
Consultation on a market investigation reference on home credit

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OFT747b

- 1 The OFT has decided to consult on a market investigation reference to the Competition Commission (CC) of the market for the supply of home credit (HC) in the United Kingdom. HC consists of the provision of small sum credit, the repayments for which are collected in regular instalments (typically weekly) by agents who call for that purpose at the customer's home. The core HC business is the supply of cash loans. Some HC lenders also use the sale of shopping vouchers, hampers, or other goods on credit, to attract customers for their cash loans.

- 2 This decision follows the OFT's consideration of the National Consumer Council's (NCC's) super-complaint about HC. As a result of its preliminary review, the OFT suspects that there are market features that prevent, restrict or distort competition in the market for the supply of HC in the UK.

- 3 Overall, it appears to the OFT that competition among suppliers of HC is restricted. Lenders seem to have limited incentive to compete on price or attempt to win business by taking over other lenders' loans. The following features of the HC market appear to be causing or contributing to this restriction of competition:
 - many HC customers are in a poor bargaining position and their financial need may mean that they are not price-sensitive
 - customers may have difficulty comparing loans and do not appear actively to do so
 - step-up and 'roll-over' loans tend to tie customers in to existing lenders

- agents' relationships with customers contribute to making them unlikely to switch lenders
 - aspects of the structure of the market may deter entry, particularly on a significant scale.
- 4 Under section 131 of the Enterprise Act 2002 (the Act), the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts, or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.
- 5 In guidance published in March 2003,¹ the OFT said that it would make references to the CC only when the reference test set out in section 131 of the Act and, in its view, each of the following criteria, have been met:
- it would not be more appropriate to deal with the competition issues identified by applying the Competition Act 1998 (CA98) or using other powers available to the OFT
 - it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference
 - the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it
 - there is a reasonable chance that appropriate remedies will be available.²
- 6 The OFT believes that the test for a reference set out in section 131 of the Act is satisfied and that each of the additional criteria set out in its own guidance is also satisfied. We summarise below our view as to the

¹ *Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act* – see www.offt.gov.uk

² Paragraph 2.1

features of the market that, in our view, prevent, restrict or distort competition and discuss how we believe the criteria set out in our guidance have been met.

- 7 The OFT's guidance says that in consulting on a reference a view should normally be expressed as to the possible definition of the market (or markets) affected.³ This is set out in Annexe A.

Features of the market which prevent, restrict or distort competition

- 8 The OFT has reasonable grounds for suspecting that there are particular features that prevent, restrict or distort competition in the market for the supply of HC.
- 9 Customers in the market for HC generally are in a poor bargaining position due to the high perceived risk that they will default on payments, the shortage of alternative sources of small sum credit and their frequently difficult circumstances and pressing need for a loan. Factors such as the amount borrowed, amount of the weekly repayment, flexibility on repayments and rapid availability of the loan may take precedence in the eyes of the customer over the loan's overall cost. This may result in a tendency for customers to make decisions on any particular loan they are offered according to whether their need outweighs the costs and whether they can afford the weekly repayment, rather than whether it represents good value in comparison with other loans.
- 10 HC customers do not appear to be active in comparing the prices and other terms on which credit is supplied by different lenders. This may partly reflect high levels of satisfaction with the quality of service provided by HC lenders generally. Customers seem to appreciate: the convenience of borrowing from HC lenders who are seen as friendly, understanding and helpful; the balance of flexibility and discipline on

³ Paragraph 3.7

repayments; the relatively low likelihood of being turned down; the agreed end-date for repayments; the discouragement to over-borrowing from lending only the amount requested or less; the relative lack of paperwork; and the regular, reliable collection service.

- 11 In theory the APR can be used as a measure for comparing the cost of different forms of credit. HC customers may, however, not see the APR until they have the credit agreement and are on the point of signing. Customers may in any case not understand APRs and may be largely unaware of current APRs for other types of loan. HC lenders have pointed out that there are no hidden penalties in HC lending and missed payments do not incur charges. These extra costs are included in the cost of HC credit and are therefore reflected in the HC APR, whereas APRs on other forms of credit generally omit such charges. HC lenders have told us that this means that customers who look only at the APR may not be comparing like with like. We note this point, but consider that it supports the view that customers have difficulty comparing the cost of HC loans with that of other forms of credit. Customers could also use the total amount payable to compare the prices of different HC loans. This would, however, only be possible where the amount borrowed and the term of repayment were the same. At present, HC loans may not be sufficiently standardised to allow such comparisons to be made.
- 12 Collectively, these aspects of consumer conduct seem likely to inhibit their propensity to switch between lenders. Furthermore, we have identified several features of supplier conduct that appear to inhibit customers from switching, thus restricting competition.
- 13 Step-up loans, whereby HC suppliers lend small amounts to new customers and make larger amounts available once customers prove themselves reliable with repayments, are standard practice in the HC market. This means that switching to a new lender can require starting with small amounts again unless the new lender accepts payment books for previous HC loans as evidence of a customer's repayment history. This feature increases the propensity for customers to maintain a relationship with their current HC lender or lenders, rather than switching to a new HC lender or lenders. In a market where creditworthiness is difficult to establish, step-up loans are a sensible way for lenders to

minimise their own risk, and may also contribute to responsible lending. However, this does not alter our view that lending on this basis tends to tie customers in to their existing lender.

- 14 'Roll-over' loans, whereby customers take out further loans with the same lender before fully repaying their current loan, are common in the HC market. A roll-over loan will tie the customer in to the same lender for a longer period. In our view this is a feature that may inhibit price comparison and customer switching. To the extent customers find it easier to accept new loans or roll-over existing loans with the same lender than go elsewhere, and likely that they will do so, this entrenches borrowing from the current lender.
- 15 Switching may also be made less likely by the use of agents to market HC loans and collect HC repayments. We were told that a significant proportion of collection agents operating in the market are self-employed, and are paid on a commission basis calculated as a percentage of the money that they collect from customers. It is possible that the nature of the relationship between agents and customers may create a feeling of obligation on the part of customers to the agents who collect loan repayments from them. Customers will be aware that agents can allow extra time to make repayments, and may wish not to do anything which might jeopardise a potential source of credit for the future.
- 16 The HC market shows high and increasing concentration which is likely to reduce customer choice. The four largest companies have a combined market share of outstanding balances of 69 per cent (up from 60 per cent five years ago). The largest company alone accounts for 49 per cent of the market. Over the last decade there has been a gradual decrease in the number of smaller operators in this market, with the largest companies all expanding their business via acquisition. Some small lenders who responded to our questionnaire told us that they were willing to sell their loan books in order gradually to wind down their business and exit from the market, but that the larger companies' interest in purchasing appeared to have decreased. We have been told

that the market is flat or declining. These features, taken together with the limited propensity of customers to switch lender, may act as a deterrent to new entrants, whose ability to attract good customers would be limited.

- 17 We were told that personal recommendations and word of mouth play a key role in attracting new customers and this could also make it harder for a new entrant to win customers. In addition, the larger lenders' investment in networks of branches and agents is significant and it would take an entrant time to replicate this. Any entrant would also have a higher bad debt risk than an existing market player.
- 18 The only significant new entrant in the last decade (Park Direct Credit) entered the market on the back of customer relationships built up on its hamper and voucher business, another door-to-door market, and expanded partly by acquisition of other HC lenders.
- 19 Entry on a smaller scale, on the other hand, is likely to be significantly easier. We were told, anecdotally, of a number of examples of such entry. Regulatory barriers – the requirements on licensing and terms of agreements under the Consumer Credit Act 1974 – are perceived to be low. The legislation in this area is about to be changed, with the planned introduction of a Consumer Credit Bill. However, it seems unlikely that this will make entry to the HC market significantly more difficult.

Appropriateness of a reference

- 20 The OFT guidance states that, when dealing with a suspected competition problem, the OFT will only consider a reference to the CC in one of two circumstances: first, when it has reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition but not to establish a breach of the CA98 prohibitions, or secondly when action under CA98 has been or is likely to be ineffective for dealing with the adverse effect on competition identified.⁴ We have found no evidence of any agreements that could be

⁴ Paragraph 2.3

addressed by CA98 action under either the Chapter I prohibition or Article 81 on the basis that they might prevent, restrict or distort competition in this market. The features which we have identified as likely to prevent, restrict or distort competition in the HC market include aspects of the structure of the market and of the conduct of customers as well as of suppliers' conduct. The supplier conduct features appear to be prevalent throughout the HC market and to be unrelated to the market power of individual lenders. Consequently we do not believe CA98 enforcement action against individual market players under Article 82 and/or Chapter II (abuse of dominance) would be effective in addressing the features we have identified as preventing, restricting or distorting competition.

- 21 We consider that other powers available to the OFT would not adequately address the competition issues we have identified. Other possible OFT action includes an OFT market study, enforcement action under consumer legislation, and consumer education. A market study is not appropriate in this case because, in the event of it confirming the concerns about the operation of the market discussed in this paper, the OFT's powers to put in place the kind of remedies which would be likely to be necessary would be limited. The CC has substantive powers to seek undertakings and make Orders that are binding on undertakings operating in a market. We believe that the test for a market investigation reference under section 131 has been satisfied, and that there is a reasonable chance that appropriate remedies will be available. In these circumstances consulting on a market investigation reference is more appropriate than conducting a market study.
- 22 As set out in paragraphs 18-19 of the response to the super-complaint we plan, if appropriate, to investigate new complaints that have come to light in the course of the super-complaint, and to consider educating HC consumers in the course of our ongoing consumer education work. These actions on their own will not, however, address all the features we have identified as having adverse effects on competition. Therefore a decision to consult on a market investigation reference is the most appropriate response.

- 23 The OFT has power under section 154 of the Act to accept undertakings instead of making a reference to the CC. The current view of the OFT is that, given the features which are suspected of having an adverse effect on competition, the industry-wide nature of these features, and the number of parties involved, we are not currently able to judge with any certainty whether particular undertakings would effectively address all the problems that may exist and achieve as comprehensive a solution as is reasonable and practicable. The OFT will, however, consider any proposals for undertakings made in the course of this consultation.

Proportionality

- 24 The OFT guidance identifies three factors as relevant to whether an adverse effect on competition is significant, and thus whether a reference to the CC is appropriate, and these three criteria are met by the market for the supply of HC.⁵ Firstly, the size of the market is significant, estimated at approximately £2bn per year in outstanding balances. Secondly, a significant proportion of the market is affected by the features that prevent, restrict or distort competition, which appear to be prevalent throughout the UK, as is suggested by national pricing, the low levels of switching and the nature of these features. Thirdly, the features identified as adversely affecting competition are unlikely to be short-lived. While the HC market is said by some parties to be in decline, some of the parties appear to be making healthy profits and there is evidence of some market entry by smaller players.
- 25 The OFT has considered the possibility that the concerns considered in this paper might be mitigated as a consequence of changes in the market which might be brought about by the forthcoming revisions to consumer credit legislation, thus making the kind of remedies which might follow a CC investigation redundant. We take the view, however, that the nature of the features of the market in question is such that they are not likely to be significantly affected by the new legislative requirements.

⁵ Paragraph 2.28

Remedies

- 26 If the CC decides that there is one or more adverse effects on competition it must take action to 'remedy, mitigate or prevent' the adverse effect on competition and to 'remedy, mitigate or prevent any detrimental effects on customers' so far as those effects have resulted from the adverse effect (section 138 of the Act). In order to achieve that, the CC may accept undertakings from appropriate persons or may make an Order under section 161 of the Act. Such an Order may contain anything permitted under Schedule 8 of the Act, as well as supplemental provisions. Schedule 8 provides the Commission with wide-ranging powers falling within the following general areas: general restrictions on conduct, general obligations to be performed, acquisitions and divisions, and the supply and publication of information.
- 27 The OFT therefore believes that the wide range of remedial powers available to the CC, with or without any 'supplementary consequential or incidental provisions' should be capable of providing appropriate remedies to the spread of concerns raised. The extensive powers available to the CC, we believe, provide the best means of remedying any adverse effects on competition, and any detrimental effects on customers, and of making the supply of home credit work better.

ANNEXE

A POSSIBLE MARKET DEFINITION

Product market

Demand side substitution

- A.1 Some HC customers also use a number of other credit products to provide small sum credit. For these products to be in the same market as HC there must be a possibility of demand side substitution influencing the conduct of existing HC suppliers.
- A.2 The NCC set out a list of distinctive product characteristics which it considered consumers look for in HC:
- trust in and familiarity with the providers, products and procedures
 - simple, straightforward and speedy access
 - small amounts
 - confidence that they will not be refused
 - a cash-based system, ie, not requiring a bank account
 - repayment systems that suit household budgeting strategies, eg weekly
 - repayment discipline – a clear schedule
 - flexible repayments
 - understanding and recognition of their financial circumstances
 - no penalties or charges for default, eg, for missed payments.

A.3 A range of other small sum credit products are available. These include:

- agency mail order
- pawnbroking
- buy-back shops
- retail credit
- payday loans
- credit cards
- store cards
- personal loans
- overdrafts

Data presented by the NCC and corroborated by responses from HC lenders indicate that at any one time some consumers of HC may use one or more of these other products. It has been put to us that these data indicate that all 'small sum credit products' are to varying degrees substitutes and hence may be regarded as competing in the same consumer market.

A.4 Of these other products, agency mail order (AMO) is probably the product closest to HC in that it also provides for home collection of cash payments on a weekly basis. Consumers enjoy a similar flexibility to vary payments without incurring extra charges. However, as a source of credit AMO is clearly restricted to the goods on offer in the particular mail order catalogue. The cost of credit to the consumer that is included within the total amount payable can only be inferred by comparing the sum of the instalments with the cost of the same goods when offered for one-off cash payments. We have seen no evidence to suggest that consumers make such comparisons.

- A.5 Products such as credit and store cards, personal loans and overdrafts all involve penalty charges if minimum payments are not made on time or if credit limits are exceeded. Credit and store cards and overdrafts do not provide the borrower with a clear schedule of the repayments needed to pay off the debt within a particular period, nor the total cost of credit for a given purchase.
- A.6 Both the CCA and individual HC suppliers have stressed that their home credit product is far more transparent in setting out the total cost of credit than many of the other credit products available to their borrowers. They point to the additional charges which users of other products may incur and which are not included within the total cost of credit or the APRs quoted for these products. Examples include charges for missed payments or for exceeded credit limits. Price comparisons between the inclusive price offered by HC and likely cost in use of other credit products are therefore not easily made.
- A.7 Many consumers of HC will not have access to the full range of alternative credit products listed in paragraph 3. Some will have exhausted their entitlement and have borrowed as much on, say, credit and store cards as their credit rating will support. Although some 5 million consumers now have basic bank accounts⁶ there remains a proportion of HC borrowers who are without a bank account and are restricted to those credit products not requiring such an account.
- A.8 We understand, based on evidence cited by NCC and from comments made in meetings with lenders that consumers of HC tend to regard these other credit products as complementary to HC and use a variety of them to maximise their access to credit.
- A.9 Overall we doubt that there is sufficient functional similarity between HC and the other small sum credit products available to many HC customers such that HC lenders will be constrained in terms of price (the cost of credit) by substitution to other small sum credit products. More comprehensive evidence from consumer surveys would be needed to reach a firmer conclusion.

⁶ BBA

Supply side substitution

- A.10 The question here is whether suppliers of the other products can switch to supplying HC. The timeframe for this is the short run (for example, within one year), whereas new entry into the market occurs over a longer timescale.
- A.11 AMO is also the closest product to HC in terms of supply. Both products require a network of locally-based agents able to collect relatively small sums in cash on a weekly basis. To support these agents, both require a network of local or regional offices. The only significant supplier to enter the HC sector in the last five years, Park Group, diversified into HC from the supply of hampers which requires a similar infrastructure to AMO. We are not aware, however, of any recent moves by AMO suppliers to diversify into the supply of HC.
- A.12 While a number of suppliers of credit outside HC have moved into small sum credit, there is no indication that they intend to go as far as offering weekly home cash collection. Moreover, many of the existing HC suppliers told us that they have moved the other way, diversifying into other forms of small sum credit. Some did so in order to take advantage of the increased penetration of bank accounts, to launch credit products which did not involve weekly home cash collection. Indeed, we are aware of at least one CCA member who had ceased weekly cash collections entirely and lends exclusively to consumers with bank accounts from which payments are collected direct.
- A.13 The limited scope for supply side substitution does not suggest that the market should be defined more widely than HC.

Geographic market

- A.14 Home credit is essentially locally based, with agents providing the contact with the customer. Agents are in many cases remunerated by the commission paid on the sums they collect from customers. There are limits in terms of the maximum area and minimum customer density which can be handled by one agent if that agent is to earn an acceptable level of remuneration. A large proportion of business is reported to come

from word of mouth recommendations. A few large lenders operate nationally or over several regions. This coverage is confirmed by evidence from lenders with under 100 agents who were asked to list other HC suppliers operating in their respective areas. These medium and small sized lenders cover much smaller areas.

- A.15 We found no evidence of significant price differentiation either by region or in relation to the degree of competition locally. This might suggest that the relevant geographic market is the UK. However, there was some evidence of service geared to individual customers' circumstances, which might suggest that HC is supplied in very localised geographic markets. We have not drawn any firm conclusions as to the relevant geographic market for HC. Our analysis of the features of the market suggest that they are prevalent throughout the UK, whether the relevant geographic market is defined narrowly (local markets) or widely (the whole of the UK).