

6. Competition in the home credit market

Introduction

- 6.1. In Sections 4 and 5, we considered the external constraints on the price of home credit imposed by competition from other forms of credit and the threat of new entry. This section considers the intensity of competition between home credit lenders and the degree to which this drives prices down towards the costs of supply.
- 6.2. The structure of this section is as follows:
- In paragraphs 6.3 to 6.7, we discuss the geographic nature of competition between home credit suppliers.
 - In paragraphs 6.8 to 6.88, we evaluate the intensity of price competition between home credit suppliers—in a competitive market, we would expect to see a process of vigorous price competition—and discuss possible explanations for what we found.
 - In paragraphs 6.89 to 6.165, we consider the extent to which home credit lenders compete to make more credit available to customers and the implications of and constraints on this form of rivalry.
 - In paragraphs 6.166 to 6.194, we discuss other dimensions of rivalry between home credit suppliers: competition to refinance loans and on the terms of early settlement; differentiation according to product characteristics; competition to offer the highest quality of service; and to attract and retain the best agents.
 - Finally, in paragraphs 6.198 and 6.200, we explore the extent to which home credit lenders have the incentive and/or ability to coordinate their activities.

Geographic scope of our analysis

- 6.3. Competition between home credit lenders has both a local and a national dimension. In this inquiry we have looked at the competitive strategies of the large suppliers at a national level, as well as the nature of local competition in some particular areas.
- 6.4. The defining feature of home credit loans is that they are generally offered in, and repayments are collected from, customers' homes. Some aspects of the home credit offering, such as the service offered by an individual agent and the decision to make credit available to an individual customer, are largely determined at a local level. To the extent that they depend on the agent, we might expect some aspects of competition between home credit lenders to take place at this local level. There are also regional differences in home credit customers' use of other credit products—for example, credit unions are more widespread in Northern Ireland. However, our analysis of competition in particular local areas suggested that competitive conditions are generally similar in different parts of the UK.
- 6.5. The majority of prices paid by customers are set nationally, and are the same everywhere in the UK. The largest lenders all operate pricing structures which do not vary by location. For Provident and Shopcheck this means that the same range of loan products is available at the same price virtually everywhere in the country. For LSB, S&U, Park and Mutual it means that product terms and prices are the same in

all the regions in which they operate. There is some variation in the prices charged by small and medium suppliers, who operate in distinct parts of the UK, though we have found no clear relationship between their prices and local market structure.

- 6.6. We concluded that price competition between home credit lenders takes place mainly on a national basis. Although aspects of non-price competition have a clear local dimension, the largest lenders have developed company lending criteria and service standards, through which they seek to achieve a degree of consistency across their operations.
- 6.7. We considered the implications of this pattern of local and national competition for the definition of the relevant geographic 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. It is not clear that defining the market as a national market or a series of local markets makes any material difference to our analysis of competition. As customers do not travel to purchase home credit loans, the geographic market is likely to be local, when considered purely from the demand side. However, we have analysed the market mainly at a national level, as prices and competitive conditions are generally similar in different parts of the UK. We consider the extent to which national market shares are useful in assessing competition in paragraphs 6.161 to 6.170.

Competition on price

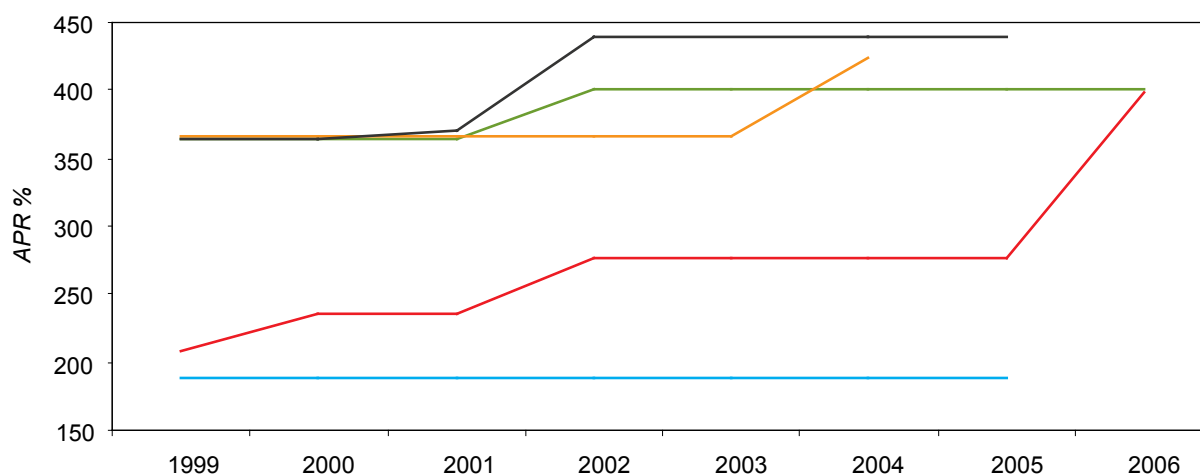
- 6.8. We looked at the evidence of competition on prices offered to, and in practice paid by, customers. Paragraphs 3.6 to 3.15 discussed the different measures of price for a home credit loan. In the analysis which follows we use both APR and TCC where practical. We focus mainly on the headline price for home credit loans. This is the most visible aspect of price and it is here that we would expect price competition to manifest itself most vigorously. Other determinants of the price of home credit paid by customers *ex post* are missed repayments and early settlement rebates (see paragraphs 3.21 and 3.22). Flexibility over repayment terms is one aspect of customer service, which we discuss in paragraphs 6.187 to 6.191. The level of early settlement rebates is discussed in paragraphs 6.171 to 6.179.
- 6.9. In assessing the intensity of price competition between home credit suppliers we have considered the following factors:
- (a) *The stability of prices over time.* In a market with vigorous price competition, we would expect to see price movements in both directions, as suppliers respond to changes in costs and competitive pressures.
 - (b) *The responsiveness of customer demand to changes in suppliers' prices.* In a market demonstrating vigorous price competition, we would expect unilateral price rises by one supplier to result in substantial sales losses to its competitors.
 - (c) *The extent to which price differences between suppliers persist over time.* In a market with vigorous price competition, we would not expect to see substantial differences in price persisting between suppliers serving the same customer base (unless they were explained by differences in other product attributes).
 - (d) *The variability of prices charged to different groups of customers.* In a market characterized by vigorous price competition, we would expect to see pricing structures that approximately reflect the cost of supplying different customer groups.

Price stability

- 6.10. Competitive markets are often characterized by prices responding to the actions of market participants and to external shocks. In particular, where prices have been competed down to a competitive level where market participants are earning their cost of capital, price might generally be expected to respond to external shocks, whether economy wide or industry specific. In markets characterized by price competition we might expect to see considerable variation in pricing levels over time, with prices being adjusted for short- or medium-term advantage.¹
- 6.11. We observed in our provisional findings that there have been few price changes over the last five years, and that, where there have been price changes, these have almost all been upwards.² Figures 6.1 to 6.3 show the evolution of prices offered by the six largest lenders since 1999 (2006 prices were not supplied in all cases).

FIGURE 6.1

Comparison of large suppliers' main short-term cash loans over time



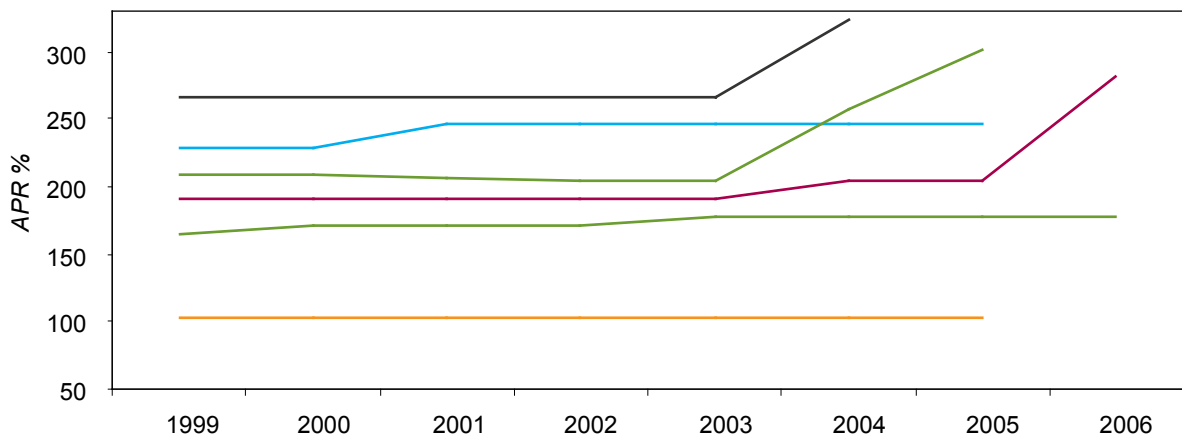
Source: Responses to CC's market questionnaires.

¹Paragraph 3.79 of the CC3 says that 'Prices in competitive conditions, though tending to the same level, are, over time, likely to exhibit significant variation as they respond to changing supply and demand conditions'.

²As noted in paragraph 4.104, the apparent increases in prices charged by S&U in 2005, which are shown in Figures 6.1 to 6.3, are actually price changes rather than price increases, representing the incorporation of what had previously been a charge for insurance into the price of the loan.

FIGURE 6.2

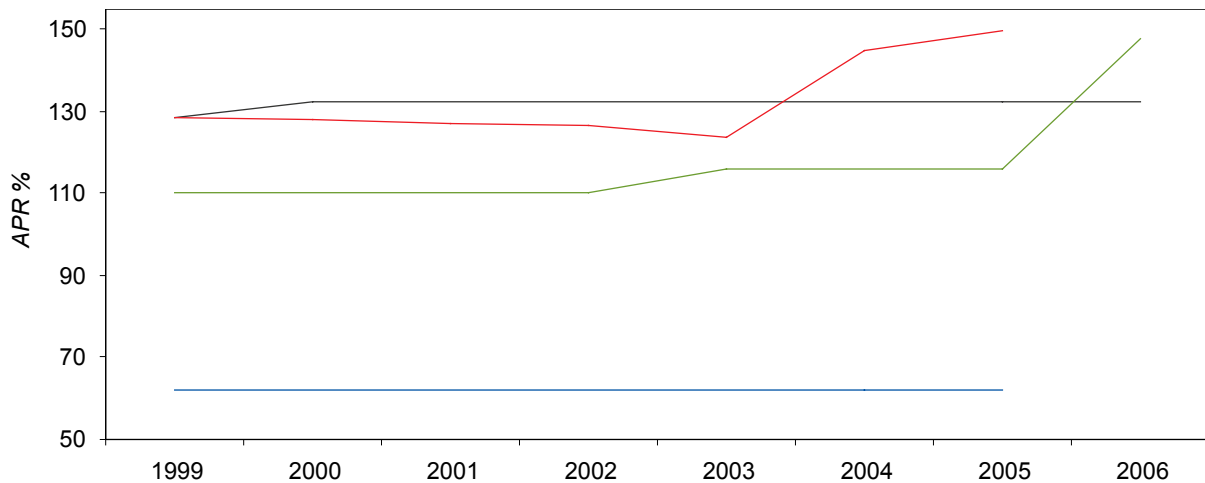
Comparison of large suppliers' main medium-term cash loans over time



Source: Responses to CC's market questionnaires.

FIGURE 6.3

Comparison of large suppliers' main long-term cash loans over time

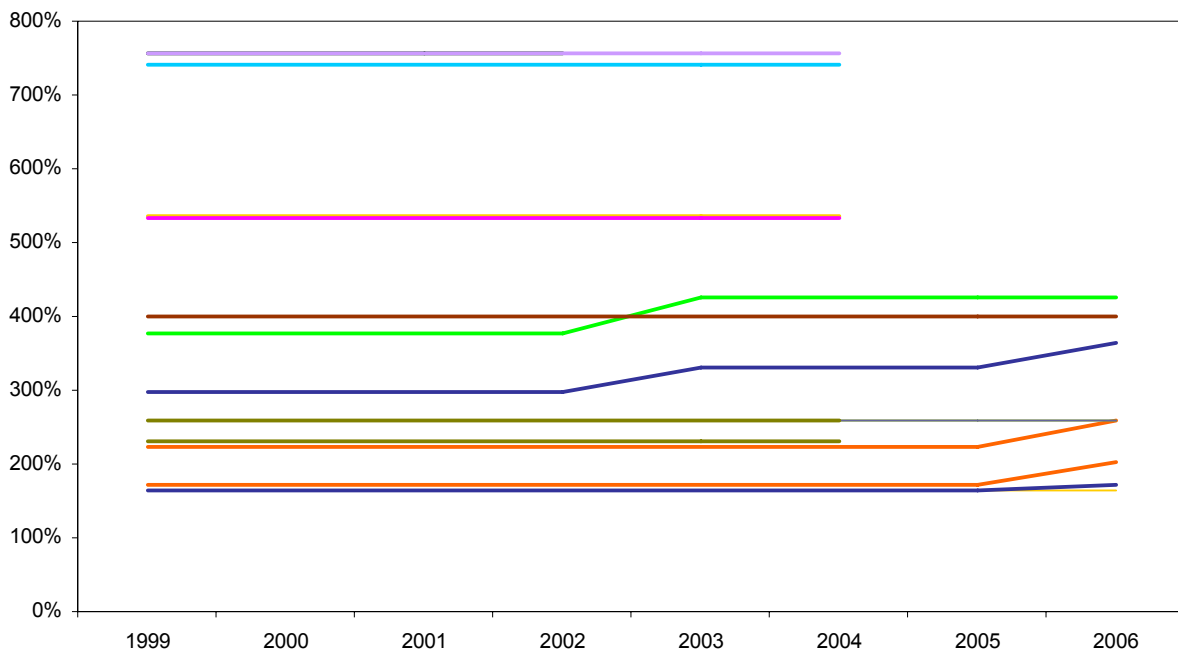


Source: Responses to CC's market questionnaires.

6.12. Figure 6.4 shows the evolution of prices offered by medium-sized lenders over the same period.

FIGURE 6.4

Comparison of cash loans over time: medium-sized businesses



Source: Responses to CC's market questionnaires.

- 6.13. The prices offered by medium-sized lenders have been largely constant in the period, though there is some evidence of price rises more recently. Five of the six largest lenders raised the prices of at least some products in the last few years. We observed only two downward changes in price (as measured by APR) since 1999. Both were partial reversals of recent APR increases and both were subsequently followed by price increases. One lender increased the price of its medium-term product at the same time as reducing the price of its longer-term product (a reduction effected by lengthening the term of the loan, reducing the APR but increasing the TCC). We were told that this was a deliberate decision designed to encourage borrowers to move to the longer-term product, which was considered to be a better-value product.
- 6.14. Our analysis of data provided confidentially to the CCA by its members showed that between 1994 and 2004 the proportion of long-term loans was increasing. It also showed that regional and national average APRs had not changed significantly over the period (if anything, increasing slightly between 2002 and 2004). 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.
- 6.15. We asked a sample of small lenders in four selected locations³ for details of the last occasion on which they changed their prices. While there was some evidence of recent price increases (attributable, according to the lenders, to the burden of new regulation) we found that many small lenders changed their prices infrequently if at all. Two told us that they had not changed their prices in over ten years. We found no evidence of price reductions.

³Ayr, Dumfries, Nottingham and Sunderland.

Responsiveness of demand to price changes

- 6.16. We noted little response from customers to the few changes in price we did observe (see paragraphs 4.94 to 4.105). For most lenders, the overall value of loans issued has been highly consistent over the period. In some instances where they have changed the prices of their products, there has been no noticeable change in demand. In others, there appears to have been some shift in demand from one product to another offered by the same lender (see paragraph 4.101). We saw very little evidence of customers switching between suppliers in response to price changes, as we might expect in a competitive market.
- 6.17. Provident told us that it was not correct to use the natural experiment of past price changes to test the sensitivity of demand to shifts in price, because the data on these events was likely to be influenced by other factors and was thus unreliable. Provident submitted that the better basis for calculation of the elasticity of demand for an individual supplier was by calculating a Lerner index, derived from the relationship in economic theory between the price-cost margin and elasticity of demand of a profit-maximizing firm acting unilaterally. This calculation suggested that demand for Provident's products was sensitive to price changes; with an elasticity of -2.4 so that a 10 per cent rise in Provident's prices could be expected to result in a 24 per cent fall in demand.
- 6.18. Of these two sources of evidence on demand sensitivity, we place more weight on the demand response to past price changes. It is the more direct approach and does not depend on the validity of the assumptions underlying the calculation of the Lerner index.⁴ We acknowledge that factors other than price will affect the demand for a particular supplier's products. However, if the demand for its products were as sensitive to price as suggested by Provident's Lerner index calculations, we still would expect to be able to observe a substantial reduction in its sales following its price rises.⁵ We were unable to detect any reduction in demand for Provident's two largest-selling products following their most recent price increases, either by simple observation of the data or by econometric analysis.
- 6.19. If demand were responsive to prices, we would expect firms pursuing an expansionary strategy to accompany this with lower prices, even if only for an initial period. This was not what we observed. Park entered the market with a relatively high-priced set of products; this did not appear to inhibit it from securing some market share. Cattles likewise sought to expand its market share in 2000 to 2002 but without cutting prices. Rather, Cattles attempted to expand despite offering some of the highest prices available in the market. More generally, we found no evidence that price changes by the largest lenders we observed had formed part of a strategy designed to attract customers. Nor did we observe that changes to prices formed any part of a reaction to external developments (for example, changes in interest rates) or to market developments such as the entry or expansion of a competitor.

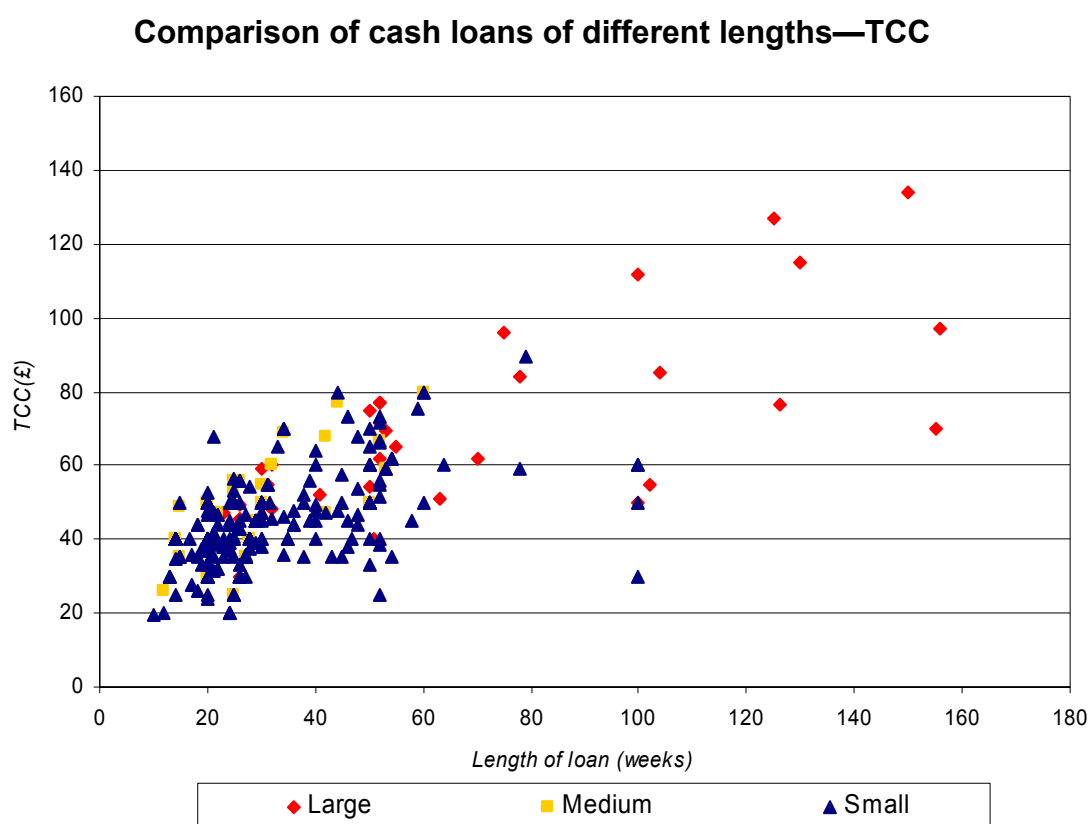
⁴The Lerner index is a method of calculating the market power of a firm, derived from a firm's profit-maximizing behaviour. A monopolist would set prices, such that: $(p - c) / p = -1/\epsilon$ where p = price; c = marginal cost; and ϵ = the price elasticity of demand. Using data on price-cost margins (assuming these can be accurately measured), this equation can be inverted to estimate the own-price elasticity of demand facing a monopolist as: $\epsilon = -p/(p - c)$. Provident pointed out, and we accept, that it was not necessary to assume that it was a monopolist in order to use this method to calculate an own-price elasticity. The equivalent formula for a non-monopolist is $\epsilon = -S_i * p / (p - c)$, where S_i is the firm's market share, assuming symmetric firms.

⁵The most recent increase in the period of Provident's one-year loan (from 54 to 55 weeks) increased the TCC from £62 to £65 on £100—an increase of just under 5 per cent.

Persistence of price differentials

6.20. In our analysis of 452 cash loan products we identified significant variations in prices between home credit suppliers even between loans offered over similar periods.⁶ Figures 6.5 and 6.6 show this by reference to the TCC and the APR of the loans. Loans of similar lengths are offered on very different terms. For example, loans repayable over 11 to 20 weeks (a quarter of all the products analysed) vary from an APR of 201.1 per cent (TCC £24 per £100 borrowed) to an APR of 1,564.3 per cent (TCC £50 per £100 borrowed). Most of these are loans offered by small lenders. Even the longest loans, which we found to be the exclusive preserve of the largest lenders, varied substantially in price. APRs for loans over 71 weeks (4 per cent of the total) varied in price from 32.7 per cent (TCC £30 per £100 borrowed) to 185 per cent (TCC £96 per £100 borrowed). Loans of between 20 and 60 weeks, which account for the majority of all home credit loans, had TCCs varying from around £20 to around £80.

FIGURE 6.5

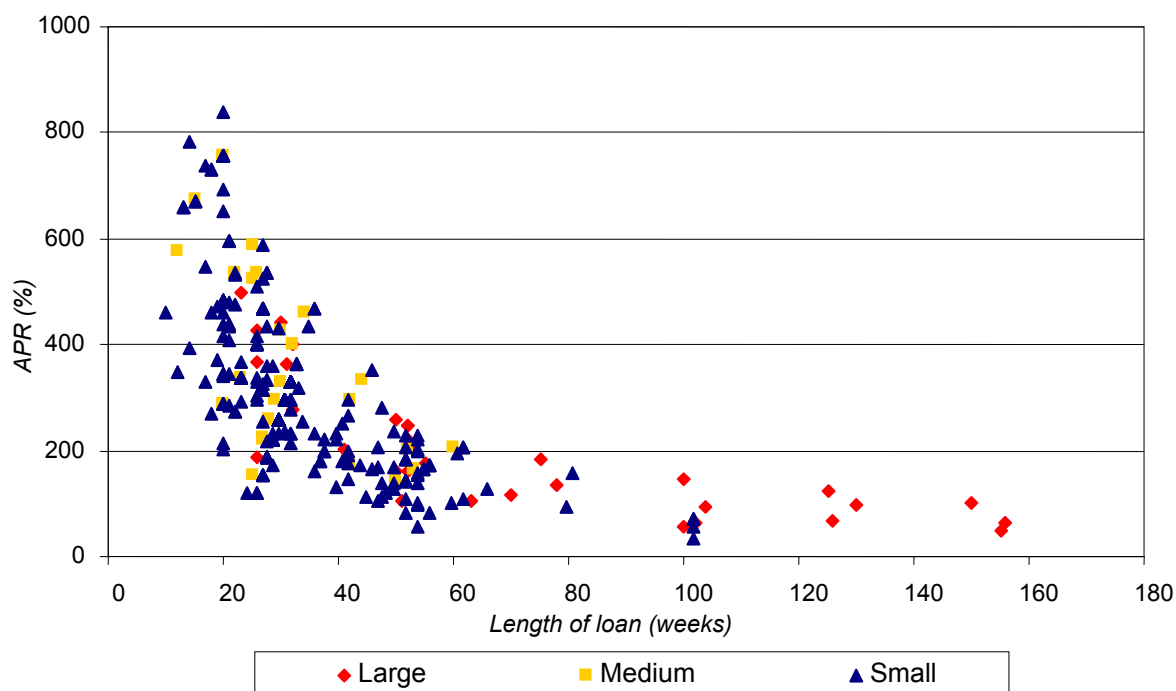


Source: Responses to CC's questionnaires.

⁶For which we consider price comparisons to be most valid and most feasible for customers.

FIGURE 6.6

Comparison of cash loans of different lengths—APR



Source: Responses to CC's questionnaires.

- 6.21. We observed from this analysis that small lenders tended to offer shorter loans, but that they also offered both the cheapest and the most expensive loans for periods up to about 60 weeks. We also observed that of the larger lenders, Mutual offered the lowest prices on all but the longest loans. Mutual's 26-week loan has a TCC of £30 on £100 advanced and an APR of 188 per cent; the other four large lenders who offer a loan of similar length all charge a TCC of over £45 on £100 advanced and an APR of over 250 per cent. Mutual's 51-week loan has a TCC of £40 on £100 advanced and an APR of 104 per cent; the other four large lenders who offer a loan of similar length all charge a TCC of over £50 on £100 advanced and an APR of over 200 per cent. Only among two-year loans is there a product in the market from a large lender which is cheaper than the Mutual offering (102 weeks, TCC £55, APR 62 per cent) and that has a very restricted availability (this is Cattles' 100-week re-finance product which has a TCC of £50 and an APR of 56 per cent only available to selected existing customers).
- 6.22. The CCA, of which Mutual is not a member, told us that Mutual did not provide a fair comparison of prices because it could cross-subsidize its home credit prices from other activities. While we note that Mutual would not be unique in this (many home credit lenders of all sizes have other lines of business), we found no evidence that Mutual, or any other lender, did so.
- 6.23. Not all of the products we analysed are available in all parts of the UK. Many small lenders have very limited geographic scope. Even one of the large lenders, Mutual, only operates in a relatively narrow area of the East Midlands and eastern England. When we looked at four locations in more detail, we found that the national picture was broadly replicated. In each location we found Provident and one or more other national lenders, and a few smaller lenders. We found that in these locations,

substantial price differentials had persisted, in some cases over long periods of time, without any apparent impact on market shares.

- 6.24. Given the infrequency with which suppliers change their prices for home credit loans (see paragraphs 6.10 to 6.15), it is clear that large price differentials have persisted for long periods of time, both at a local level and between the main national suppliers.

Variability of prices across customer groups

- 6.25. In our Emerging Thinking we also observed that there seemed to be little variation in prices offered by lenders, either by location or by customer characteristics.

Variation in pricing by location

- 6.26. All lenders with national or geographically widespread presence (including all the largest) offer the same products in every location, regardless of the presence of other competing offers. In some areas this means that their products are among the cheapest available under all measures; in others among the more expensive.
- 6.27. In our analysis of local areas,⁷ we found that the presence of few or many small lenders offering loans on different terms made no difference at all to the prices offered by the national lenders. They offered the same products at the same prices regardless of the number of lenders present in the area (which varied from two to thirteen). Large lenders told us that it was difficult to compete on price with small lenders which are, they told us, often very tightly managed, have low overheads and choose customers very carefully to minimize bad debt risk. However, the absence of any responsiveness of large lenders' prices to either the number of smaller lenders in a location or their prices suggests that smaller lenders do not impose much competitive pressure on larger lenders' prices.
- 6.28. Our analysis of localities did not enable us to reach a clear view of the extent to which smaller lenders locally compete with one another. But we heard some evidence that smaller lenders tended to concentrate on known areas or groups of customers, and little to suggest intense price competition between small lenders.

Variation in pricing by customer characteristics or payment record

- 6.29. We also found little variation in the prices offered to different sorts of customers. In other markets we note that suppliers generally compete for particularly attractive customers on price, for example through discounts or special offers to new customers. We found no evidence of introductory offers; new customers are offered smaller loans, at the same prices as are offered to established customers. In a highly competitive market, we might also expect discounts to be offered to established good customers whose business suppliers particularly wanted to retain, especially if they believed them to be under threat from other suppliers. Such behaviour might be thought to be particularly likely in a business where some home credit lenders continuously need to find new customers to replace those they have lost, and where retaining good customers is clearly desirable (see paragraphs 6.132 to 6.137).
- 6.30. Despite the difference in value to a lender between a customer who pays regularly and in full and one who does not, we found no difference in the terms offered to

⁷We selected the areas in part to have examples of areas where smaller lenders were both numerous and scarce.

them.⁸ Lenders told us that it was impossible to predict in advance whether a customer would pay well on a given loan. Customers' repayment performance varied over time and with changes to their personal circumstances (see paragraph 2.24). However, we observed that there was rarely any element of reward (in the form of a good payment discount, for example) for those who paid well or on time. Only if too many payments were missed would access to future credit be jeopardized.

- 6.31. We regard the absence of any kind of discount or reward for good or prompt payment (which could be granted at the end of the loan when the payment record is known) as curious. In practice, home credit lenders appear to charge the highest effective interest rates to their best customers (those who pay promptly in full, and those who repay early, whether or not they renew the loan, will generally be the lowest-cost customers to serve and may also provide the most revenue—see paragraphs 3.21 and 3.22).
- 6.32. In other credit markets many lenders vary prices according to the perceived credit risk of the customer (which is in essence a form of variation of prices based on cost to serve the customer). All but one of the providers of mainstream credit products we spoke to⁹ said that they incorporated at least an element of risk-based differentiation into their pricing structures (for example, we were told that customers gained access to lower-priced products once they had proved their creditworthiness¹⁰). We found no evidence that headline home credit prices are ever varied by customer in this way, and lenders told us that they were firmly opposed to risk-based pricing. The absence of risk-based pricing gives rise to an element of cross-subsidy in home credit, in that those customers who represent the least credit risk (and those who pay most consistently and on time) subsidize the rest.
- 6.33. We found some evidence that some lenders vary prices across different customers in some circumstances and heard anecdotal evidence that other small lenders might do likewise. This would not be surprising, given that we were told that smaller lenders often had the closest relationships with and the best knowledge of their customers. But we saw no evidence that this practice was widespread even among the smaller lenders. And we saw no evidence of it at all among medium and large lenders.
- 6.34. The only evidence we found that different terms are offered to established customers was the evidence that once they have established a credit record, lenders make larger sums available, generally over longer periods. This facility is not generally available to new customers or those who have not established a good payment record.
- 6.35. Some lenders told us that this was a form of price differentiation, because longer loans are cheaper (in the sense of having a lower APR) than shorter loans. It is unclear to us that longer, larger loans should be considered to be cheaper than shorter loans. They generally have a higher TCC than shorter loans and can be more profitable for suppliers. We consider this practice to be a manifestation of what we term 'competition on availability of credit' rather than of price competition (see paragraphs 6.89 to 6.92).

⁸Other than for the fact that a customer who misses payments pays a lower effective interest rate.

⁹The evidence from providers of mainstream credit products is on our website.

¹⁰Customers with a good credit record held by a CRA could be eligible for cheaper products from more than one lender.

Summary of evidence on intensity of price competition

6.36. Taken together, the above evidence leads us to conclude that price competition between home credit suppliers is weak. Prices are resistant to downwards movement. Demand is almost entirely unresponsive to changes in price. Substantial differentials persist between the prices of the cheapest and most expensive suppliers, both nationally and locally, without substantial shifts in business between them.¹¹ Nor is there any evidence of selective price competition either in response to local market conditions or to attract or retain particularly profitable customers.

Lenders' explanations for pricing behaviour

6.37. Lenders offered two explanations for the pattern of pricing behaviour we had observed.

6.38. First, we were told that there was little variation in prices over time because they were already, as a result of competition, at competitive levels which represented good value for money for customers, and that no further downward movement was possible without reducing margins below acceptable levels. Lenders argued further that relative stability of prices in a period when costs were rising could also be regarded as indicative of competitive pressure, in that competition had served to prevent them from passing cost increases on to their customers.

6.39. Second, we were told that consistent national pricing was desirable to provide certainty, clarity and consistency to customers. It would not be fair to offer different terms to neighbours. Moreover, there were marketing and other advantages for a national lender in offering the same terms everywhere.

6.40. We consider each of these explanations in turn and then also consider what lenders told us about the way in which they set their prices.

No scope for cutting prices

6.41. We considered the contention that prices were already at competitive levels in the context of our analysis of whether profits in excess of the cost of capital were being earned (paragraphs 3.61 to 3.144). We concluded there that the evidence did not support the notion that prices were already at competitive levels.

6.42. Home credit lenders also told us that many components of costs were increasing. These included increased fuel and other costs associated with home collection (though we have not seen any evidence that agent remuneration has increased to compensate for cost increases which are borne by agents; agent pay has not changed as a percentage of collections in ten years).

6.43. More significantly, lenders told us that bad debt levels had increased in recent months. Several factors were cited as causes:

- the effect of increased credit availability, which led to customers having more debts to service;
- changes to the laws governing personal bankruptcy, specifically the provisions in the Enterprise Act 2002 which, S&U told us, had increased the number of people

¹¹Nor any apparent difference in the product (cash) or service provided.

able and prepared to declare themselves bankrupt in order to escape their creditors; and

- changes in consumer attitudes to debt, notably a greater reluctance among some groups to meet their repayment obligations.

6.44. We note that increases in bad debt have been experienced by UK lenders of all kinds in recent months. Mainstream lenders told us that current increases in bad debt across all forms of consumer credit are a consequence of developments in the wider economy (for example, increase in fuel and Council Tax bills), which may reduce the money available in household budgets for debt repayments. These developments might be expected to affect people with limited disposable income first and most severely.¹² Lenders also told us that they were paying higher ESRs than previously as a result of the changes to the ESR regulations (see Appendix 3.4 for an explanation of the ESR regime).

6.45. The fact that home credit lenders have not passed on recent increases in costs to their customers in the form of price increases is not, in our view, strong evidence that prices are constrained by competition. We might have expected price increases to have followed cost increases experienced by all market participants even if prices were above competitive levels. If prices were at competitive levels and firms were efficient, then price increases would have been essential for firms to remain profitable.

6.46. We consider that there are other constraints on home credit lenders which may discourage them from raising prices at the present time. The large lenders in this industry are acutely aware of the public perception of them and of the regulatory scrutiny that they face. To raise prices either ahead of or during the current inquiry would have been seen by these suppliers as increasing regulatory and reputational risks. We note further that, even with static prices and subject to the rises in costs that we have seen, prices appear to be sufficiently high to enable firms making up a substantial part of the market to make returns in excess of the cost of capital.

6.47. We accept that stable prices are not necessarily indicative of a lack of competition. However, we consider that in this case the pattern we have found of static or rising prices is unlikely to be indicative of significant price competition.

Fairness and efficiency requires a single pricing policy

6.48. Lenders told us that, as in other industries, there were good arguments for offering consistent national prices, notably the ability to spread the cost of advertising and marketing materials. In addition, they told us that customers valued the transparency, consistency and fairness of home credit pricing, and that varying prices by geography or by customer characteristics would weaken these benefits.

6.49. We accept that clear and consistent pricing provides some benefit for customers. We also recognize that national pricing may be the most sensible strategy where flexing prices locally is complex or otherwise difficult to implement. Assuming that prices set by local lenders vary, a national lender setting national prices would, in essence, be trading off some local areas where national pricing makes it less competitive against others where it would be more competitive, and could be expected to set prices with

¹²One mainstream lender showed us industry-level data which demonstrated that credit card arrears had risen substantially between January 2004 and December 2005. Mortgage arrears and court orders related to mortgage repayment also increased over this period.

that balance in mind. The lender might seek to compensate through additional marketing effort or agent incentives in some areas. We recognize, therefore, that a single national price is not in itself evidence of absence of competition.

- 6.50. However, we are not persuaded by the arguments that the almost complete lack of variation in pricing between customers with different characteristics that we observed is a necessary part of this market. Lenders do distinguish between customers, for justifiable reasons, in the amount they lend (see paragraph 2.18). We see no reason why they could not similarly distinguish by pricing in a way which need not alter a consistent headline price but could be readily understood by customers, for example by offering discounts for a good payment record. We noted in our Emerging Thinking that some element of cross-subsidy is inevitable in all markets which involve risk of this kind. In home credit, the absence of differential pricing entrenches that cross-subsidy.
- 6.51. One lender told us that it would be unreasonable and inconsistent to expect all the patterns of discounting identified in paragraphs 6.25 to 6.35. We do not consider that extensive discounting, special offers or other aspects of price differentiation need to be present in the market for us to regard it as competitive. However, we consider that the lack of evidence that any forms of variability in pricing between customers exist, other than in isolated instances, in home credit is not consistent with a market in which price competition is an important element. We are also not convinced that a situation in which the customers with the best repayment records for loans of a given length pay the highest effective interest rates would be the case in a market characterized by strong price competition for potentially profitable customers.¹³

How lenders set prices

- 6.52. We also investigated the history and process of price setting in the home credit business.
- 6.53. We were told that historically an industry standard price had evolved (an example quoted to us, on more than one occasion, was of a £100 loan repaid over 20 weeks at £7 per week creating a TCC of £40 and an APR of 481.4 per cent). We found these terms still offered by some small lenders.
- 6.54. Most of the larger home credit lenders told us that they set prices with a view to achieving desired levels of return, but also sought to ensure that they did not fall seriously out of line with national competitors.
- 6.55. Provident's substantial share of the market, and the fact that it publishes its loan prices on its website, makes it inevitable that other lenders should look to its prices as a benchmark for the products it offers. Some lenders told us that Provident's prices were difficult to match because of the economies of scale it was able to secure. However, we found no pattern of all other lenders' prices being consistently above or below Provident's; in all the locations we studied there were loans on offer which were more expensive than Provident's, and others which were less expensive (in both TCC and APR terms).

¹³This pattern might be considered to indicate the existence of barriers to switching; in other markets introductory offers might be expected to seek to overcome these; we noted the absence of such offers in paragraph 6.28. As discussed in paragraph 6.35, it is not clear to us that offering larger and longer loans to established customers constitutes a form of selective lower pricing.

- 6.56. Provident told us that it sought to set prices below its principal national competitor (Cattles). On its one-year (55-week) loan, Provident's price is lower than Cattles' 52-week product on all measures. The half-year (31-week) loan offered by PPC is cheaper than Cattles' half-year (30-week) loan on all measures; the more popular GPC half-year (32-week) loan has a higher TCC (though a lower weekly payment and APR) than Cattles'. Cattles' two-year (100-week) loan is cheaper on all measures than Provident's 105-week loan (though its availability is limited—see paragraph 6.21).
- 6.57. Mutual told us that its somewhat lower prices (see paragraph 6.21) were not set with regard to competitive pressures, but were based on the owning family's view of what constituted a fair deal for customers and an adequate return.
- 6.58. Other lenders told us that they set prices primarily to achieve a desired level of return, while maintaining consistency with national competitors. We were also told that some prices in the industry are still based on traditional formulae (see paragraph 6.53).

Other explanations for observed pricing behaviour

- 6.59. Suppliers' explanations of their pricing behaviour did not fully explain the pattern of prices that we observed. The argument that prices are already at competitive levels is not supported by our assessment of profitability. The desire to operate a simple pricing structure does not fully explain the observed lack of price variation, which we would expect to come under pressure if price competition were more vigorous. In setting their prices, lenders displayed some awareness of each other's charges and a desire not to get too far out of line. However, lenders' accounts of their price-setting processes did not indicate a great deal of rivalry over price, or a desire to offer the lowest price in the market, such as we might expect if price competition were intense.
- 6.60. We therefore considered two further reasons for the lack of price competition that we encountered:
- customers' attitudes to the price of home credit loans; and
 - incentives on suppliers to compete on price.

Customer attitudes to price

- 6.61. As noted in paragraph 6.84, several lenders told us that customers valued other aspects of the home credit offer more than price.

Evidence from customer research

- 6.62. Evidence from market research studies also suggested that factors other than price were likely to be decisive both in customers' decisions to take home credit and in their choice of lender.
- 6.63. The qualitative research by AIA identified the following as being important factors in the appeal of home credit:
- the personal, approachable service provided by the agent;

- customer confidence that they would not be turned down for a loan and the speed with which funds would be made available;
 - a perception of some customers that they were excluded from other forms of credit; and
 - customers' perception that home credit loans were better tailored to their needs than other forms of credit: for example, in the simplicity of the application process, the approach to missed payments and the regular collections at agreed times.
- 6.64. In the quantitative research conducted for the CC, NOP asked customers to explain, in their own words, the main reason for choosing home credit as opposed to any other kind of borrowing. Many of the factors identified in the qualitative research were also mentioned in this larger sample.¹⁴ Convenience was a common theme underlying many of these responses (46 per cent). This includes both the ease with which a loan may be arranged, as well as the ease with which repayments could be made. 20 per cent of respondents highlighted the difficulty of obtaining credit from other sources as a reason for taking out a home credit loan. Habit and loyalty was the third most important category accounting for 12 per cent of responses. By contrast, only 2 per cent of respondents cited price as a reason for taking out home credit.
- 6.65. In market research conducted for Provident, the market research company Quaestor¹⁵ compared the factors that were considered important on the last borrowing occasion of customers who took out a home credit product with those who used another form of credit. The four factors which were relatively most important in the decision of those who took home credit were weekly payments, the frequency of payments, the existence of a payment book and face-to-face contact. The factors that were relatively less important for those who chose home credit were speed of approval, the time to repay, the cost of credit and monthly payments.
- 6.66. Price also appears to have played a relatively minor role in customers' choice between home credit lenders. NOP asked customers about the reason for choosing their most recent home credit lender. The top eight reasons quoted were:
- 'It's easier to borrow from my usual lender' (30 per cent).
 - 'I just like dealing with my agent' (12 per cent).
 - 'Family or friend recommended/suggested' (8 per cent).
 - 'I get good service from this agent' (6 per cent).
 - 'I know the lender I'm using is cheaper than the others' (4 per cent).
 - 'Only one I knew of' (4 per cent).
 - 'They came to my house/to my door and offered it' (4 per cent).
 - 'They suggested the loan' (4 per cent).

¹⁴See Chart 10 of the NOP quantitative research for full details of the specific reasons given.

¹⁵Project: Space, slide 25. Survey based on a sample of 556 current and paid-up customers.

- 6.67. Grouping these reasons together, NOP found that habit and loyalty were key drivers of choice of lender, with 41 per cent of respondents saying that they chose the supplier of their most recent loan through habit or loyalty. Over a quarter said that they chose because of the agent. Other reasons were recommendation (11 per cent), convenience (8 per cent), price or value for money (8 per cent), good service (4 per cent) and advertising (1 per cent). Thus fewer than one in ten customers cited price as a reason for choosing their most recent home credit lender.
- 6.68. NOP also asked whether customers had compared prices between providers. 11 per cent of customers said that they had found out how much it cost to borrow the same amount from another home credit provider. Those who normally had loans with more than one provider were more likely to compare costs (17 per cent) than those who normally used one provider (6 per cent). Even among those customers who are best placed to make a price comparison, less than one in five did so. Provident told us that customers' responses to this question might underestimate their awareness of competitors' prices; they might not have reported that they 'found out' prices from other suppliers if they already knew them. Nevertheless, we still regard the numbers who said that they found out prices as low.

Explanations for customers' lack of price sensitivity

- 6.69. We do not believe that customers' observed lack of price sensitivity necessarily means that they are irrational in the choices they make. If other features of a particular lender's home credit product—for example, immediate availability, weekly affordability or trust in the agent—are more important than price for many customers, it is rational not to choose a different product which, in the absence of these considerations, might appear to offer better value for money. Some customers, by contrast, may have reasons for not shopping around—for example, an unwillingness to incur search costs which might be small by contrast with the possible savings available—which might be regarded as less rational. However, in stating that customers appear insensitive to price, we neither make nor imply any judgement on the rationality (or otherwise) of customers' preferences; rather we record their observed behaviour.
- 6.70. One possible reason for customers' reluctance to compare prices may be that it is difficult to do so. Lenders told us that it would be wrong to assume that their customers are any less capable of comparing prices and assessing value for money than any other group of customers. Provident showed us research which demonstrated that when presented (in the course of a research study) with full information about different home credit and other credit products a group of home credit customers was no less able than a control group of non-customers to reach rational conclusions on value for money.
- 6.71. We do not consider that it is necessary to believe that home credit customers are less able than others to make value for money comparisons in order to believe that it is difficult to compare the value for money of home credit products. Research by the FSA and others has shown that consumers have great difficulty in assessing and comparing the value of financial products. Recent research has found that around 10 per cent of the population cannot properly interpret a percentage.¹⁶ Earlier research for the OFT found that a third of people could not think of or did not know of a method to compare credit deals; just under 20 per cent of all respondents (and

¹⁶*Levels of Financial Capability in the UK: Results of a baseline survey* carried out on behalf of the FSA by Elaine Kempson, Adele Atkinson, Stephen McKay and Sharon Collard, University of Bristol Personal Finance Research Centre.

nearly 40 per cent of those in socio-economic group E) did not know whether a higher or lower APR was cheaper.¹⁷

- 6.72. Moreover, there are specific issues related to home credit which make price comparisons difficult. We were told, and the AIA research confirmed, that when considering the price of a loan customers preferred to look at weekly repayments (in order to assess affordability) or TCC. Where loans are for different periods, comparisons based on these measures may not tell the whole story. The APR is designed to enable fair comparison between loans of different lengths and payment profiles. However, lenders have told us, and we agree, that the APR has significant limitations not only for comparing different credit products but also for comparing home credit loans of different lengths (see Appendix 3.1). APRs, especially for shorter-term home credit loans, can be very high. We do not consider that the APR is a useful comparator for customers, when it is at such high levels. With APRs above 100 per cent, customers may be able to tell that a particular APR is greater than another, but the APR conveys little further useful information.
- 6.73. Moreover, as indicated in Figures 6.5 and 6.6, even where lenders offer similar products, they do not generally offer loans of identical lengths. For example, while Provident, Cattles and S&U all offer loans of around 30 weeks and around 50 weeks, the precise periods of the loan and weekly repayments vary. These are illustrated in Table 6.1.

TABLE 6.1 Price comparisons using different measures of price

<i>Lender</i>	<i>TCC £</i>	<i>Term weeks</i>	<i>Weekly repayment £</i>	<i>APR %</i>
<i>One-year products</i>				
Cattles	76.80	52	3.40	246.5
PPC	65.00	55	3.00	177.0
S&U	66.67	50	3.33	213.0
<i>Half-year products</i>				
Cattles	59.00	30	5.30	440.3
GPC	60.00	32	5.00	399.7
PPC	55.00	31	5.00	365.1
S&U	60.00	32	5.00	399.7

Source: Provident, Cattles, S&U.

- 6.74. Table 6.1 illustrates that the choice of measure can affect the perception of the relative cost to the customer of different loans, even of similar duration. For example, the Cattles 30-week product has a lower TCC than the GPC 32-week product, but a higher APR and weekly repayment. We saw evidence from Provident which suggested that some customers were able to assess loans with different characteristics and make judgements on them, but also evidence that the attractiveness of a loan to customers varied depending on the measure of price cited. Other lenders (including CLC and Your Finance) told us that they designed products to appeal to customers particularly concerned about one measure of price, often the weekly repayment.
- 6.75. We consider the impact of differences in the exact periods of loans which are otherwise similar further in paragraphs 6.181 to 6.186. Without reaching any conclusion on the reasons for these differences at this stage, we consider that they inhibit ready comparison of prices.

¹⁷OFT Credit Survey, November 2004.

- 6.76. The absence of a single clear measure of price also has the effect of making it possible for suppliers to change prices in ways which disguise the impact on customers. Customers whose principal focus is on the weekly repayment may not realize, or may not place much weight on, the fact that an increase in the length of a loan increases the TCC and will generally increase the APR. Several of the price increases we have seen in recent years consisted of increases in the length of a loan without necessarily increasing the weekly payment. We saw pricing strategy documents from one lender which suggested that it was well aware that this method by which to increase prices was least likely to provoke a reaction from customers.
- 6.77. We heard evidence that it is not always easy for customers to find out prices of competing products. While some lenders publish their prices¹⁸ and others quote them willingly, in some cases prices are only communicated to customers by an agent visiting the customer's home. We observed that in other credit markets in which prices are published, comparisons between prices of similar products are readily available, for example in newspaper or in price comparison websites. We found no evidence of any similar mechanism having evolved in home credit. The NOP survey found that 55 per cent of customers agreed with the clearly incorrect proposition that all home credit loans cost the same.
- 6.78. We also noted that, compared with some other credit markets, relatively few suppliers advertise using their price as a selling point. Some lenders told us that the regulations on advertising credit products (see paragraph 2.44) played a role here. Because the APR is the measure theoretically capable of enabling comparison between loans of different durations, the regulations on advertising credit products require it to be prominently displayed in any advertisement which mentions the price of the product. We were told that this gave rise to home credit lenders making no mention of price in some of their advertising materials because they did not wish to give prominence to an APR figure which might be seen as high by customers and which they considered a misleading and unhelpful guide to the cost of the loan. The CCA told us that the effect of the regulations significantly inhibited competition.
- 6.79. We find it hard to judge whether, and if so to what extent, the advertising regulations themselves inhibit competition by limiting the use of price in advertising material. We saw some advertisements with pricing information in them, including some (from Mutual, Your Finance and Universal Loans) explicitly making price comparisons of different kinds. Thus it is clear that, where lenders want to highlight prices and price comparisons, they can and do. We are not convinced that, against a background of weak price competition, the advertising regulations themselves further inhibit competition of this kind (though, were price competition more intense, we consider that they might).

Conclusion on customers' price sensitivity

- 6.80. Lenders and researchers have told us that home credit customers are financially astute and that, in many cases, their financial circumstances make them very conscious of price and value for money. There was some support for this view in the TGI survey, which found, for example, that home credit customers were more likely than a control group to agree that 'When doing the household shopping I budget for every penny' and that 'I look for the lowest possible prices when I go shopping' (on the other hand, home credit customers were less likely to describe themselves as 'very good at managing money'). We would expect the savings which might be

¹⁸For example, Provident publishes the prices of its GPC and PPC products (on separate websites).

available from taking out a cheaper loan to be significant—in the context of a limited household budget—and attractive to them. While home credit customers would not necessarily value price above other product features and might not necessarily be prepared to invest significant effort in seeking out such savings, they might be expected to take advantage of them if they were available.

- 6.81. However, we have found that this is a market in which price comparison is particularly difficult. We consider that the difficulty of comparing prices derives from a combination of the inherent difficulty of assessing and comparing the prices of financial service products, the drawbacks of the APR as a means of comparison, the rarity of directly comparable products and difficulties customers face in finding out the price of home credit products. This last factor is affected, to a limited extent, by the regulations on advertisements.
- 6.82. We consider that the evidence of lack of response to price changes, and the research evidence on consumer attitudes, taken together indicate that home credit customers are relatively insensitive to the price of home credit. The reason for this seems to us to be a combination of customers' difficulty in comparing prices and the fact that many place a higher value on other aspects of the product than on the price.

Incentives for suppliers to compete on price

- 6.83. We also considered the incentives for suppliers to compete on price.
- 6.84. Some lenders told us that competing largely on features other than price was simply a rational response to the observed price insensitivity of customers. We were told further that we could never realistically expect to see intense competition on levels of APR or TCC, given that price was only one factor, and often not a very important one, among the many considered by customers in deciding what to borrow and from whom.
- 6.85. We recognize that lenders are more likely to compete on price if they are faced with highly price-sensitive customers. However, we consider that this explanation overstates the extent to which the observed lack of price competition is simply the result of customer preference and behaviour. Customers' behaviour is influenced by the conduct of suppliers. The fact that suppliers do not set prices in a way which enables them to be easily compared (and in many cases do not even make their prices readily available without a home visit) seems to us to contribute to customers' insensitivity. Moreover, while we have cited evidence of customers' lack of reaction to price rises and to persistent price differentials, we could not expect to have observed customers' sensitivity to price reductions, for example, where almost none have been offered.
- 6.86. We consider that in a competitive market we could reasonably expect to have seen at least some examples of companies choosing to use price or aspects of it as a competitive weapon, at least periodically, in the market to test the sensitivity of the whole, or of segments, of the customer base. Although we have found no obstacles inhibiting companies from competing using price, we have seen almost no such examples. We consider that the absence of price sensitivity among customers may help to explain the unwillingness of lenders to compete on price observed in paragraphs 6.8 to 6.35. Similarly, the unwillingness of lenders to compete on price reinforces customers' insensitivity to price. We consider that the evidence demonstrates that both of these factors exist, and that they can be expected to reinforce one another.

- 6.87. We also consider that there are other factors which further discourage lenders from competing on price. Although reducing price might attract some new customers, a high proportion of these might be expected to be high-risk customers (see paragraphs 5.27 and 5.28). Any lender cutting prices across the board in order to attract new customers would also experience a reduction in the stream of revenue earned from the rest of its customers who, presumably, would not have been likely to switch even in the absence of a price cut.¹⁹
- 6.88. We therefore consider suppliers' observed reluctance to compete on price to be driven in part by the insensitivity of customers to price and in part by the balance of incentives which does not encourage them to cut prices.

Competition on credit availability

- 6.89. Given limited incentives to compete on price, established home credit suppliers have tended to pursue an alternative strategy rather than competing directly on price. This strategy consists of identifying existing customers who are most likely to represent good credit risks—normally by lending small initial loans—and then making more credit available to these customers. We refer to this strategy as 'competition on credit availability', and we consider that it has two key components—the size of the loan which is offered and the timeliness of the offer for the customer.
- 6.90. Home credit lenders recognized the importance of availability as a basis of competition. Provident showed us evidence from a survey of its local managers which indicated that the ability to offer credit quickly was crucial in securing a sale before the competition. Other lenders supported the view that the ability to offer a loan at the point at which the customer needed it was important to retaining the customer's business.
- 6.91. It is on the issue of availability that competition is at its most local. A loan will only be available to a customer from a given lender if there is an agent who can call at the customer's house to issue the loan and to collect repayments. We were told that in many cases the customer's need for credit was urgent, so the ability to respond quickly to that need was also paramount.²⁰
- 6.92. There are two aspects of competition on credit availability, which make it a particularly attractive strategy for established lenders. First, availability is an important driver of customers' demand for home credit. Second, suppliers who have already established a relationship with a particular customer enjoy a number of incumbency advantages, related to their ability to make credit available to existing customers.

Importance of credit availability to home credit customers

- 6.93. We were told by academic commentators and by lenders that, for many home credit customers, the availability of a line of credit was critical. This can be for several reasons:
- Some customers have few realistic alternatives to home credit. This may be because they do not have a bank account or a credit record (both of which

¹⁹The reduction might be less if those customers were prepared to borrow a larger amount at a lower price.

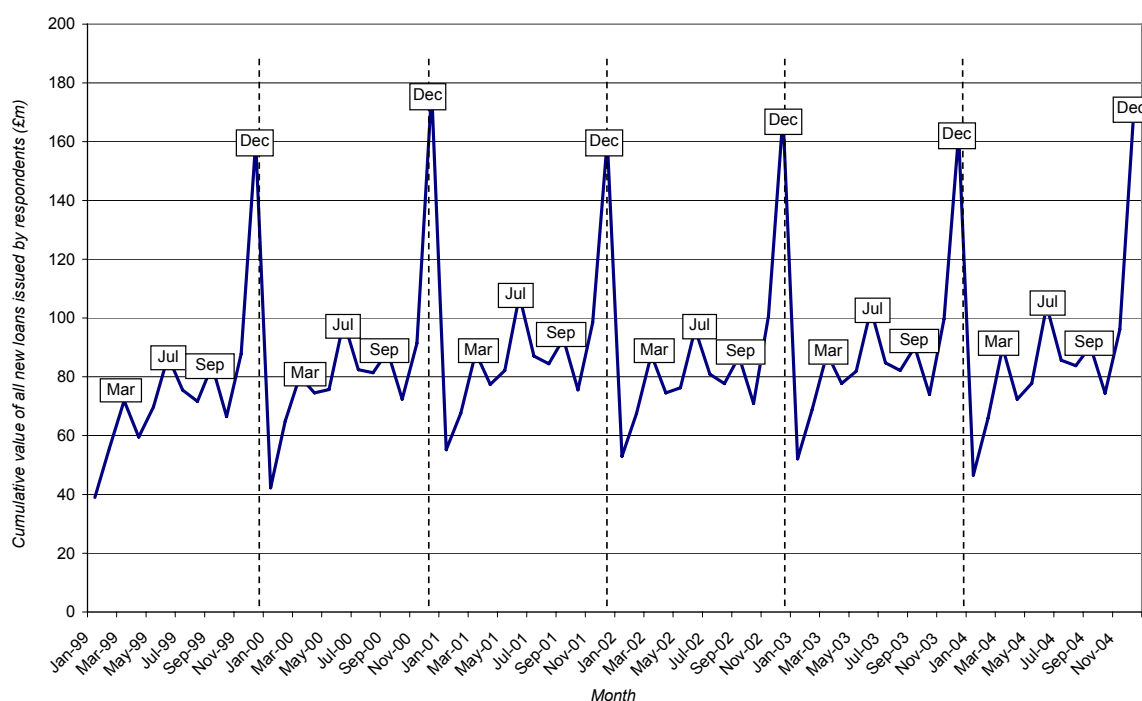
²⁰See, for example, Figures 10 and 11 of the NOP survey. Similar observations were also made in the AIA report and by lenders.

substantially increase access to mainstream credit)²¹ or because their ability to borrow on other sources of credit is exhausted.

- Some customers may exclude themselves from other sources of credit which are theoretically open to them. Such customers may avoid other forms of credit because of previous bad experiences or may, wrongly, believe that they have no alternative to home credit.²²
- Many home credit customers have few or no savings (see paragraph 2.108). Available credit is thus essential to their ability to deal with seasonal or unexpected pressures on their finances. The highly seasonal pattern of home credit loan issues indicated in Figure 6.7 suggests that home credit loans are taken out at points in the year when the financial pressures on households are greatest. This is consistent with the pattern of reasons for taking out a home credit loan described in paragraphs 2.116 to 2.119.

FIGURE 6.7

Seasonal pattern of home credit loan issues



Source: Company responses to further information requests.

6.94. We were told that some customers were very concerned to maintain a relationship with agents, to ensure that the availability of credit when they next needed it was not compromised. This was cited as a major reason for multi-sourcing; customers valued the availability of more than one line of credit. If they exhausted one or it otherwise became unavailable, the other remained an option. LSB [redacted] told us that payment performance declined dramatically if customers were told that there was likely to be no further credit forthcoming from that source.²³ They attributed this to the fact that

²¹As indicated in paragraph 4.69, while a full service bank account serves as a gateway to credit options, not all bank accounts do so; for example, basic bank accounts, in general, do not.

²²See, for example pp9–10 of the AIA report.

²³See our analysis of barriers to exit in paragraphs 5.56 to 5.60.

customers would rationally prioritize payment to the lender who might provide further credit over one who would not.

Incumbency advantages

6.95. We found that since the primary focus of competition is to make credit available quickly to a customer, an incumbent lender (ie one who already has a relationship with the customer or the customer's household)²⁴ has four significant advantages over other lenders:

- knowledge of the customer's circumstances and credit needs;
- point-of-sale advantage from the presence of the agent;
- knowledge of the customer's creditworthiness; and
- an established relationship of trust between customer and agent.

All of these derive from shortfalls of information which is desirable for establishing a borrowing relationship. Information about the borrower is unavailable to some lenders, and information about some lenders or agents is unavailable to the borrower.

Knowledge of customer circumstances and credit needs

6.96. Through the weekly visit, the agent of an incumbent lender has the opportunity to develop a strong understanding of a customer's circumstances, notably the level and regularity of the customer's income and expenditure commitments, and where these might give rise to a need for credit.

6.97. An incumbent lender's knowledge of these circumstances may not be perfect—indeed, the customer may at times have an incentive to ensure that the lender does not know the whole truth—but will be better than that of any other lender.

6.98. Thus an incumbent lender is most likely to be able to recognize when a customer may need credit, or indeed to prompt that need by suggesting further credit. We consider that the knowledge of the timing of customers' needs for a new or renewal loan provides a particular advantage to the incumbent lender in being able to offer a new loan at the optimum time for the customer.

6.99. The importance of this advantage is substantial. The majority of home credit loans are made to existing customers. For large lenders, we estimate that 82 per cent of loans by volume and 89 per cent of loans by value are to existing customers.²⁵ The convenience associated with borrowing from the usual lender is the most frequently cited reason for choosing a particular home credit supplier (see paragraph 6.66).

²⁴There may, given the extent of multi-sourcing, be more than one incumbent lender in the same household (see paragraphs 6.125 to 6.131). A lender with a significant presence in a local area may have other advantages over one who does not; these are addressed in paragraphs 5.36 to 5.47.

²⁵Source: CC working paper on customer turnover, multi-sourcing and switching.

Point-of-sale advantage from presence of the agent in customer's home

- 6.100. The incumbent lender's position confers a form of point-of-sale advantage in offering further credit to an existing customer; one not available to other lenders who do not have cause to call at the same house. The position of other lenders is further weakened by the effect of the legislative requirement that a lender should have written permission to call before offering a loan to a new customer. Thus even if the agent of a non-incumbent lender were somehow to become aware of a customer's need for credit, that agent would still need first to secure a written permission to call and then (on a later occasion) to return to discuss the loan.
- 6.101. By contrast, an incumbent lender's agent may have a standing permission to call built into the loan documentation. As indicated in paragraph 2.41, lenders regard their agents as free to suggest further loans when visiting to collect instalments, though we were told that some lenders instruct their agents to leave at least 24 hours before returning. This reinforces the convenience to the customer of dealing with an existing lender relative to a new supplier.
- 6.102. An incumbent lender has the further advantage that the customer does not incur the search effort or costs involved in finding another lender. We were told by lenders, and by some of the customers and agents interviewed in the course of the AIA research, that customers often found agents by word of mouth. The importance of such recommendations suggests that customers' ability to find another lender may vary from customer to customer according to the number of lenders active locally and the customer's family and social networks.²⁶

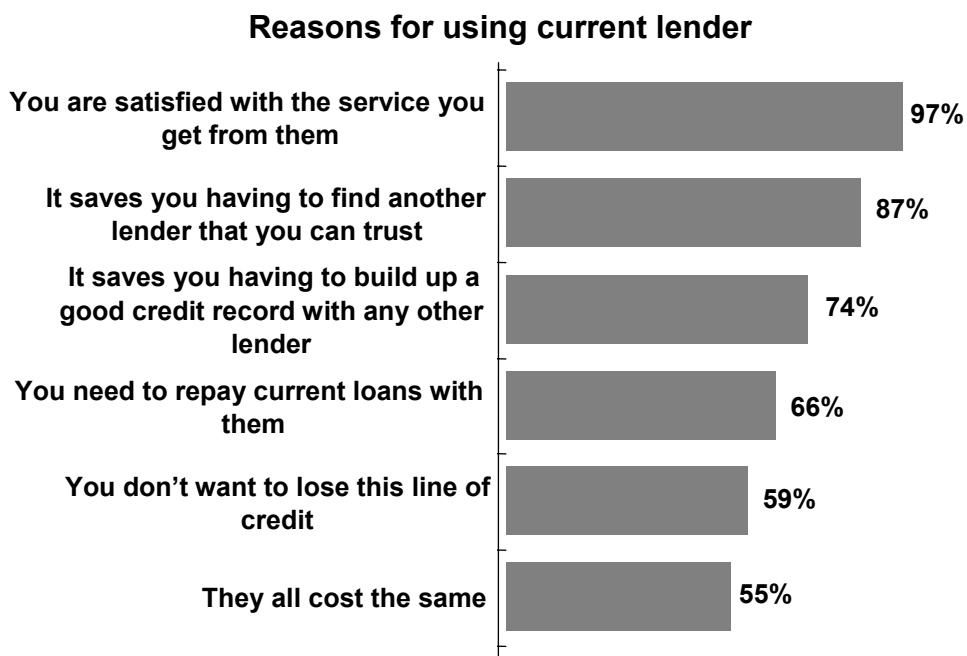
Knowledge of the customer's creditworthiness

- 6.103. In the absence of any publicly available information on the borrower's creditworthiness, an incumbent lender has unique knowledge of the borrower's payment record on that lender's loan and on previous loans from that lender.
- 6.104. This advantage is additional to the understanding of the borrower's overall financial circumstances, which can be inferred from the weekly visit. Several lenders told us that the customer's repayment record on their most recent loan was much the best predictor of the customer's likely repayment record on a new loan. We were also told by lenders 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. Thus an incumbent lender is substantially better equipped to judge the borrower's creditworthiness than a lender with no experience of the customer. The lender with the longest experience of the customer, or the largest loans, may be best equipped of all.
- 6.105. This knowledge should enable the lender to decide more quickly whether to make credit available—indeed, most agents know in advance of any visit whether the customer is likely to be offered more credit by their company—and may make agreement to a request for a loan more likely. This may be of value to customers, in that the risk of rejection when they ask for a loan (which the AIA research found to be important) would be reduced.

²⁶For a discussion of the importance of social networks, see, for example, Meadows P, Ormerod P & Cook, W, *Social networks: their role in access to financial services in Britain*, 2004.

6.106. It also makes it likely that the incumbent lender would lend more than any other. In this as in some other credit markets (for example, credit cards and overdrafts) larger credit facilities are offered only once customers have proved their ability to repay smaller ones. This is recognized by consumers—for example, NOP found that the third most important reason given (by 74 per cent of respondents) for staying with an existing lender was that ‘it saves you having to build up a good credit record with any other lender’ (see Figure 6.9).²⁷

FIGURE 6.9



Source: NOP World.

Notes:

1. The question asked was: Which of the following are reasons why you would choose to use your current or recent lender in the next two years?
2. Effective base: all who are likely to take a loan with their current lender only in the next two years (377).

6.107. Lenders told us that customers could use their payment books to demonstrate to other home credit lenders their record of repayment.²⁸ Opinion was divided on the value of this. We were told by suppliers that most customers have their payment books. This was broadly confirmed by NOP who found that 82 per cent of respondents had an up-to-date payment record.

6.108. However, as discussed in paragraph 5.31, customers in need of a loan have a strong incentive not to tell lenders the whole truth about a repayment record that might be imperfect. Thus they might be expected to show lenders a payment book showing a good repayment record but not one showing a poorer record.

6.109. Provident told us that all PPC loans to the same customer would be recorded in the same book, and would thus be visible to another lender. However, we do not consider that sight of another lender's payment book—which may or may not be the only one—is as good a guide to the creditworthiness of a customer as a company's own

²⁷Source: NOP 'Home credit customer research', Chart 19. The question was asked to those customers who said that they were likely to take a loan in the next two years, but would only use a current or recent lender. Multiple responses were allowed.

²⁸We found (see paragraph 2.19) that virtually all lenders use payment books or cards, kept by the customer and updated by the agent, to record payments.

records and the weekly visit. Lenders can therefore have only limited faith in the payment book as an indication of the customer's creditworthiness. This view was also supported by Park. As a recent entrant, Park has considerable recent experience of seeking to assess customers' creditworthiness through this method, which adds to the weight we place on its view of this issue.

- 6.110. We noted that the advantage enjoyed by an incumbent of having better knowledge of a customer's creditworthiness could be reduced if lenders were to share data on this subject with other lenders through CRAs. We found that very few home credit lenders do so. We considered the reasons for this.
- 6.111. Were creditworthiness data more widely available, and customers were thus able to communicate their creditworthiness to prospective lenders in a more reliable way, prospective lenders would have a better opportunity to compete for one another's customers. This would be of greatest benefit to entrants or those seeking to expand. Experience of data sharing in other industries suggests that all lenders would be in a better position to control bad debt by making better-informed lending decisions.²⁹ Providers of mainstream credit products told us that the more data they had on customers, the greater the predictive power of their scoring models. This might suggest that lenders have an incentive to share creditworthiness data.
- 6.112. However, there are disadvantages of data sharing for lenders too. Were creditworthiness data more widely available, other lenders, new entrants and providers of other forms of credit would all be in a better position to compete for lenders' customers. One of the key advantages of incumbency would be undermined. To the extent that the market overall was more competitive, the returns of all participants might be lower.
- 6.113. There are also costs associated with participating in data-sharing arrangements. Most data-sharing arrangements are designed for other forms of credit, and we were told that there would be difficulties, and associated costs, in reflecting some of the unique characteristics of home credit (for example, the weekly payment pattern and the treatment of missed payments) in any data-sharing arrangement. Lenders would also need to develop systems to store and transmit data to a CRA in the appropriate form, and would incur further costs of accessing data from the CRA. Home credit lenders told us that their approach to assessing creditworthiness using information gleaned through agent visits and customers' recent repayment records had served them well and that, in the absence of any clear evidence that creditworthiness data of this kind would significantly enhance the quality of their lending decisions, the likely costs of data sharing might well outweigh the benefits.
- 6.114. We consider in paragraphs 6.151 to 6.154 how this balance of incentives is somewhat different for large and smaller lenders. But the incentive for home credit lenders to share data is not clear. The absence of data sharing in home credit allows incumbency advantage deriving from the incumbent's greater knowledge of customers' creditworthiness to persist.

Established relationship of trust between customer and agent

- 6.115. By taking a loan from an incumbent lender, a customer is continuing with an established relationship of trust. We were told that it was important to customers to be able to trust their agent to call regularly every week, to ensure the discipline of weekly

²⁹We review the considerable economic literature on this subject in Appendix 2.1.

payment. Another dimension of this trust was the expectation on the part of the customer that the agent would respond in a reasonable fashion, if the customer missed an occasional repayment due to unforeseen circumstances.³⁰ The NOP report found that, of customers who said that in future they were likely only to take a loan from their current lender, 87 per cent cited as a reason that doing so saved them from having to build up a relationship of trust with someone else (see Figure 6.9).

- 6.116. The relationship with an agent is clearly very important to some customers. Some (44 per cent, according to NOP) said that they would stay with the same agent even if the agent moved company.
- 6.117. We noted (see paragraph 2.11) that not all agents have the same responsibilities. Most notably, LSB agents do not make lending decisions. We considered whether this influenced in any way the incumbency advantage that LSB might enjoy. We concluded that since the agent still had the opportunity to gather information on customers' circumstances and creditworthiness (and to pass it on to branch office managers as necessary), and to establish a relationship of trust, LSB was probably in the same position to exploit the advantages of incumbency as other lenders.

Potential disadvantages of the agent relationship

- 6.118. The NCC told us that 'the psychology of the relationship between the customer and agent, which is often built on friendship and is conducted in the emotionally significant environment of the home, may leave the customer vulnerable to exploitation in this regard'.³¹ This could provide the agent with the opportunity to prolong the relationship beyond the point at which the customer wished to remain with a lender or to press credit on the customer which was not wanted or needed. We do not regard this as a competition issue, but we record in paragraphs 6.119 to 6.123 our findings relevant to the subject.
- 6.119. We heard very few complaints from customers on this subject. Although there were some complaints about the reliability of agents in the AIA report³² and among customers who contacted us directly,³³ we did not regard the number or significance of these as great. The NOP survey suggested that customers generally saw their relationship with agents as good but professional. For example, 85 per cent of customers agreed that they limited their contact with agents strictly to business. 79 per cent of customers said that they did not owe the agent any favours.
- 6.120. The NOP survey also found that just over half of home credit customers had borrowed exactly the amount that they needed. 37 per cent of customers had borrowed 'a bit extra', while 11 per cent had borrowed less than they actually needed. Customers were somewhat more likely to borrow a bit extra, if they trusted their agent to give good advice about borrowing money (39 per cent), than if they did not (29 per cent). There was no statistically significant relationship between customers' friendship with their agent and their likelihood of borrowing a bit extra.
- 6.121. This does not appear to us to constitute exploitation. Furthermore, in principle, we consider it legitimate for lenders to offer further credit to established customers where, in their judgement, the customer is able to repay. Indeed, we could not reasonably expect a commercial lender not to do so. We accept that it would be a

³⁰The AIA research cited in paragraph 6.63 supports this view.

³¹NCC supercomplaint on home credit, p4.

³²AIA report, pp32–34.

³³Summary of feedback from home credit customers, published alongside Emerging Thinking.

cause for concern if an agent were to misuse a close personal relationship he had built up with a vulnerable customer to persuade her, in the guise of giving friendly advice, to take out a loan that was clearly against her interests. But we have seen no evidence of that happening.

- 6.122. We also acknowledge that there are safeguards inherent in agents' commission structures which discourage irresponsible lending. Lenders told us that in many cases agents, using their own judgement of the customer's ability to pay, chose not to lend to a customer even where the company's data on the customer suggested that a further loan was possible. We found that only in very few cases of over-indebtedness received by credit advice organizations was home credit cited as part of the reason for the problems faced by the borrower.³⁴ This suggests that these safeguards are usually effective in preventing serious overindebtedness problems, though we heard from some smaller lenders anecdotal evidence that offers of additional credit from other lenders or their canvassers had led some of their customers into situations where they were having difficulty meeting their repayment obligations.
- 6.123. The NCC told us that quantitative research of the kind conducted by NOP was not the best guide to behavioural issues like the relationship between customers and agents, and that we should place more weight on the evidence from the AIA qualitative survey and from the NCC's own work. We recognize that there may be risks associated with the agent relationship, but on balance we consider that the evidence is consistent with a general picture of agents seeking to establish and maintain a good relationship with their customers by meeting their expectations. However, such good relationships, once established, further contribute to the advantages enjoyed by incumbents.

Other factors relevant to incumbency advantages

- 6.124. Two further factors are relevant to our assessment of incumbency advantages and the nature of competition between home credit suppliers on credit availability:
- the widespread practice by customers of taking out home credit loans with more than one lender ('multi-sourcing'); and
 - the incentives on firms to retain existing customers.

Multi-sourcing and multiple incumbency

- 6.125. The incumbency advantages we have identified do not prevent borrowers from seeking to maximize the availability of credit by multi-sourcing (see paragraphs 3.168 to 3.170). NOP found that the majority of loan holders (55 per cent) said that they normally held loans with one lender. However, just under a third (31 per cent) said that they normally used two lenders and 14 per cent said that they normally used three or more lenders. This pattern was broadly confirmed by suppliers' impressions.
- 6.126. Multi-sourcing affects the nature of incumbency advantages. The incumbency advantages that we have identified operate at a variety of levels. Clearly they are strongest by comparison with any potential home credit lender who has no previous experience of that borrower or household. A lender who has lent to that borrower in the past is in

³⁴Sue Edwards, *In Too Deep: CAB Clients' Experience of Debt*, May 2003, The National Association of Citizens Advice Bureaux.

a somewhat better position, but that lender's knowledge of the borrower's circumstances is likely to be more outdated than an incumbent lender's. A lender with some more recent knowledge of the household or family may be in a better position still. But none of these has the same advantages as are conferred by having a current or recent loan to that customer.

- 6.127. The position is different again for those customers who have loans from more than one lender. In these cases, all incumbent lenders have an advantage over all non-incumbents. Assuming that all call weekly, no incumbent lender has a point-of-sale advantage over another. However, it is possible that one incumbent may have some advantages over another. A lender with a longer-standing relationship—which may also mean a record of larger loans to the customer—can be expected to have better knowledge of the customer's circumstances and creditworthiness, and may have a longer and deeper relationship of trust. In some cases, therefore, one incumbent lender may be in a position to offer more credit than the other, which may be a significant advantage.
- 6.128. Where a customer is borrowing from multiple home credit lenders, we might expect that this could intensify rivalry between those lenders, in order to induce the customer to switch part or all of her business from one lender to another. Customers who multi-source could increase or decrease the level of borrowing from each lender, perhaps favouring the lender offering better terms. This would be a difficult behaviour pattern to observe, and some lenders told us that it happened. We heard some anecdotal evidence that were it to happen, it would be likely to be the relationship with the agent which would determine which lender was preferred rather than the terms on which the loan was offered.
- 6.129. Lenders told us that, for some borrowers, multi-sourcing was a prelude to switching entirely. We found some evidence that this might be the case for some customers. Analysis of data from the NOP survey suggested that those who have recently started using a new lender are more likely to go to a new lender in the future instead of their existing lender. However, there was no evidence that this group was more likely to compare prices of different products. But the sample sizes for these analyses were small and we saw no evidence that the number of such borrowers was substantial.
- 6.130. We did not find evidence that multi-sourcing necessarily led to switching away from either lender or, by implying a threat to withdraw business, imposed a competitive pressure on existing lenders to which they responded. Indeed, where customers are multi-sourcing to maximize their access to different lines of credit,³⁵ the threat to move their business has little credibility; home credit companies and agents know that the customer will want to retain a relationship with them in case of need.
- 6.131. We conclude that multi-sourcing might be expected to intensify rivalry between lenders compared with a situation in which customers only borrowed from one lender. However, we have seen no evidence of any such competition on the basis of price—there is no evidence that multi-sourcers are offered better prices than any other customers. It is rare for a customer to borrow from more than two suppliers at a time, and we regard a situation in which a customer is faced with only two incumbent suppliers as less than fully competitive. Customers who borrow from three or more home credit lenders are likely to represent a high credit risk (we found that multi-sourcers were more likely than other customers to miss payments) and may therefore be unattractive to lenders. There is little evidence that many customers use

³⁵We heard some evidence that this was a motivation for multi-sourcing for at least some customers.

multi-sourcing as a prelude to switching and no evidence that any customers have been able to use this situation to negotiate a better price with either lender, nor that they impose any broader constraint on lenders.

Incentives to retain existing customers

- 6.132. The incumbency advantages we have identified are reinforced by the strength of lenders' incentives to retain existing customers.
- 6.133. The best available data on most home credit customers' creditworthiness rests with a lender from whom the customer has recently taken a loan. Other lenders may be restricted to publicly available data such as the existence or otherwise of county court judgements. A known, existing customer is therefore likely to be more attractive to a lender than a customer new to home credit, or even one with experience of home credit but not of that lender. Lenders, recognizing that other lenders' customers may be hard to persuade to switch away from an incumbent lender, and that even if they switched they would take time to become profitable, have only a limited incentive to pursue such customers. This adds to the adverse selection risk which makes attracting any customer new to a lender hazardous. As indicated in paragraph 6.106, knowledge of the customer and his creditworthiness gained from the experience of repaying a loan allows incumbent lenders to have greater confidence in the customer's ability and willingness to repay, and consequently to lend more.
- 6.134. Several lenders told us that they sought to increase the amount lent to existing customers, even if doing so required them to lengthen the term of the loan.
- 6.135. We considered the benefits to lenders of this approach. The fact that the fixed costs associated with a loan are roughly the same regardless of the loan size means that they represent a smaller proportion of revenue on a larger loan. In addition to this effect, a larger loan will be more profitable still, provided the increased revenue outweighs any increased risk of default because the loan is less affordable³⁶ or because the money is at risk for longer.³⁷ [✂]
- 6.136. It is therefore clear that an established customer has the potential to be substantially more profitable than a new one. One lender provided a further demonstration of this by estimating the difference in value between a new round of customers and an established one. It found that an established round was worth more than an un-developed one, even after allowing for the effect of the experience of the agent.
- 6.137. We recognize that it is common in business for established customers to be worth more to suppliers than new ones. However, we consider this effect to be particularly pronounced in home credit, because of the reduced risk of bad debt and the opportunity to lend more at higher margins over cost to existing customers. Both factors derive from the difference between the level of information available to a lender on the credit needs and creditworthiness of new and existing customers. Both factors apply in other credit markets, but might be expected to be mitigated in those circumstances by the existence of shared information on creditworthiness.

³⁶Which could happen if weekly payments increased but the loan term stayed the same.

³⁷Which could happen if weekly payments stayed the same but the loan term got longer.

Impact of incumbency advantages on competition

- 6.138. We consider that most of the advantage available to incumbent lenders derives from the information about customers which they have but which non-incumbent lenders do not.
- 6.139. This informational advantage gives incumbent lenders a competitive edge in deciding to lend the sums the customer wants when the customer needs them. The effect is to make it more likely that a customer will look to a particular incumbent lender (or, in some cases, lenders) whenever the customer has a credit need. Conversely, if a customer wants to get a loan from a lender with whom the customer currently has no relationship, the new lender is only likely to offer a relatively small sum to an unknown customer. It could take considerable time for a customer to build a comparable reputation with another lender, since more than one loan of at least half a year's duration would need to be satisfactorily repaid in order to demonstrate creditworthiness. In a market where swift and ready availability of credit appears to be important to customers, this is a significant inhibition to switching.
- 6.140. We consider that this inhibition of competition confers a degree of market power on incumbent lenders, insulating them from the full competitive pressure caused by the threat (or the reality) of customer switching. Thus every incumbent lender has a degree of market power in respect of every established customer. This market power will be greatest where the lender is the customer's sole source of credit. However, even where the customer borrows from a number of lenders, not all will have the same information as one another. The intensity of competition for that customer's business will be muted, by comparison with a situation in which all potential suppliers are able to offer credit on the basis of similar information about the customer.
- 6.141. We recognize that, to an extent, this pattern of incumbency advantages may characterize a number of markets, in which customers prefer to deal with a known supplier. However, we consider that an important reason for this pattern in home credit—and one which distinguishes home credit from these other markets—is the absence of any information on the creditworthiness of the customer to non-incumbent lenders. In other credit markets, while an incumbent lender may have the best, richest and most recent data on the customer's circumstances and creditworthiness, other lenders will generally have access to information from a CRA record when assessing a customer for credit. In home credit the asymmetry between the availability of information to an incumbent lender and another lender is much greater.
- 6.142. In summary, we consider that there are substantial incumbency advantages. These confer market power on existing lenders, which are strengthened by the absence of publicly available data on customers' creditworthiness. These advantages inhibit customers from switching, and make a customer more profitable to an existing lender than to a new one. These effects restrict competition by substantially reducing the competitive pressure on incumbent lenders which might otherwise exist from customers switching, or threatening to switch.
- 6.143. The CCA told us that these advantages were the result of investment by lenders over a period of time, and they should be entitled to returns from that investment. We recognize that lenders have invested in this way over time and that replicating that investment contributes to the barriers to entry we identified in Section 5, and we considered the replication of the knowledge of customers in particular in assessing the value of Provident's intangible assets (see paragraph 3.111 and Table 3.10). But we do not consider this argument relevant to our assessment of the impact of these advantages on competition.

Market structure and the position of Provident

6.144. The NCC supercomplaint, and the OFT in its reasons for reference, drew our attention to the high level of concentration in the market. Here we consider the evidence on market structure and the implications of this structure for competition.

Evidence on market structure

6.145. Our best estimates of shares of supply on a variety of measures were presented in Table 2.4. It is clear that, at a national level, this is a highly concentrated market and one in which the leading lender (Provident) has a very substantial market share. We found (see paragraph 2.98) that Provident accounts for around 60 per cent of the supply of home credit in the UK on most measures, and that the six largest lenders together account for over 90 per cent of UK supply.

6.146. We also examined the differences in Provident's market share by region and in a selection of local areas. We found that Provident was the market leader, and had at least a third of supply in all regions of the UK, and in all the localities we examined.

6.147. Market shares of this scale, either at the national or the local level, often confer some degree of market power, in particular the ability to raise prices above the competitive level and thus to maintain profitability without regard to competitive constraints from other lenders. We considered whether this was the case in the particular circumstances of home credit.

Benefits to Provident of its scale

6.148. Provident and some other lenders told us that only limited importance should be attached to national market shares. There were few economies of scale attributable to national scale, and the more important consideration was local density. Others took a different view, arguing that Provident's scale gave it unique advantages which enabled it to earn better returns than the market as a whole.

6.149. We consider that to the extent that there are substantial incumbency advantages in the home credit market, Provident is likely to benefit the most, owing to its substantial share of customer relationships. Provident may be expected to have existing relationships with over two-thirds of all UK home credit customers.³⁸ Provident would enjoy the advantages of incumbency detailed in paragraphs 6.95 to 6.137 in respect of all of these customers.

6.150. Moreover, as a result of its market position, Provident is uniquely able to take steps to sustain and benefit from these incumbency advantages:

- By its decision not to share creditworthiness information, Provident may play a wider role in preventing the sharing of such information across the whole market.
- By operating two brands, Provident may be able to retain the business of customers who would otherwise meet some or all of their borrowing requirements from other lenders.

³⁸Table 2.4 indicated that Provident had over 60 per cent of all customer relationships in 2005. Given that between a third and a half of all customers multi-source, this is likely to underestimate Provident's share of all home credit customers.

Lack of data sharing

- 6.151. We considered whether the position of Provident, and in particular its substantial share of customer relationships, influenced its incentives to share data, or whether its size or share of customer relationships influenced other lenders' incentives to share data.
- 6.152. In paragraph 6.112 we indicated that the disadvantage for lenders of sharing data is the opening up of their customer bases to competition from other lenders (and from other forms of credit). Provident, as the largest incumbent, has most to lose from this (and also least to gain from gaining better knowledge of others' customer bases). To the extent that the lack of data sharing contributes to the preservation of incumbency advantage, Provident, as the largest incumbent, might be expected to benefit most from the status quo. It thus has an incentive not to share data.
- 6.153. Smaller lenders might gain more from access to data on others' customers (collectively a much larger group than their own). These benefits would be greater the larger the customer database available to them. The absence of Provident's data on home credit customers would limit those potential benefits and might thus weaken the incentive on others to share. However, the potential benefits to other lenders of sharing may be limited anyway (see paragraph 6.112). They would not necessarily be great for lenders with limited geographic reach—theoretical access to the records of customers who they could never serve is not a significant benefit. Moreover, others—both other home credit lenders and, potentially, other providers of sub-prime or mainstream credit products—would gain better access to their customers. This might be a substantial risk for smaller lenders who, we were told, may have a high proportion of reliable customers. The costs and practical challenges of data sharing (see paragraph 6.113) may also be expected to bear disproportionately on smaller lenders, further reducing their incentives.
- 6.154. We consider that Provident has a clear incentive not to share data. But other lenders do not have a clear incentive to share data, irrespective of Provident's behaviour. Only lenders seeking to expand, who would value data which would enable them to assess new customers better, may be the exception. Even were Provident to share its data, it is not clear that the incentive on others to share would be powerful enough to outweigh the potential disadvantages. We conclude that while Provident's share of the market contributes to the lack of data sharing, it is not the sole cause.

Operation of two brands

- 6.155. We also considered the impact of the existence of two operating companies (PPC and GPC) within Provident's business. Provident told us that it had run GPC and PPC in parallel since the acquisition of GPC in the late 1970s. Provident thought it desirable to have a second agent force in the market so that where customers wanted to use more than one source of credit; they could use PPC and GPC.
- 6.156. We found no other lender operating two parallel businesses in the same geographical area in this way. S&U still operates companies under the names they have always had, but these operate in different geographies. PPC and GPC operate side by side, sometimes based in the same office premises. Each business concentrates on a different segment of the market—PPC's main product is a 55-week loan; GPC's is a 32-week loan; both are the most popular product in the market in their category. From the NOP survey, we estimate that 5 per cent of all home credit customers have loans with both PPC and GPC.

- 6.157. We find it curious that two of the top three lenders could have operated alongside one another under the same ownership for 20 years or more without much apparent effort being made to capture any of the potential synergies from common ownership. While evidence provided by Provident suggests that, in recent years at least, Provident's operational management has believed that there are as many risks associated with integration as benefits, we suspect that the absence of any effort to eliminate duplicate costs may indicate the existence of relatively muted competitive pressure (see paragraph 3.154).
- 6.158. More recently Provident has moved to integrate some of the back-office functions, and told us that it would soon be able to share customer data between the two businesses. We might expect this to reduce the ability of customers to gain the benefits of multi-sourcing between them. A customer with a bad payment record or with no scope to borrow further from, say, a PPC agent might formerly have had the opportunity to borrow from a GPC agent. This is less likely to occur if PPC and GPC share data with each other.
- 6.159. However, that approach has not been fully developed. To date, PPC and GPC have offered multi-sourcing options for customers as if they were separately owned (we have seen some evidence that many customers may have been unaware of the common ownership). While Provident may have reaped some reward from this, we have seen no evidence that in the period we have studied either the ownership of GPC or the market share that Provident has had as a result of that ownership have conferred any market power on Provident.
- 6.160. We considered the impact of the two brands on prospects for entry and expansion in paragraphs 5.53 to 5.55.

Other links between market structure and market power

- 6.161. Some other lenders argued that Provident's scale gave it unique advantages which enabled it to earn better returns than the market as a whole. Provident argued by contrast that there were few economies of scale attributable to national scale, and the more important consideration was local density.
- 6.162. We have found that Provident's market share enables it to enjoy the benefits of incumbency advantage in respect of its large customer base, that it is one factor contributing to the absence of data sharing (see paragraph 6.154) and that the strategy of maintaining two brands may have sustained barriers to entry (see paragraph 5.55). However, other than these effects, we found no evidence that Provident derives any market power from its national scale or market share.
- 6.163. We found that both nationally and in the areas we studied, Provident's prices were not the highest. In most cases its rates were more expensive—measured by APR or TCC for broadly comparable loans—than at least some other lenders, but cheaper than others, including some other large suppliers.
- 6.164. We noted in Section 3 that Provident was earning a rate of return that was above both its cost of capital and its other national competitors, but that small suppliers could also enjoy high returns. We believe that this observed pattern of returns may best be explained by the existence of economies of density in the provision of home credit (see paragraphs 5.36 to 5.39). These mean that, while the efficiency advantages of national scale may be modest, the advantages of having a critical mass of customers who can be effectively served by one agent, and concentrated groups of agents who can be cost-effectively managed from a single office, are greater. Thus,

the largest lender (Provident) which enjoys the economies of local density by virtue of its size can earn returns superior to most other lenders, but it is also possible for small but focused lenders to earn good returns. We consider that this offers a better explanation for differences in returns than explanations based on Provident's national position.

6.165. Though some other lenders told us that they thought Provident was in a position to exercise market power, none alleged any form of abuse of its position. In particular, we heard no allegations of any form of exclusionary behaviour or of any attempts to erect barriers to entry or to use market position to disadvantage any other competitor. We are not obliged to reach any conclusion on whether Provident's position in the market is dominant within the meaning of Article 82 of the EC Treaty or Chapter 2 of the Competition Act 1998. We therefore express no view on this.

Other dimensions of competition

6.166. We considered five other dimensions on which competition between home credit lenders could take place:

- competition to refinance existing loans;
- competition on the terms of early settlement;
- competition on product characteristics;
- competition on service quality; and
- competition to attract the best agents.

Competition to refinance existing loans

6.167. Refinancing an existing loan (sometimes referred to as 'renewing' or 'rolling over' a loan) enables home credit customers to borrow more money while maintaining weekly repayments at similar levels. Having had the issue of renewals highlighted in the NCC supercomplaint, we considered the effects of renewals on competition and what conclusions we should draw from the absence of switching by balance transfer which we observed (see paragraph 3.167).

6.168. As indicated in paragraph 3.167, we estimated that up to half of borrowers repay loans early, and around 40 per cent of loans issued each year involve the refinancing of a previous loan. The topic of renewals is covered in depth in Appendix 2.3. The NCC in its supercomplaint drew attention to the issue of renewals and expressed concern that they might be sold aggressively by agents to customers. Lenders told us that renewals were sought by customers who wanted the opportunity to borrow more without necessarily increasing their weekly repayments. Evidence from market research tended to support the view that most renewals are initiated by customers, who valued the ability to borrow more without increasing repayments.³⁹

6.169. However, we observed in our Emerging Thinking that in many other consumer credit markets, there is considerable price competition at the point of refinancing, and much refinancing is done by a lender other than the one who had offered the first loan. This is largely absent in home credit (see paragraph 3.167).

³⁹See Appendix 2.3.

6.170. Without drawing any conclusions about the competitiveness of those other markets, we consider the level of refinancing other than by the existing lender in home credit to be very low. This appears to us to be a further manifestation of the incumbency advantages outlined in paragraphs 6.95 to 6.137.

Competition on the terms of early settlement

6.171. We found little evidence of competition on the terms available to borrowers who repay their loans early. When a loan is repaid early, the customer must pay the total amount payable under the agreement he has already paid, less a rebate. We described the rebate arrangements and expressed the view that in the particular circumstance of home credit the minimum statutory rebate appears to us to be more favourable to the lender than to the customer in paragraph 3.51.

6.172. We found little evidence of competition between lenders to offer better rebates than the statutory minimum when loans are repaid early, even when the loans are renewed. Most calculated the rebate in accordance with the ESR regulations.⁴⁰ The regulations allow lenders to choose whether they do the calculation based on the contractual schedule of payments or on the actual payments made. Most (though not all) lenders told us that they calculated the rebate on the basis of contractual payments, which is administratively simpler and more generous to the borrower in that she is not penalized for any missed payments over the course of the loan. But we found that only two of the large suppliers (and some small ones) offered rebates that are more generous than the statutory minimum; the practice is most prevalent where the loan is renewed.⁴¹ To our knowledge, no large supplier offers more generous rebates than the statutory minimum to customers who settle a loan early for any reason other than renewals.

6.173. Lenders told us that the level of ESRs was not a significant competitive variable;⁴² borrowers could not be expected to decide which lender to borrow from on the basis of the likely rebate in the event of them repaying the loan early. Even those who told us that they did pay more than the statutory minimum in rebates (at least when loans were renewed) did not say that this gave them a significant competitive advantage. Mutual told us that its refinancing discount for customers who renewed a loan with it did not bring business benefits but was part of its organizational culture. We were told by one small supplier that it had on one occasion gained some extra custom by paying a larger rebate than others, but we have no reason to suppose that this is common.

6.174. We considered whether we could ever realistically expect much price competition on the amount of the rebate. We accept that, as lenders suggested, this is unlikely to be a decisive (or even a significant) feature in a borrower's initial decision. We have seen no evidence that it is. It may therefore be the case that we could never realistically expect competition to influence the level of rebates paid. Indeed the very fact that the Government has thought it necessary to legislate to ensure that rebates are paid might be regarded as indicating this.

6.175. We considered whether, in a more competitive market, competition might focus more on rebates. We believe it is unlikely that customers would ever be swayed by rebate

⁴⁰See paragraph 2.52 and Appendix 3.4.

⁴¹Mutual offers a refinancing discount for customers who renew a loan with it. [§] told us that it used the actuarial formula set out in the regulations but did not defer the settlement date by four weeks. Some smaller suppliers also offer better terms than the statutory minimum.

⁴²See Appendix 3.4.

levels at the point of the initial buying decision, but more likely that competition on rebate levels might be used to retain good customers who lenders considered at risk of defection. More broadly, in a highly competitive market, levels of rebate might be one among many competitive variables used by lenders, even if not the most obvious. But it is hard to tell how much impact on rebate levels such competition might have.

- 6.176. We also considered whether low rebates might have adverse effects on competition. We thought there were two possibilities: low rebates might discourage borrowers from settling a loan early and switching to another lender; and they might distort the incentives for a non-incumbent lender to offer a new loan, especially by comparison with an incumbent.
- 6.177. We found that the former effect was likely to be marginal at best. Even with higher rebates than those we have observed, our analysis suggested that large price differentials would be required to encourage customers to transfer the balance of a small, short-term loan from one lender to another. Given the absence of significant competition on more obvious aspects of price (like the headline APR), we consider the likelihood of such offers being made to be very small.
- 6.178. While it is clear that the second effect exists (incumbent lenders who would benefit from the low rebate have more of an incentive to offer a refinancing than lenders who would not), it is hard to tell how significant it is among other incumbency advantages.
- 6.179. We conclude that the low level of rebates may be a consequence of a lack of competition, but we cannot conclude with any certainty that even in a more competitive market we could expect significant competition on this dimension. We also conclude that the low level of rebates is, in essence, one example of muted price competition (see paragraphs 6.8 to 6.88) and of incumbency advantage (see paragraphs 6.95 to 6.137).

Competition on product characteristics

- 6.180. We considered whether there was any obvious competition on product features other than price. Lenders told us, and we recognize, that home credit is a simple product (see the discussion of innovation in Section 3) so the scope for much variation in product features was limited.
- 6.181. The principal area of variation in product terms was in the length of loans. Figures 6.5 and 6.6 showed that loans vary widely in length, though there is some clustering around particular loan periods. For example, there are many loans of around half a year and many of around a year's duration; not all are repayable over the same number of weeks.
- 6.182. We considered whether the variation in the length of loans represented competition on product features. Lenders told us that customers were often primarily concerned with affordability (that is, whether they could meet the regular weekly payments from within limited budgets). We did not consider that variation within the bounds indicated in Table 3.1 represented real differentiation on this dimension. Nor did it appear to us to have been designed as such. We observed that the length of loans appeared to be the result of a series of extensions to the term of the loan over time which had turned, for example, Provident's 53-week product (at the start of 1999) into a 55-week product today.

6.183. We also observed in our studies of local markets that in general the smaller lenders offered the shorter loans and the larger lenders, the longer ones. The reasons for this were not clear, but may include some combination of the following:

- Longer loans for larger amounts imply a larger funding requirement and having money at risk for a longer period. Small lenders may be unwilling or unable to bear such risks.
- Longer loans are more profitable if the risk can be managed, hence their attraction to larger lenders.
- There remains residual demand for shorter loans among smaller lenders' customers.
- Multi-sourcing customers may prefer to take different loans from different lenders.
- Smaller lenders, less exposed to public scrutiny, may be more willing to lend at higher APRs.

6.184. We have seen no evidence that the differentiation in the length of loans offered which we have found is designed to be a form of non-price competition. We do not consider it to respond to any obvious customer desire for products varied in this way. We have seen no evidence that the variability in loan terms is designed to inhibit comparison. However, we consider that the effect of loan products being offered on terms which are not readily comparable may inhibit direct comparison of prices and thus restrict price competition further (see paragraphs 6.73 to 6.76).

6.185. Your Finance, an ultimately unsuccessful entrant to the market in the East Midlands, told us that following its initial market research it had decided to offer relatively short-term loans with a higher weekly repayment rate but lower overall costs (see paragraphs 5.5 and 5.6). We consider that while Your Finance's approach to competition was unusual and innovative, the most striking thing about it was its rarity.

6.186. We said in our Emerging Thinking that the provision of standardized documents by the CCA to smaller lenders might result in some similarity in the terms on which some products are offered, and in discouraging competition on aspects of service covered by regulation.⁴³ The CCA told us that our concerns were unfounded. The terms which were common in the documentation were largely concerned with the legal requirements on lenders and were unlikely to be of sufficient importance to customers to be a source of effective competition. It was thus unrealistic to suppose that there would ever be competition on these features of the product. The CCA told us that lenders were not obliged to use CCA documentation and that even if they did use the CCA's standard documentation, it did not prevent lenders choosing to offer somewhat different terms. We heard no evidence that desirable product differentiation was inhibited by the provision of standard documentation by the CCA, and we do not think that it can be said to inhibit effective competition.

Competition on service

6.187. Several home credit lenders told us that they competed vigorously on service because that mattered more to many customers than price. We recognize that it is important for lenders to provide a consistent service to customers including, notably,

⁴³Emerging Thinking, paragraphs 27 and 63.

agents who call consistently and reliably. All lenders told us that this was a key element of competition.

- 6.188. Some lenders told us that they lost customers when agents failed to provide such service. This view was supported by market research evidence that some customers who had abandoned home credit had done so partly as a result of dissatisfaction with the service provided by the agent. However, no lender was able to provide examples of how providing better or more consistent service (overall or on any specific dimension of their service offer) had enabled them to win customers from rivals.
- 6.189. Nor did we hear of much obvious differentiation of service. S&U told us that it sought to employ higher-quality representatives than its competitors. Mutual and CLC both told us that having employed (and, in CLC's case, full time) agents gave them an advantage. In the case of Mutual, levels of agent churn seemed relatively low (which might be expected to result in a more consistent service for customers), but we could not reliably conclude that employing agents was the sole, or even the principal, reason for this.
- 6.190. We were told that customers principally valued the reliability and consistency of the agent's calling pattern and in some cases the attitude of the agent (especially in periods when the customer was having difficulty meeting the repayment schedule). The AIA research provided some further evidence for this. We heard nothing to suggest that any large lender was consistently better than others on these dimensions, though some suggested that smaller lenders, and especially those proprietors whose own money is at risk, may make special efforts to ensure that they provide a good service in these areas.
- 6.191. We consider that, although service quality is important to customers, competition to offer better service is not particularly intense and cannot be considered to compensate for the observed lack of price competition.

Competition for agents

- 6.192. Some home credit lenders told us that there was some competition for the best agents. We considered whether this imposed some competitive pressure on them. We recognize that even if it did, it would be likely that the agents, rather than the customers, would secure the benefits of competition for their services. This would not have the same effect on customers as direct competition for their business.
- 6.193. We observed that agents did not often move between companies. Not all home credit companies had reliable data on which of their agents had worked in home credit before. Of those who did, most told us that a quarter or less of their agents had experience in home credit before joining them; only Park quoted a figure (40 per cent) significantly higher than this. Home credit lenders told us that most agents who left did so in the first year. Many do so because they conclude that the job is not right for them. Those who last a year in one company often then remain for a long time. We found that over 40 per cent of the agents of five large lenders had been with the company for five years or more.
- 6.194. We observed relatively little evidence of attempts to attract agents away from their existing companies. We found that there had been no significant changes to basic commission structures or rates among the largest lenders in the last ten years. In the course of our inquiry, Provident mounted two promotional campaigns to encourage agents to move: one targeting competitors' agents with a message that Provident was committed to the industry (implying that others were not); and one offering a

£1,000 bonus for switching. Provident told us that the campaigns succeeded in recruiting experienced agents, but that retention and performance will be key to the overall success and value for money of the campaigns, and that their impact was still being assessed. These campaigns appeared to be isolated examples.

- 6.195. Several lenders told us that they preferred not to recruit former agents from other companies, preferring those who came to the company fresh, rather than those who might be thought to have a particular perspective on the industry or way of operating. Moreover, the different agent models adopted by some companies might be expected to limit such competition. Those who use full-time agents are not generally likely to want to recruit from the ranks of other lenders' part-time agents, and vice versa.
- 6.196. We assessed the incentives for agents to move companies (and the role played by restrictive covenants in their contracts in those incentives) in Section 5. We consider that the incentive not to move companies (including the effect of the restrictive covenants) explains why we have observed relatively little competition for agents. In the absence of significant turnover of agents, the elements of incumbency advantage represented by the agent-customer relationship (see paragraphs 6.115 to 6.123) remain in place.
- 6.197. We conclude from our analysis in paragraphs 6.166 to 6.196 that, other than the pattern of competition on availability we identified in paragraphs 6.89 to 6.94, there is no other form of competition which compensates for the weakness of price competition we found in paragraph 6.36.

Coordination and coordinated effects

- 6.198. We considered whether the current level of market concentration might give scope for coordination between firms.⁴⁴ We noted that firms have substantial scope to observe each others' behaviour both locally and at national level. We heard conflicting evidence on how visible competitors' prices are to one another. Provident publishes its prices on the Internet, but we were told that many other home credit lenders' prices are only available from an agent in the course of a home visit to discuss a loan.⁴⁵ However, we consider that lenders' prices are, by and large, transparent to competitors, in that it does not appear difficult for a determined lender to find them out. The active role played by the CCA within this market risks having the effect of increasing transparency between its members through facilitating frequent contact between them. The high barriers to entry and, particularly, expansion and the limited competition from other forms of credit suggest that coordination between existing suppliers, if achieved, would not be undermined by external competitive factors.
- 6.199. We conclude, however, that these factors need to be set against the current situation in which we find that home credit lenders enjoy a degree of unilateral market power as a result of incumbency advantages (see paragraph 6.137) and where a lack of

⁴⁴Paragraphs 3.58 to 3.66 of CC3 describe coordinated effects and the conditions facilitating them.

⁴⁵At the Open Meeting, Terry Jacques, from the Association of British Credit Unions, said:

As part of my job, in the last four years I have carried out research throughout Yorkshire—in Leeds, Doncaster, Scarborough, York, Selby and others (just to give an indication)—and as part of that research I visited Provident outlets, Shopcheck and many other sub-prime lenders. I saw a total lack of transparency in terms of the product being provided. There is some very nice literature here, one provided by the Provy. It is attractive and it advertises instant loans; the same for Welcome Finance. The one thing you will not find on this literature—and I failed to find any literature in all of the sub-prime members in the home credit companies that I visited—is any reference to interest rates and APR. When you ask the question, as I have done, you get funny looks and you do not get a direct response.

price competition obtains generally (see paragraph 6.36). These factors suggest that home credit lenders do not, at present, have a strong incentive (or indeed a need) to coordinate. The wide dispersion of prices suggests that price competition in this market is so weak that coordination would be unnecessary. Our analysis of price increases did not indicate that price increases took place at the same time or that there is a pattern of price leadership by any one.

6.200. In summary, we have not found evidence which would lead us to conclude that suppliers are engaging in any practices in which it would not be in their interests to engage independently and without coordination.