gives you an indication.

Provident told us that all its loans to one customer were generally recorded in the same payment book, but this is not true of all lenders. The illustration remains, in our view, valid, if not necessarily in relation to the companies cited.

- Established lenders have a point-of-sale advantage arising from the presence of the agent in the customer's home.
- A relationship of trust may develop between customer and agent. This makes it more likely that the customer will seek credit from an established lender. It also means that established lenders are more likely to benefit from word of mouth recommendations. We were told that such recommendations were a particularly effective way of attracting good customers.¹¹

5.35. These informational advantages are also enjoyed by established lenders over other established lenders who do not already have a relationship with a particular customer or household. The implications of such incumbency advantages for competition between home credit lenders are discussed in paragraphs 6.95 to 6.143.

Economies of local density

5.36. We were told by home credit lenders that home credit demonstrates local economies of density. Substantial advantages are enjoyed by those incumbent lenders who have a critical mass of customers within a particular locality. Agents are able to operate in a tightly defined area, which enables them to spend less time travelling between customers and helps agents develop a local reputation. This may improve agents' efficiency, and also improve agent retention by making it easier for agents to earn a target level of remuneration without incurring substantial travel costs. Lenders further benefit from density by spreading local overheads over a greater number of customer accounts, through more effective management control and through a reduction in time spent travelling by branch managers. Increased local density can also reduce bad debt: as local knowledge helps agents make better lending decisions; local reputation increases the likelihood of word-of-mouth recommendations; and collections performance is improved where agents are more able to be flexible in when they call and to call back more often.

5.37. Local economies of density may be enjoyed by small as well as by large lenders. We were told that some local lenders operated within very small areas—perhaps as small as a single estate—in which they enjoyed a strong presence and a good reputation. We were told that such lenders often had little interest in expanding outside their area.

5.38. A new entrant, or a firm expanding into a new area, will take time to establish sufficient local density for their operations in that area to be profitable. This increases the scale of initial losses and reduces the likelihood of large-scale, rapid entry.¹² Establishing local density is likely to be harder for firms that may be considering entry against incumbent lenders when customer numbers are static or declining than it was for companies that established themselves while the sector was expanding.

5.39. Provident told us that the failure of medium-sized companies to develop local density reflected their own management decisions (or failings) and did not indicate the existence of a barrier to entry or expansion. We do not necessarily consider these

¹¹AIA report, p50. A similar finding was made by Mori in its qualitative research with agents for the NCC.

¹²Park, which attempted to enter on a large scale in a number of locations, described its difficulties as follows:
[You] end up with very small amounts of debt in quite geographically widespread locations. To give you some examples, the Warrington office actually administered debt down in Walsall in the West Midlands, out in Bangor in north Wales, so obviously the distance between those places is actually immense, and the whole system is totally inefficient because one of the local managers was having to drive, say, from Bangor in north Wales into Warrington twice a week to administer the agencies, and basically we were paying managers just to be couriers.

barriers to be insuperable, but recognize the fact that it would take time and effort even for a committed management team to build local density. This reduces the constraint posed to incumbent suppliers by the threat of entry and expansion.

Existence of an agent network

- 5.40. Small-scale entrants can establish themselves as sole traders, personally initiating and collecting their own loans. However, lenders who wish to expand or to enter on a larger scale will need to develop their own network of agents. Further expansion will also require the development of an intermediate tier of management.
- 5.41. A new entrant or a firm expanding into a new area can either seek to recruit agents who have worked for another home credit lender or to recruit agents who are new to the home credit business. We have been told by lenders that successful agents can be recruited through both routes.¹³ Lenders need to recruit agents who get on well with customers, whose judgement they can trust and who are comfortable with the requirements of the job. We have not seen evidence to suggest that potential agents are in limited supply.
- 5.42. However, new entrants may face some difficulties in recruiting agents. Agents recruited from outside home credit may turn out not to be well suited to the demands of the job. Lenders told us that it was hard to know whether a potential agent was well suited to this rather unusual and quite demanding job until they had tried it.
- 5.43. Recruiting agents from other home credit lenders may also be difficult. All large home credit companies have restrictive covenants in their contracts with agents preventing agents from approaching customers of their former employer if they move from one lender to another. While the definition of a customer varies somewhat from firm to firm, the period of the restriction is, in most cases, six months (for Mutual, whose agents are employed, it is [X] months). Companies' approach to enforcement of these covenants also varies; some send a standard letter whenever an agent leaves; others have corresponded with the new employers of their former agents. Very few cases have reached the courts, and while we heard anecdotal evidence of cases of the covenants not being strictly adhered to, we have no reason to believe that the terms of the covenants are widely flouted.
- 5.44. The existence of these covenants, while within the bounds of reasonable efforts on the part of lenders to ensure that agents and customers they have developed do not leave them, may act as a disincentive on agents to move between home credit companies.
- 5.45. However, agents have strong incentives independent of the covenant to stay with the existing lender. An established round may be expected to provide a more reliable and consistent income stream than one which an agent has to build. Loan size is likely to be larger for an established round, yielding more commission per call, as a result of step-up loans. One lender told us that an agency which experienced no changes of agent during a year earned substantially more revenue and made a substantially greater contribution than one which experienced two or more changes of agent. We would expect the greater revenue earned to be reflected in higher commission for the agent.

¹³Mutual told us that it recruited from outside the industry. CLC told us that it recruited both from inside and preferably from outside the industry. Both suppliers told us that other transferable skills, such as good judgement and the ability to get on with people, were as important as experience in home credit. In some cases, lenders regard experience with other lenders as a disadvantage if agents' experience is of a different business model (eg full-time as opposed to part-time agents).

- 5.46. The agent's better knowledge of a customer should reduce the level of missed payment and bad debt, to the extent that these are under the agent's control. By contrast, an agent moving to a new lender would at best be given an existing round of unknown quality; the agent would have to spend time and effort developing sufficient knowledge of the customers to be able to collect and to lend effectively. At worst, the agent would need to find new customers to build up some or all of a round. Either way, the agent's likely earnings would be lower with the new company than with the old, possibly for some time. Some, but not all, home credit companies provide an element of guaranteed income to compensate some new agents, at least in part, for this (see paragraph 2.7), but since it is not offered to all new agents even by those who do offer it, we do not consider this to offset the disincentive.
- 5.47. To an extent, these issues are also faced by incumbent lenders. There is considerable 'churn' of agents in their first year, even with some established lenders. However, existing lenders have the advantage of being able to offer a new agent an existing round or part of a round.
- 5.48. We consider that all of the incumbency advantages we identified in paragraph 5.26 and discussed in paragraphs 5.27 to 5.47 place a prospective entrant at a disadvantage by comparison with an incumbent lender, and represent significant barriers to entry or to large-scale expansion.

Advantages enjoyed by Provident because of its scale

- 5.49. We also considered whether Provident's size and share of the market may enable it to behave in a manner which, whether intended or not, creates barriers to entry and expansion. We saw no evidence of Provident using its size or financial strength to respond aggressively to new entry. Provident told us that it might respond to a particularly effective local competitor by increasing its marketing effort, but not by reducing its prices locally. This was due to its national pricing policy and practical difficulties in selectively changing pricing with a large self-employed agent base and national coverage. However, Provident does enjoy some benefits from its scale, which give it a sustainable advantage over new entrants and its competitors.
- 5.50. Most importantly, Provident has a relationship with over half of current home credit customers and, through its data on past customers who might return to home credit, a further group of potential customers. Provident thus has a powerful information advantage over its competitors and any potential entrant through its knowledge of their characteristics, payment records and creditworthiness. This advantage may be increased by the existence of Provident's own proprietary IT-enabled behavioural credit-scoring system which uses data on customers and their repayment records to assess creditworthiness.
- 5.51. Provident told us that other lenders could readily replicate such a system at reasonable cost, though we found that none had done so to date. Since the robustness and hence value of such a system depends on the number of customer records within it, we might expect the value of Provident's system to exceed the value of a system of any other lender. Provident told us that the business case for its system estimated a value to it of the system in 2001 of £[redacted] million a year, consisting of a £[redacted] million benefit from a [redacted] per cent reduction in bad debt and £[redacted] million increase in margin due to additional sales. Experience to date suggests that this was a considerable underestimate; a more recent assessment suggested a value to Provident of £[redacted] million a year. Provident also told us that it would not have been able to develop its strategy of offering longer, larger loans in the absence of the SEL system. Provident also told us that much of the cost involved in implementing this

system was driven by the need to integrate it with systems covering a large national agent force and that smaller home credit competitors could achieve similar gains with far less investment and complexity.

- 5.52. Provident's scale may also be of some value in the market for agents. Provident told us that it sought to attract agents by advertising its commitment to the home credit business. Provident has around two-thirds of the agents currently operating in the market, and given agent churn, may be expected to know of many more former and potential agents and their quality. Provident benefits from economies of density across much of the UK, which may help attract new agents. However, we have not found any evidence that potential agents are in short supply.
- 5.53. We also considered carefully whether Provident's strategy of operating two brands (PPC and GPC) might restrict the opportunities for new entrants by reducing their scope to position themselves or their products in a way which is distinctively different to Provident.
- 5.54. We were told that brand was unimportant to customers; rather that the relationship with the agent was the key determinant of whether a customer remained loyal to one lender. This appeared to be supported by our customer research, and we found no evidence that home credit companies put significant effort or resource into brand building. So we did not consider that the mere possession of two brands had a significant impact.
- 5.55. Provident told us that where customers wanted to use more than one agent, it preferred the customer to use a PPC agent and a GPC agent rather than agents of competing lenders. We think that the existence of two brands (one with the best-selling one-year product, and one with the best-selling half-year product) may have limited the available competitive space perceived by any potential new entrants, but we have no basis for assessing how significant this effect might have been alongside the other barriers we have identified.

Barriers to exit

- 5.56. The existence of barriers to exit can also affect entry conditions. If it is difficult or costly for firms to exit a market, this can increase the risks associated with entry.
- 5.57. Traditionally, those seeking to exit have sold businesses to larger companies. Much of Cattles' expansion between 1999 and 2002 consisted of buying smaller lenders. We were told that in this period prices for book debt were quite high by historical standards, and also (by the CCA) that prices for book debt were on a longer-term declining trend. Some of the larger lenders told us that they were interested in buying selected businesses or book debts. LSB runs a standing advertisement in the CCA journal advertising its willingness to consider acquisitions (so, periodically, do other lenders). S&U told us that it had recently acquired debt from another lender in the South-West of England where that complemented its current geographical coverage. We were told that these were not the only examples of recent requisitions of book debt. However, we were told by the CCA and others that prices for businesses were currently low, with home credit receivables being sold at a greater discount to book value than in recent years. This suggests that there is little interest currently in entering the market or in expanding by acquisition.
- 5.58. In the course of our inquiry both Park (see paragraph 5.11) and Your Finance (see paragraph 5.6) have ceased trading. Park's book debts were acquired by Cattles. In Your Finance's case Mutual was engaged to collect the debts. In neither case did the

acquirer propose to continue to operate the business as ongoing companies. Rather their intentions appear to be to collect all the debts and market other services to the customer base. We were also told that in both cases the price paid for the business represented a very substantial discount of the book value of the debt. We regard this as evidence that, in the present climate, it may be difficult for those selling home credit debt books to recover their investment.

- 5.59. We were also told that running down a business was difficult. When customers recognize that no further credit will be forthcoming from a particular source, collection rates fall and the level of default increases as customers' incentives to pay are reduced. This is consistent with what we were told about customers' desire to maintain a line of credit with lenders. [X] told us that they had experienced this phenomenon and that it had complicated their efforts to rationalize their customer bases or exit from local markets. They had been obliged to manage the run-down of the books slowly and carefully or risk significant write-offs of bad debt. Smaller lenders also commented on the difficulty of extricating themselves from relationships with some customers without the risk of incurring significant defaults.
- 5.60. It is hard to assess the impact of barriers to exit as a barrier to entry. But we would expect that the difficulty of running down or selling a home credit business in a declining market, where it was foreseen, would be a factor which would discourage a potential entrant.

Impact of entry/expansion on competition

- 5.61. We considered the extent to which recent examples of entry or expansion have affected competition.
- 5.62. We noted that Park did not seek to enter the market with a low price proposition. Similarly, the expansions by Cattles and by CLC were not accompanied by a reduction in their prices—neither company was a particularly low-priced supplier to start with. Your Finance highlighted value for money as part of its overall offering (and offered a lower TCC, but a higher weekly repayment than competing products) and we have been told of one new entrant in Leicester (Universal Loans) which has aggressively advertised its lower prices as an entry strategy. Neither Park's nor Your Finance's propositions have proved sustainable.
- 5.63. Entry or expansion by an existing player does not appear to have resulted in any reduction in prices by other players, either locally or nationally. We could see no difference in price levels between locations in which entry had taken place, compared with those in which it had not. This is not especially surprising since, as noted above, new entrants did not appear to seek to attract new customers on the basis of a lower-price offering. In addition, the large lenders operate national pricing policies, which reduce the likelihood of a response on price to a local competitor.
- 5.64. We also explored the extent to which entry had generated a response on variables other than price. Lenders told us that they had increased marketing efforts in particular areas in response to local competition. For example, Provident increased its marketing expenditure, primarily on its Greenwood brand, at the time of Cattles' expansion and it has broadly maintained it at this level since. But we found no evidence that profitability of incumbents was harmed in those parts of the UK where entry took place.

Assessment

- 5.65. Home credit lenders told us that barriers to entry and expansion in home credit were low and that the main impediment to expansion had been the uncertainty generated by this inquiry.
- 5.66. We found that entry on a small scale is feasible, and has taken place in recent years. There has been one example of larger-scale entry since 1998. We acknowledge that entry is possible and that the uncertainty associated with this inquiry may have deterred some firms from seeking to expand as rapidly as they might otherwise have done.
- 5.67. We found that neither the regulatory framework, nor access to capital or to appropriately qualified staff, represented significant barriers to entry.
- 5.68. However, we found some substantial barriers to large-scale entry. First, home credit is a mature market. This lack of market growth reduces its attractiveness to potential entrants and implies that, to a large degree, a new entrant would need to take customers away from incumbent lenders or to lend to customers who are already borrowing from other home credit lenders.
- 5.69. Second, incumbents have a number of advantages over new entrants. They have better information about customers' ability to make repayments and likely borrowing requirements. This enables them to lend larger amounts at lower risks than a new entrant. As a consequence, a new entrant is likely to have to be prepared to incur higher levels of bad debt in the early months and years of operation, while an incumbent lender is able to lend profitably.
- 5.70. Incumbent lenders in a particular location also benefit from economies of density and have in place a network of agents and the supporting management infrastructure. A new entrant needs to take time to build such density, and in the meantime has to bear a high management overhead if it is to avoid the high bad debt levels which we have seen are associated with weak local management control.
- 5.71. Provident benefits to a greater extent from these incumbency advantages, particularly as they relate to customer information, but does not otherwise appear to be behaving in a manner that increases barriers to entry or expansion.
- 5.72. Third, while we have received mixed evidence on the issue, we consider that barriers to exit are also significant and might deter potential entrants.
- 5.73. To a large extent, these factors also militate against rapid expansion by existing players. A firm seeking to expand into new locations would face the same challenges associated with achieving density and adverse selection as a new entrant. Park's experience, even when established, shows that it is hard to achieve local density in a range of locations. The experience of Cattles' expansion in 1999 to 2002 shows that even firms that are well-established in a particular area face adverse selection issues if they seek to grow their business aggressively. The same appears to have been true of Provident, which found that a project to expand its GPC brand turned out to be less successful than projected.
- 5.74. While we consider it possible that uncertainty caused by our inquiry has deterred entry or expansion, given the ample evidence of other barriers we do not consider that the impact of such uncertainty is likely to have been material.

- 5.75. To the extent that entry has taken place, it does not appear to have affected the behaviour of incumbents or their profitability. There are a number of reasons for this. New entrants have not generally sought to undercut existing lenders on price. Entry, even by Park, has not been on such a scale as to pose a substantial competitive threat to incumbents' profitability and in the case of Park has proved to be temporary. Where lenders have sought to expand rapidly, this has led to deteriorating profits and has often been reversed. As a result, neither entry nor expansion has brought forth a price response and both incumbents and entrants appear to have found it easier and more profitable to coexist than to compete.
- 5.76. We conclude that there are barriers to large-scale entry and to expansion, and that new entry, expansion or the threat of either, do not constrain home credit lenders' prices or other behaviour to a significant degree.