Payday lending market investigation

Provisional findings report

Notified: 11 June 2014

The Competition and Markets Authority has excluded from this published version of the provisional findings report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✄]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Background and context to our investigation

1. On 27 June 2013 the Office of Fair Trading (OFT), in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), made a reference to the Competition Commission (CC) for an investigation into the supply of payday lending in the UK. On 1 April 2014, the Competition and Markets Authority (CMA) took over many of the functions and responsibilities of the CC and the OFT, including in relation to this investigation.

2. This document sets out our provisional findings on whether any feature or combination of features in this market prevents, restricts or distorts competition, thus constituting an adverse effect on competition (AEC).

3. Payday lending has been, and continues to be, an issue which attracts a large amount of political and media attention. Our investigation is taking place against this background and changes to regulation of the sector. The Financial Conduct Authority (FCA) assumed responsibility for consumer credit regulation from 1 April 2014. In October 2013, it published its detailed proposals for the FCA regime for consumer credit, including payday lending, which formed the basis of its new conduct of business for consumer credit (CONC) rules now in force. As part of that new regime, the FCA has made new rules to address two issues which have been the subject of much publicity – namely the number of times that a loan might be 'rolled over' and the extensive use by lenders of continuous payment authorities (CPAs) to recover debt from a borrower's bank account. Also, following an announcement in November 2013, Parliament passed legislation which places a duty on the FCA to impose a price cap on the cost of payday loans by 2 January 2015.

4. The question that we consider in this document – of whether competition is working well in this sector – is an important one. Effective competition benefits consumers. In a well-functioning market, the competitive process encourages suppliers to keep their prices low, to innovate and to improve the service they provide to consumers. There is a clear demand for short-term, small-sum credit, which many customers are currently meeting by taking out a payday loan. Shortcomings in the competitive process can lead to customers paying more than they need to for their loans.

5. In conducting our investigation, we have been aware of the wide range of concerns that regulators, consumer groups, debt-advice charities and other interested parties have expressed about the operation of the payday lending sector. These concerns have centred on a variety of issues, including whether

lenders are acting responsibly when assessing whether customers can afford to meet the repayments due on a loan, whether advertisements for payday loans are misleading or inappropriate and whether sufficient forbearance is shown to customers who get into difficulties in meeting repayments.

6. It is clear to us that a number of these important issues go wider than the question of competition in the provision of payday loans which we are required to consider under the market investigation regime. We have been aware of the work undertaken in parallel by the FCA and the other bodies responsible for other aspects of public policy in relation to payday lending, including the introduction by the FCA of its new CONC rules, to tackle a number of the problems that have arisen in this sector in recent years and which had been identified by the OFT in March 2013 in its review of compliance by payday lenders. In addition to the normal benefits of a competition review, we expect our in-depth market investigation to inform and enhance the work of the FCA and of the other stakeholders with an interest in payday lending, by providing detailed evidence and analysis of the way the market operates. We have kept closely in touch with the FCA during our investigation and have shared information and data with the FCA, in response to its requests, in accordance with our own statutory responsibilities in relation to the information we collect.

7. In carrying out our work, we have been mindful of the implications of changes to the way that payday lending is regulated and the evolution of the market. Our assessment of competition is, by necessity, based on how competition is working now and how it has been working over recent years. In reaching our final conclusions about whether any features of the market lead to an AEC, we will seek to take into account the impact on competition of regulatory changes and other market developments. Likewise, we will consider any remedies in the context of the proposed price cap, once details of the FCA’s proposals are published, and other relevant developments.

An overview of the payday lending sector

8. Payday loans are short-term, unsecured credit products, which are generally taken out for 12 months or less. The average loan size is £260 and nearly all payday loans are for £1,000 or less. Within this broad definition a variety of products are offered, including ‘traditional’ payday loans repayable in a single instalment within one month or less and longer-term loans where the loan is repaid in a number of instalments over several months. The average duration of a payday loan is just over three weeks.

9. During the 2012 financial year, total payday loan revenue was around £1.1 billion, with lenders issuing approximately 10.2 million payday loans,

worth £2.8 billion. These figures represented a 35 to 50% increase on the preceding financial year – depending on the way in which the size of the market is measured – though more recent data indicates that this rate of growth has reduced substantially in 2013. We estimate that there were around 1.8 million payday loan customers in 2012. Customers often take out multiple loans over time and many use more than one lender – we estimate that an average payday lending customer takes out around six loans in a 12-month period, and that approximately four in ten payday customers used more than one lender in 2012.

10. Payday loans may be taken out online or on the high street. Most payday loan customers borrow online. We found that 83% of payday lending customers have taken out a loan online and 29% of customers have taken out a payday loan on the high street. There is some overlap, with 12% of customers having used both channels. The average amount borrowed on the high street (£180) was lower than that borrowed online (£290).

11. As part of the application process, payday lenders will carry out an assessment of a customer's creditworthiness and their likelihood of successfully repaying the loan. Most lenders have developed their own automated risk models, of varying degrees of sophistication, to help them make decisions about the creditworthiness of potential applicants, developed using historical customer information. The rate of loan applications that are turned down is well above 50% for many of the major lenders.

Payday loan customers and their use of payday loans

12. The median net income of an online payday lending customer is £16,500 – broadly similar to that of the wider UK population (£17,500) and significantly more than high-street borrowers (£13,400). Overall, the distribution of payday lending customers' incomes is somewhat narrower than that for the UK population – with fewer individuals with particularly low or particularly high incomes. Payday lending customers are more likely to be male and in full-time work than the population as a whole, to be younger than average and to live in larger households.

13. We investigated whether payday lending customers had experienced any credit or financial problems within the past five years. 38% of customers reported that they had experienced a bad credit rating, 35% had made arrangements with creditors to pay off arrears, 11% had experienced a county court judgment and 10% had been visited by a bailiff or debt collector. In total, 52% of customers reported having experienced one or more of these debt problems in the last five years.

14. We asked customers what they had used their most recent payday loan for. Just over half (53%) of customers told us that they had used the money for living expenses (such as groceries and utility bills), 10% said the money related to a car or vehicle expense and 7% said general shopping such as clothes or household items. When asked why they needed to take out a payday loan, 52% of customers said that the loan was linked to an unexpected increase in expenses or outgoings and 19% said the need was due to an unexpected decrease in income. 93% of those who said their need was due to a change in financial circumstances thought this change was temporary whereas 5% expected the change to be permanent. Payday loans are particularly likely to be taken out on Fridays and are somewhat more likely to be taken out at the beginning and end of the month.

15. 64% of payday loans issued in 2012 were repaid in full, either early or on time. 22% of loans were repaid in full, but after the originally agreed repayment date (including loans that were refinanced or 'rolled over'). 14% of loans issued in 2012 had still not been repaid in full by October 2013. Online customers are more likely to repay loans in full on time than high-street borrowers and the proportion of customers repaying in full on time varies significantly by lender. Customers who have previously taken out a loan with a particular lender are significantly more likely to repay a subsequent loan with the same lender in full and on time than are customers taking out their first loan with a lender.

16. When taking out their loan, customers were usually confident about their ability to repay it by the agreed date. However, a significant minority of customers (17%) reported having found getting money to repay their loan to be more difficult than they had expected. This proportion is significantly higher for those customers who: *(a)* had previously taken out payday loans in order to pay off debts to other payday lenders; *(b)* had a poor understanding of financial terms and conditions; *(c)* had been refused loans before; *(d)* had experienced debt problems in the last five years; and *(e)* said that they had taken out a payday loan as a last resort.

Repeat borrowing

17. Customers' demand for payday loans is typically recurring. Our analysis of loan-level data suggests that around three-quarters of customers take out more than one loan in a year, and that on average a customer takes out around six loans per year. These findings are broadly consistent with the results of our customer survey.

18. Furthermore, repeat custom typically accounts for a large proportion of lenders' business. More than 80% of all new loans in our data set that were

issued in 2012 were made to customers who had previously borrowed from the lender. On average, payday lending customers take out a further 3.6 loans from the same lender within a year of their first loan from that lender. Around 40% of customers had a borrowing relationship with their lender of more than one year.

19. Many customers also borrow from more than one lender. We estimate that around four in ten payday loan customers borrowed from more than one payday lender in 2012, and that on average a customer used 1.9 lenders. In line with this, 45% of respondents to our customer survey reported having ever used more than one lender. Much of the use of multiple lenders that we observed took place concurrently – ie while a loan was outstanding with another lender – or following a repayment problem with a previous loan.

20. In addition to taking out new loans, many borrowers extend the duration of their credit with their current lender by rolling over an existing loan. In 2012, around 20% of the loans in our data set were subsequently rolled over – with 16% of online loans and 26% of high-street loans rolled over. On average, loans which were being rolled over were extended 2.5 times.

Payday lenders and other market participants

21. There were at least 90 payday lenders offering loans to UK customers as of October 2013. However, the market is more concentrated than this figure might suggest, with the three largest lenders (CashEuroNet, Dollar and Wonga) accounting for around 70% of total revenue generated from payday lending in the UK in the 2012 financial year and the ten largest lenders accounting for more than 90%.

22. Around 40% of payday loan customers taking out their first loan with an online lender apply via the website of a lead generator. Lead generators are companies that contract with payday lenders to provide potential customer applications (or 'leads') in return for a fee for each lead provided. Online customers who do not apply via a lead generator may access lenders' websites directly, or by other means including using a search engine such as Google, via the websites of marketing affiliates and, to a lesser extent, by using price comparison websites.

23. Most payday lenders purchase information from credit reference agencies (CRAs) regarding applicants when carrying out a credit risk assessment. These CRAs hold large databases of individuals' personal information, past credit history and current credit commitments. This shared data is available on commercial terms to lenders. Currently, lenders usually provide information to the largest CRAs on a monthly basis; however, two CRAs (Call Credit and

Experian) have publicly announced that they are developing systems to allow lenders to provide and access information in real time or near real time.

The regulation of payday lending

24. As part of its response to the financial crisis of 2008, the Government made important changes to the regulation of financial services and banking in the Financial Services Act 2012. This resulted in the abolition of the Financial Services Authority and the transfer of its functions to two new bodies: the FCA and the Prudential Regulatory Authority. That Act also enabled the transfer of regulation of consumer credit from the OFT to the FCA.

25. Payday lenders, like any other consumer credit providers, are subject to a variety of regulatory obligations, most of which are now overseen by the FCA. As such, for example, payday lenders are required to give borrowers specified information before entering into a consumer credit agreement, to conduct a reasonable assessment of affordability, to monitor repayments and to show forbearance in resolving customers' repayment problems. Now that consumer credit is regulated by the FCA, no person may issue a payday loan, or offer any other form of consumer credit, unless that person holds either an interim permission from FCA, or has been authorised by the FCA. Over the next two years, payday lenders and other credit providers will be invited to apply for full authorisation. Like other firms regulated by the FCA, all firms providing consumer credit loans will have to comply with the high-level Rules in the FCA's Handbook, for instance with regard to treating customers fairly and cooperating with the regulator.

26. In addition, a number of further rules apply specifically to high-cost short-term credit lenders (essentially payday lenders). The rationale for these stems from widely expressed concerns about the operation of the payday lending market, including a review by the OFT of compliance by payday lenders which it published in March 2013. This pointed to a significant degree of non-compliance with consumer credit legislation and regulatory requirements. In particular, the FCA's CONC rules and guidance prohibit lenders from rolling over payday loans more than twice and provide that from 1 July 2014 no more than two unsuccessful attempts to take a payment with a CPA can be made and a CPA must not be used to take part payment.

27. Following an announcement in November 2013, the Government introduced legislation to impose a duty on the FCA to place a cap on the charges which may be imposed in relation to payday loans. The FCA plans to consult in July 2014 on its new price-capping obligations, which must come into force no later than 2 January 2015.

Assessment of competition in the UK payday lending market

28. In assessing whether competition was working well for payday lending customers, we looked first at evidence on pricing and other outcomes of the competitive process. We then considered the causes of these market outcomes by examining the adequacy of the competitive constraints acting on payday lenders from other forms of credit, the need to attract and retain customers and the threat of new entry and expansion.

Evidence of market outcomes

29. Payday lenders use a variety of different pricing structures, and the amount that a customer pays for a loan will usually consist of several distinct charges or fees. Among other factors, the cost of a loan will typically depend on the desired loan amount, duration and instalment structure; whether the loan is repaid on time, extended or topped up; and whether the customer opts to pay an additional fee in order to receive the sum borrowed more quickly.

30. We found that the prices of payday loans tend to cluster around a headline price of £30 for a £100, month-long loan. The lenders charging monthly interest around this level include some of the largest providers. In addition, several products with prices that are above £30 for a £100 month-long loan nevertheless carry headline interest rates of approximately 30% a month or 1% per day. This clustering in headline prices has emerged over time as increasing numbers of lenders have increased their prices to this level.

31. Nevertheless, we continue to observe some significant variation in the prices that different lenders charge in a number of representative borrowing scenarios. For example, the difference between the cost of borrowing £100 for 28 days using the cheapest product included in our review and the most expensive alternative was £39. The extent of price dispersion was even greater in the event that a customer repays their loan late.

32. Headline price changes are infrequent, and many lenders have made at most one change to their products' headline rate since 2008. Aside from a small number of relatively recent developments, price reductions, whether by reducing the price of existing products or via the introduction of new products, have been particularly uncommon. There is some evidence of competition between lenders taking place via the use of price promotions, but the coverage of the price promotions used by payday lenders is usually limited.

33. We found that customer demand responds weakly to prices. Where lenders have changed their prices, this has not generally resulted in a significant customer response. Lenders that have offered substantially lower rates have

not been particularly successful in attracting new business. The submissions of lenders and patterns of price dispersion that we observe suggest that customers may be particularly unresponsive to changes in late fees and other charges incurred if a customer does not repay their loan in full and on time. We have observed a significant proportion of customers taking out loans that are significantly more expensive for their given borrowing requirements than other payday loan products potentially available to them at the time.

34. We concluded that our analysis of pricing behaviour indicated significant limitations in the effectiveness of competition between payday lenders on prices, and that the competitive constraints that lenders face when setting their prices are weak.

35. This conclusion is consistent with our profitability assessment, which shows that the three largest lenders have had high and in some cases exceptional returns that have been substantially above the cost of capital over much of the past five years. The average annual return on capital employed of the major lenders included in our analysis ranged between 28 and 44% during the period 2009 to 2013. There is significant variation in the profitability of smaller lenders – with some making losses – and some evidence that future profitability may be lower than recent levels, both because of a slowing down in market growth compared with historic rates and due to regulatory changes which may increase costs and/or reduce revenues.

36. In contrast to the evidence on pricing, our analysis suggested that lenders compete on certain non-price aspects of the product offering – including launching new products and introducing faster payment services and other product features – and lenders told us that they sought to provide good customer service in order to retain borrowers. To some extent, this was supported by reported levels of customer satisfaction, which were high for some lenders. We were also aware, however, that the serious problems identified by the OFT and others about irresponsible lending and compliance with lenders' regulatory obligations clearly indicate that not all payday lending customers have benefited from good customer service. While noting this evidence of non-price competition, we took the view that lenders in a well-functioning market would also be expected to compete on prices to a greater degree than we had observed.

Market definition and competition from other forms of credit

37. The characteristics of payday loans differentiate them from many other credit products, which often do not allow customers to borrow such small amounts for short periods, access funds as quickly, or require some security. With the exception of unauthorised overdrafts, borrowing using alternative credit

products is generally significantly cheaper than using a payday loan (borrowing a similar amount for a similar duration using an unauthorised overdraft can be substantially more expensive).

38. We noted that it was relatively common for payday loan customers to use other forms of credit. However, a significant proportion of payday lending customers have experienced credit repayment problems in the past, and the evidence that we saw suggested that many customers would be constrained in the extent to which credit would be available using alternative products at the point at which they take out a payday loan.

39. Customer research suggests that in general customers taking out a payday loan do not consider other credit products to be a close substitute – only 6% of respondents to our survey reported that they would have used another credit product had they been unable to take out a payday loan. Partly this is due to the fact that many payday customers do not have credit alternatives available to them when taking out their payday loan. In addition, some customers may prefer payday loans because of the convenience, speed or discretion associated with these products, or because of a negative perception of alternatives such as a concern that spending on credit cards could more easily get out of control. We saw no substantive evidence of payday lenders taking developments in the pricing of other credit products into account when setting payday loan prices.

40. Given this evidence and the market outcomes that we observed, we reached the view that competition from other credit products was likely to impose only a weak competitive constraint on payday lenders, and in particular on their pricing.

41. We considered whether it was necessary to define separate markets for online and high-street lending and/or to identify distinct geographic markets within the UK. We found that, while some customers may have a preference for particular distribution channels, the level of segmentation was not sufficiently great to require us to define separate markets for online and high-street payday loans. We noted, in particular, that the possibility of substituting to online lenders was likely to impose a significant constraint on high-street lenders. Given this, the lack of local variation in high street lenders' offering and the relative ease with which lenders are able to open new stores in different local areas, we also did not consider that competitive conditions would differ across local areas such that it was necessary for our competition analysis to define separate local geographic markets.

42. We therefore provisionally concluded that the market relevant to our assessment of competition is the provision of payday loans in the UK.

Competition for payday lending customers

43. We reviewed patterns of shopping around and switching among payday loan customers. Our customer survey indicated that more than half of all payday loan customers do not shop around at all prior to taking out a loan. High-street customers are particularly unlikely to compare different lenders' products before taking out a loan. Where customers do shop around prior to taking out their loan, they most commonly report doing so using information on lenders' websites.

44. Around four in ten payday lending customers have used more than one lender, and so will have some direct experience of the loan terms offered by different suppliers. However, we found that much – though not all – of this use of multiple lenders takes place in situations where customers are constrained in their ability to borrow further amounts from an existing lender – for example, where they already have a loan outstanding with a lender, or have experienced a repayment problem with a previous loan. Where customers are able to access credit from an existing lender and are happy with the level of service provided by that lender, they often do not consider alternative lenders when looking for a subsequent loan.

45. We identified the following combination of market features which have given rise to the limited responsiveness of customer demand to prices that we have observed in the UK payday lending market, and which reduce the pressure for lenders to compete to attract customers by lowering their prices. These features act in combination to deter customers from comparing the different loans available, to impede their ability to do so effectively, and to discourage repeat customers from considering and/or selecting a new lender that offers a better value loan for their needs:

    (a) The context in which customers take out payday loans is often not conducive to customers shopping around to find a good-value loan and may amplify the adverse effects of other barriers to shopping around and switching lender. Customers often perceive the need for their loan to be urgent, and attach considerable importance to the speed with which they are able to access credit. Many payday loan customers are also uncertain, often with good reason, about whether, and from whom, they will be granted credit to meet their borrowing requirements. These aspects of the decision-making environment can tend to make customers reluctant to spend time shopping around for the best deal available, and can cause customers to focus on which lender is willing to lend to them (or, for a repeat borrowing, to stay with a lender that they previously used) rather than which lender offers the best-value product.

(b) It can often be difficult for customers to identify the best-value loan product on offer given their borrowing requirements. Despite information on headline rates generally being available on lenders' websites or in the shops of high-street lenders, customers' ability to use this information to identify the best-value payday loan is impeded by the complexity associated with making effective price comparisons given variation in product specifications and pricing structures across lenders, and the limited usefulness of the annual percentage rate in facilitating comparisons between payday loans. Existing price comparison websites, which might otherwise help customers compare loans, suffer from a number of limitations and are infrequently used.

(c) Customer demand is particularly insensitive to fees and charges incurred if customers do not repay their loan in full on time. Customers tend to be less aware of these potential costs of borrowing than they are of the headline interest rate when choosing a payday loan provider. This is in part because over-confidence about their ability to repay the loan on time can cause some customers to pay only limited attention to these costs when taking out their loan. Even where customers seek to anticipate the costs associated with late repayment, the information generally provided about such costs is significantly less complete, less easy to understand and/or less prominent than information on headline rates. It can therefore be difficult for customers to estimate, and so make effective comparisons about, the likely cost of borrowing if they do not repay their loan in full on time.

(d) Many online customers take out their first loan with a lender via a lead generator's website. Lead generators typically promote their ability to find customers a lender willing to offer them a loan within a short period of time. The value for money represented by different lenders' loan offerings is not taken into account in the auction process operated by lead generators, who instead sell customer applications to the highest bidder. Furthermore, there is often a lack of transparency in how the service that lead generators provide is described in their websites – particularly the basis on which applications are matched with lenders – and many customers do not understand the nature of the service offered by lead generators. An implication of the operation of this distribution channel is that lenders acquiring customers through lead generators are unlikely to have a strong incentive to lower their prices. The lead generator model may also create an incentive for lenders to increase prices to customers, as lenders offering cheaper loans would find it harder to bid high prices in lead auctions and hence acquire valuable leads.

(e) Where their choice of lender is not dictated by concerns about credit availability, customers can be dissuaded from looking at alternative suppliers by the perceived risks associated with using a new lender (ie one they had not used previously), particularly in light of the negative reputation of the payday lending sector. Customers may perceive a loss of convenience associated with applying to a new lender, particularly if the alternatives are rolling over or topping up an existing loan with an existing lender. These factors further reduce the constraint placed on lenders by the threat that existing customers will switch to another lender offering a better-value product.

Entry and expansion

46. We noted that the first UK payday lenders began offering loans ten years ago or more. Since then, we have observed firms employing a variety of different entry strategies, including start-ups, firms entering by acquisition, entry by North-American-based lenders, and diversification by lenders originally offering non-payday credit products. The payday lending sector as a whole (high street and online) has expanded rapidly in recent years, with growth particularly strong between 2010 and 2012. Wonga has expanded particularly rapidly since its entry in 2008 and CashEuroNet has also increased its share of supply significantly. Entry by companies into the payday lending sector has been observed regularly since 2008, at a rate of at least two to five new entrants per quarter. These patterns indicate that historically large numbers of lenders have managed to enter the market, and that a few lenders have been very successful in growing their businesses. Further, recent entrants were often optimistic about their ability to expand successfully to the next stage of their development.

47. Notwithstanding these historic patterns, and as indicated by the evidence on market outcomes, entry by new firms into the payday lending market does not appear to have resulted in existing lenders facing an effective constraint when setting their prices.

48. One reason for this is the factors described above which reduce payday customers’ sensitivity to prices, and weaken price competition between lenders. For example, on many occasions where we have observed new providers entering payday lending, these lenders have relied to a large extent on lead generators for new customers: a lender sourcing new customers via a lead generator is likely to have little or no incentive to compete on prices (see paragraph 45*(d)*).

49. In addition, the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion is further weakened by the following market features:

(a) New entrants will face certain disadvantages relative to more established lenders, in particular:

(i) The ability of new entrants to expand and establish themselves as effective competitors is likely to be obstructed by the difficulties associated with raising customers' awareness of their product in the face of the barriers to shopping around and switching summarised in paragraph 45, the strength of the well-established brands that already exist in the market and the costs associated with advertising on a sufficient scale to be effective in overcoming these obstacles.

(ii) While the ability to assess credit risk accurately is a necessary requirement for any provider of personal credit, it is likely to be a particularly important determinant of a provider's success in the payday lending sector, because of the relatively high credit risk profile of payday lending customers and the significant limitations associated with the information available to lenders about these customers from CRAs. Because of their greater reliance on new customers and the role of learning in the credit risk assessment process, new entrants are likely to face some disadvantages in their ability to assess credit risk for a period, which would put them at an initial cost disadvantage relative to more established providers.

(b) The history of non-compliance and irresponsible lending by some payday lenders and the resulting negative reputation of the sector are likely to reduce the constraint imposed on payday lenders' pricing by the prospect of new entry. In particular, the reputation of payday lending is likely to deter some businesses with established reputations in other sectors – such as mainstream credit suppliers – from entering the market. This reduces the likelihood of entry by parties with the capability to transform the nature of competition in the market. Potential entrants may also be dissuaded from entering payday lending by the difficulty – itself linked to the current reputation of the sector – in establishing banking relationships, and the very small number of suppliers currently willing to provide banking services to payday lenders.

Provisional findings

50. For the reasons set out above, we have provisionally found, pursuant to section 134(1) of the Act, that there are a number of features in the provision

of payday loans in the UK which contribute to, and help to explain, the failure by many payday lenders to compete on price and which either alone or in combination give rise to an AEC within the meaning of section 134(2) of the Act. These features are:

(a) The structural and conduct features set out in paragraph 45, which limit the extent to which customer demand is responsive to the price of payday loans, and so reduce the pressure for lenders to compete to attract customers by lowering their prices. These features relate to: (i) the context in which customers take out payday loans; (ii) difficulties customers face in identifying the best-value loan for them; (iii) customer insensitivity to fees and charges incurred if they do not repay their loan in full on time, itself linked to the difficulty of finding out the relevant information; (iv) the operation of the lead generator distribution channel; and (v) the perceived risks and loss of convenience of switching lender.

(b) The structural features summarised in paragraph 49 which weaken the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion by smaller lenders. These features relate to: (i) disadvantages faced by new entrants in raising customers' awareness of their product (partly because of the features described above in subparagraph *(a))* and in assessing credit risk; and (ii) the impact of the reputation of the payday lending sector in deterring potential entrants.

51. We identified two sources of customer detriment which are likely to arise as a result of the AEC. We have provisionally identified:

(a) Some customers currently pay more for their loan than they would if price competition were more effective.

(b) There may be less innovation on pricing (eg in relation to the introduction of risk-based pricing or flexible pricing models) than we would observe in a market in which price competition were more effective.

52. Our initial assessment indicates that the scale of the customer detriment caused by the AEC is likely to be material. On the basis of a range of plausible assumptions about the level of prices that might be observed in a market in which price competition were more effective, we estimated that, on average, borrowers are overpaying by around £5 to £10 per loan. This is relative to a typical loan of £260 taken out for just over three weeks, and with a total cost of credit for a customer that repays in full and on time of around £75. Applying these savings to the total number of loans issued in 2012 that were repaid in full would imply potential annual savings to customers from

having more effective price competition in excess of £45 million per year. In addition, we considered that the current use of risk-based pricing and flexible pricing models was undeveloped relative to the level that we might expect to see in a well-functioning market, and so a further detriment (which we did not seek to quantify) was likely to exist associated with the overall level of market efficiency and the extent to which prices currently reflect the cost of supplying different groups of customers. These figures are indicative, and we will examine further the extent of customer detriment, and the benefits of effective intervention, during the next stage of our investigation.

Provisional findings

1. Introduction

The reference and statutory task

1.1 On 27 June 2013 the OFT, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), made a reference to the CC for an investigation into the supply of payday lending in the UK. The terms of reference for our investigation are provided in Appendix 1.1. This document sets out our provisional findings from this investigation. We are required to publish our final report by 26 June 2015 although, in accordance with our published policy of endeavouring to complete market investigations within 18 months of reference and consistent with the provisions of the statutory framework, we intend to do this significantly earlier and under our current timetable we will publish our final report in December 2014/January 2015.

1.2 On 1 April 2014, the CMA took over many of the functions and responsibilities of the CC and the OFT.[1] Accordingly, the functions of the CC in relation to the reference were transferred to the CMA.[2] These provisional findings are now published by the CMA in exercise of its functions under section 136(1) of the Enterprise Act 2002, read with paragraph 2 of the Schedule to the Order.

1.3 The CMA is required by section 134(1) of the Act to determine whether any feature or combination of features in this market 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, thus constituting an adverse effect on competition (AEC).[3]

1.4 Under section 131(2) of the Act, a 'feature' of the market can refer to: *(a)* the structure of the market concerned or any aspect of that structure; *(b)* any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or *(c)* any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

[1] The CMA works to promote competition for the benefit of consumers, both within and outside the UK. It aims to make markets work well for consumers, businesses and the economy.
[2] This transfer was under Schedule 5 to the Enterprise and Regulatory Reform Act 2013 and the Schedule to the Enterprise and Regulatory Reform Act 2013 (Commencement No. 6, Transitional Provisions and Savings) Order 2014 (the Order).
[3] Our guidelines state: 'A market investigation may examine any competition problem and identify the feature causing the problem. It aims only to see if competition within the particular market under review is working well or can be improved and is not seeking to establish general rules and obligations for firms.' (*Guidelines to market investigations, CC3* (the Guidelines), paragraphs 18–21.)

1.5 If the CMA finds that there is an AEC, it is required under section 134(4) of the Act to decide whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or any detrimental effect on customers[4] so far as it has resulted from, or may be expected to result from, the AEC; and, if so, what action should be taken and what is to be remedied, mitigated or prevented. The Act requires the CMA 'to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any detrimental effects on customers so far as resulting from the AEC'.[5] In considering remedies, the CMA may take into account any relevant consumer benefits, as defined in the Act, arising from the feature or features of the market.[6]

1.6 This section provides the context of the investigation, an overview of the conduct of the investigation, and the structure of the remainder of the report.

Context of the investigation

1.7 As we noted in our August 2013 issues statement, payday lending has been, and continues to be, an issue which attracts a large amount of political and media attention. Our investigation is taking place against this background and changes to regulation of the sector.[7] The Financial Conduct Authority (FCA) assumed responsibility for consumer credit regulation from 1 April 2014. In October 2013, it published its detailed proposals for the FCA regime for consumer credit, including payday lending which formed the basis of its new conduct of business standards for consumer credit (CONC) rules now in force. As part of that new regime, the FCA has made new rules to address two issues which have been the subject of much publicity – namely the number of times that a loan might be 'rolled over' and the extensive use by lenders of continuous payment authorities (CPAs) to recover debt from a borrower's bank account. Also, following an announcement in November 2013, Parliament passed legislation which places a duty on the FCA to impose a price cap on the cost of payday loans by 2 January 2015.

1.8 This reference into the supply of payday lending in the UK followed an OFT examination of the market which concluded that there may be competition problems which needed in-depth investigation.

[4] A detrimental effect on customers is defined in section 134(5) of the Act as one taking the form of: *(a)* higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or *(b)* less innovation in relation to such goods or services.
[5] Section 134(6) of the Act.
[6] Section 134(7) of the Act.
[7] We summarise the legislative framework governing payday lending and how this has changed in Section 3 and Appendix 3.1.

1.9 The question that we consider in this document - of whether competition is working well in this sector - is an important one. Effective competition benefits consumers. In a well-functioning market, the competitive process encourages suppliers to keep their prices low, to innovate and to improve the service they provide to consumers. There is a clear demand for short-term, small-sum credit, which many customers are currently meeting by taking out a payday loan. Shortcomings in the competitive process can lead to customers paying more than they need to for their loans.

1.10 In conducting our investigation, we have been aware of the wide range of concerns that regulators, consumer groups, debt-advice charities and other interested parties have expressed about the operation of the payday lending sector. These concerns have centred on a variety of issues, including whether lenders are acting responsibly when assessing whether customers can afford to meet the repayments due on a loan, whether advertisements for payday loans are misleading or inappropriate and whether sufficient forbearance is shown to customers that get into difficulties in meeting repayments.

1.11 It is clear to us that a number of these important issues go wider than the question of competition in the provision of payday loans which we are required to consider under the market investigation regime. We have been aware of the work undertaken in parallel by the FCA and the other bodies responsible for other aspects of public policy in relation to payday lending, including the introduction by the FCA of its new CONC rules, to tackle a number of the problems that have arisen in this sector in recent years and which had been identified by the OFT in March 2013 in its review of compliance by payday lenders. In addition to the normal benefits of a competition review, we expect our in-depth market investigation to inform and enhance the work of the FCA and of the other stakeholders with an interest in payday lending, by providing detailed evidence and analysis of the way the market operates. We have kept closely in touch with FCA during our investigation and have shared information and data with the FCA, in response to its requests, in accordance with our own statutory responsibilities in relation to the information we collect.

1.12 In carrying out our work, we have been mindful of the implications of changes to the way that payday lending is regulated and the evolution of the market. Our assessment of competition is, by necessity, based on how competition is working now and how it has been working over recent years. In reaching our final conclusions about whether any features of the market lead to an AEC, we will seek to take into account the impact on competition of regulatory changes and other market developments. Likewise, we will consider any remedies in the context of the proposed price cap, once details of the FCA's proposals are published, and other relevant developments.

Conduct of the investigation

1.13 During our investigation, we have published a considerable number of documents (including the issues statement, the annotated issues statement and various working papers and other evidence gathered) on the CMA website.[8] We describe in Appendix 1.1 the process we followed in our investigation and how we utilised the evidence, data and information we received.

Structure of provisional findings report

1.14 This document, together with its appendices, constitutes our provisional findings. It refers, where appropriate, to material published separately on the CMA website. The report, however, is self-contained and is designed to provide all material necessary for an understanding of our provisional findings. The accompanying Notice of Possible Remedies sets out details of remedies we have identified as possibly being effective in addressing the AEC we have provisionally found and is the starting point for a discussion of remedies with the relevant parties to the investigation.

1.15 Following consideration of responses to these provisional findings and our Notice of Possible Remedies, as well as any further evidence received, we will publish our provisional decision on remedies and subsequently our final report.

1.16 The remainder of these provisional findings is set out as follows:

- Section 2 describes the background to the payday lending sector, including information about customers and their use of payday loans.
- Section 3 provides information on the relevant policy frameworks and regulation of the industry.
- Section 4 sets out our analysis of market outcomes, including prices, profitability and various indicators of non-price competition.
- Section 5 considers market definition including the constraints from other forms of credit.
- Section 6 considers the extent and nature of rivalry between payday lenders, with a particular focus on the role played by payday loan

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[8] www.gov.uk/cma-cases/payday-lending-market-investigation.

customers in driving competition, and assesses whether there are any barriers to effective competition arising on the demand side of the market.

- Section 7 considers entry conditions and assesses whether there are barriers to entry and/or expansion in the market.
- Section 8 presents our provisional findings in relation to the statutory questions that we are required to answer.

1.17 Appendices supporting each section are numbered according to the first section where they are relevant and are listed in full in the table of contents at the beginning of this report.

2. Background to the payday lending sector

Introduction

2.1 In this section we provide background information on the payday lending sector. It describes:

(a) the main characteristics of payday loans (paragraphs 2.2 to 2.16);

(b) some of the main characteristics of payday loan customers (paragraphs 2.17 to 2.24);

(c) the way in which customers use payday loans (paragraphs 2.25 to 2.55);

(d) the high street and online distribution channels and the characteristics of customers who use each channel (paragraphs 2.58 to 2.64);

(e) the application and approval process for payday loans (paragraphs 2.65 to 2.74);

(f) the size and structure of the payday loan sector (paragraphs 2.75 to 2.81);

(g) the main providers of payday loans (paragraphs 2.82 to 2.118); and

(h) other participants in the sector such as lead generators and price comparison websites (paragraphs 2.119 to 2.145).

Basic characteristics of a payday loan

2.2 We considered the basic characteristics of payday loans and how we should define a payday loan for the purpose of this investigation.

2.3 Payday lending is defined in our terms of reference as 'the provision of small-sum cash loans marketed on a short-term basis, not secured against collateral, including (but not limited to) loans repayable on the customer's next payday or at the end of the month, and specifically excluding home credit loan agreements, credit cards, credit unions and overdrafts'.[9] As noted above, the term 'payday loans' is not used exclusively to refer to loans linked to the borrower's payday.

2.4 In its conduct of business rules contained in the Consumer Credit sourcebook (CONC), the FCA has adopted a similarly broad definition so as to capture the range of different short-term unsecured loan products on offer in the payday

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[9] See Appendix 1.1.

lending sector. It uses the term 'high-cost short-term credit', to reflect the fact that loans are not necessarily paid back on the borrower's payday, and to capture longer-term products that are repaid over several months. It defines high-cost short-term credit as regulated credit agreements:

(a) which are borrower–lender or P2P[10] agreements; and

(b) in relation to which the annual percentage rate (APR) is equal to or exceeds 100%, either:

(i) in relation to which a financial promotion indicates that the credit is to be provided for any period up to a maximum of 12 months or otherwise indicates that the credit is to be provided in the short term; or

(ii) under which the credit is due to be repaid or substantially repaid within a maximum of 12 months of the date on which the credit is advanced;

(c) which is not secured by a mortgage charge or pledge; and

(d) which is not:

(i) a credit agreement in relation to which the lender is a community finance organisation; or

(ii) a home credit loan agreement, a bill of sale loan agreement or a borrower–lender agreement enabling a borrower to overdraw on a current account or arising where the holder of a current account overdraws on the account without a prearranged overdraft or exceeds a prearranged overdraft limit.[11]

2.5 A range of different types of product are captured within these definitions, with variation in terms of how long money can be borrowed for (ranging from a day up to a year or more) and how much can be borrowed (from small, fixed amounts to larger amounts that are repaid in instalments). A notable recent trend has been the development of instalment loans to replace, or be offered alongside, more 'traditional' fixed term payday loan products that require the loan to be repaid in a single repayment on a borrower's payday, generally within 30 days or fewer.

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[10] Peer-to-peer lending (abbreviated frequently as P2P lending) is the practice of lending money to unrelated individuals, without going through a traditional financial intermediary such as a bank or other traditional financial institution. This lending takes place online on peer-to-peer lending companies' websites using various different lending platforms and credit checking tools.

[11] Glossary of Definitions, *FCA Handbook*; FCA 2014/12 Consumer Credit (Consequential and Supplementary Amendments) Instrument 2014, Annex A, Amendments to the Glossary of Definitions.

2.6 In this report we discuss two lending channels through which lenders can issue loans to customers. The first channel requires customers to visit a lender's (or intermediary's) website in the first instance, which we refer to as 'online' and the second channel requires customers to visit a retail store which we refer to as 'high street'.[12] We discuss the differences in these channels (and the customers who use them) in greater detail in paragraphs 2.58 to 2.64.

2.7 We describe the different types of payday loan products offered by the major payday lenders and their characteristics in greater depth in Appendix 2.1.

2.8 Notwithstanding this variation between products, there are some common characteristics, particularly in terms of the size and duration of loans which help differentiate payday lending from other forms of credit. We used transaction data provided by 11 of the largest lenders in order to identify and analyse the common characteristics of payday loans – see Appendix 2.2 for further details of the data set and how it was prepared.

2.9 Payday loans are typically for relatively small amounts. In terms of loan size, the minimum value of payday loans offered by suppliers is usually £100 or less. For shorter-term products, the maximum amount that can be borrowed by a new customer generally lies between £100 and £500. Repeat customers and those using longer-term products are often able to borrow higher amounts, although rarely more than £1,000.

2.10 Our analysis of transaction data found the average size of a payday loan to be £260. The single most common amount borrowed was £100: amounts of £200, £150, £300 and £50 were also relatively common.[13] Around 25% of all payday loans were for £100 or less, half were for £200 or less, and 90% were for £570 or less. The average value of a payday loan varies substantially across lenders, from £163 for [✂], up to £326 for [✂].[14] Figure 2.1 shows the overall distribution of loan values in our transaction database.

2.11 Responses to our customer survey suggested that high-income customers, older customers, those in full-time employment and those who owned their own house all took out larger than average loans. Unemployed customers were the customer group found to have the lowest average loan value.

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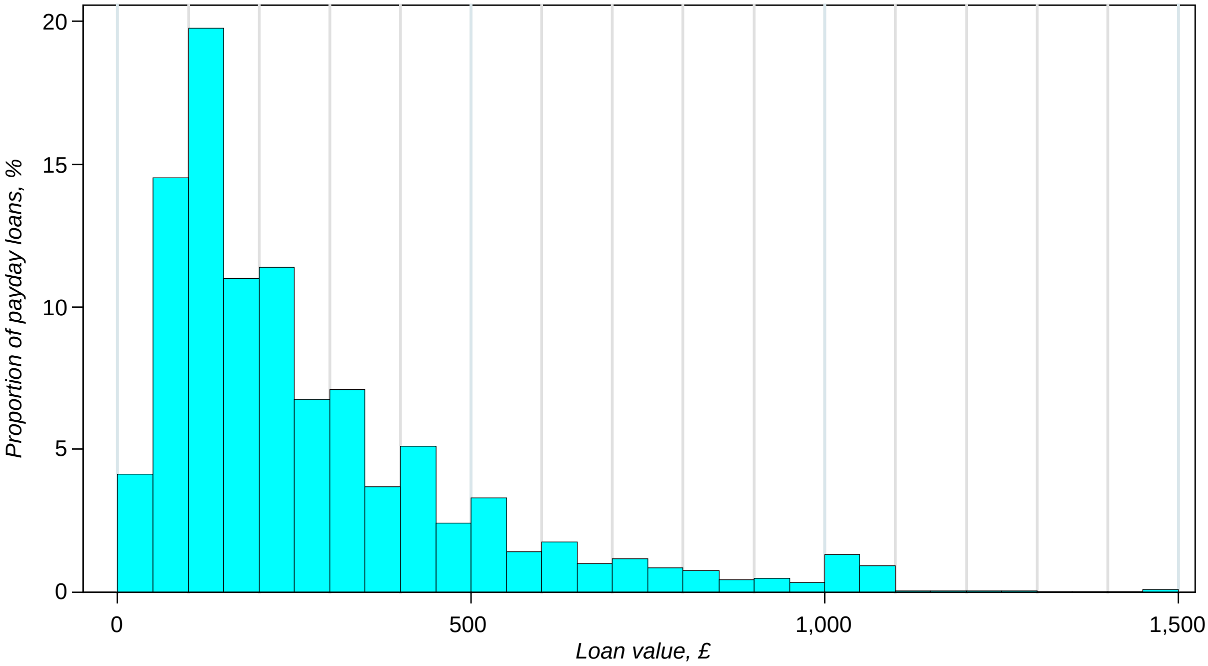
[12] Some lenders offer a 'text message loan' service, which allows customers to request a loan by sending a short message service (SMS) text message to a lender. However, these services require customers to create an account online.
[13] Source: Customer and transaction level descriptive presentation, slide 21.
[14] We describe the structure and operations of some of the largest lenders from paragraph **2.83**.

FIGURE 2.1

Distribution of loan values



Source: CMA analysis of transaction data.
Notes:
1. Analysis covers the 12 months to 31 August 2013.
2. Loan value includes top-ups made on the original loan but excludes any fees deducted from the sum advanced.

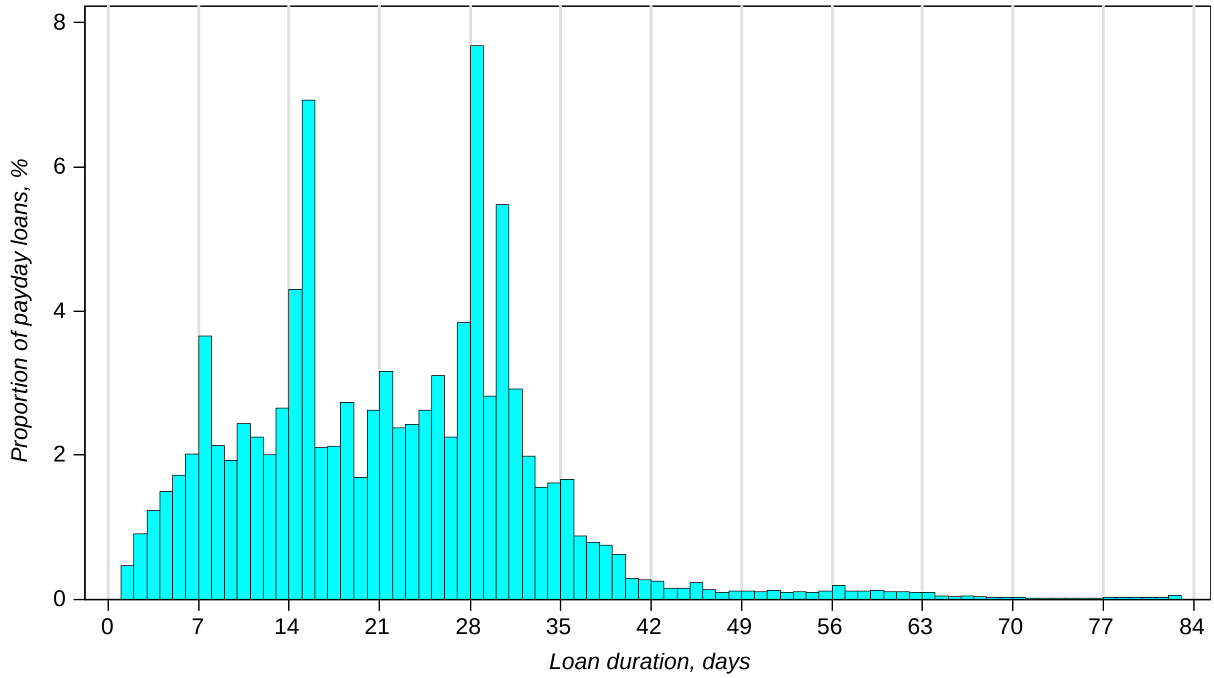
2.12 Payday loans are also typically issued for relatively short durations. Although some loans issued by the lenders from which we collected data were for a year or more, a clear majority of loans in our data set were shorter term. In particular, over 80% of loans in our data set had durations of 31 days or less, and over 95% had a duration of 90 days or less. Longer-term products generally allow customers to repay in several instalments, whereas shorter-term products are usually repaid in a single instalment.[15]

2.13 If we exclude longer-term instalment products from our data set (accounting for around 4.5% of all loans), the average duration of a payday loan is 22 days. 10% of customers borrow for a week or less, 90% for 34 days or less, and within this distribution we observe that loan durations of around a month (ie 28 to 31 days) and around a fortnight (ie 13 to 15 days) are particularly common. The average duration of a loan was slightly shorter online (21 days) than for high street customers (24 days).[16] Figure 2.2 shows the distribution of loan durations among the shorter-term products in our data set.

[15] See paragraphs 2.53 & 2.54 on the use of rollovers in the recent past.
[16] Customer and transaction level descriptive presentation, slide 27.

FIGURE 2.2

Distribution of loan durations



Source: CMA.

2.14 In contrast, instalment loans which some payday lenders offer are by their nature issued and repaid over a longer period. The duration of instalment loans varies by lender and product but typically last between two months and a year, though both longer and shorter loans may be payable in monthly or weekly instalments.

2.15 Payday loan products falling within the above definitions also vary in terms of the flexibility that they offer customers who want to borrow additional amounts. For example, some lenders allow customers to extend – or 'roll over' – an existing loan for an additional period if they pay off outstanding fees and interest. Historically different lenders have set different restrictions on how many times a loan can be extended: following new rules introduced by the FCA, no lender will be able to roll over a loan more than twice. In addition to roll-overs, some products allow customers to borrow further amounts – or 'top up' – during the course of a loan (see Section 3).

2.16 Building on the approach taken by the OFT and FCA, and in light of our own analysis described above, we have defined payday loans for the purpose of this investigation as being short-term, unsecured credit products which are generally taken out for 12 months or less, and where the amount borrowed is generally £1,000 or less. In line with our terms of reference, home credit loan agreements, credit cards, overdrafts, credit union loans and retail credit are all excluded from the scope of this investigation, though we consider the competitive constraint from these and other forms of credit in Section 5.

Characteristics of payday loan customers

2.17 We next briefly outline some of the characteristics of the people who use payday loans. We first summarise some demographic characteristics before discussing customers' incomes and their experience of credit and debt problems.[17]

Demographics

2.18 In our survey of customers, we asked about their background. We found that customers were disproportionately likely to be male and that customers were younger than the UK population as a whole (71% of customers were aged 18 to 44 compared with 46% of the population). Customers are also more likely to be working full-time than the population as a whole, and to live in larger households (as a result of having children), but this reflects the fact that customers are predominantly working age.

2.19 We discuss these characteristics in greater depth in Appendix 2.3.

Income

2.20 Both our survey and our analysis of lenders' transaction data suggested that the median income of an online payday lending customer was broadly similar to that of the wider UK population. High street borrowers typically had incomes below the UK average.

2.21 In our survey we found that 36% of all payday customers[18] had a net household income less than £18,000, 37% of customers had a net household income of £18,000 to £36,000 and 28% of customers had a net household income of greater than £36,000. However, 21% of customers responded that they did not know what their household income was and are not included in these figures. 23% of customers stated that they had a variable income. The distribution of payday loan customers' incomes is somewhat narrower than

[17] This subsection is based upon two principal sources of information, which we use throughout these provisional findings. The first is the customer research that we commissioned from TNS BMRB, and which was carried out between September and December 2013. This research included a telephone survey of 1,560 payday lending customers, and 37 depth interviews carried out face to face with payday borrowers. The second source is the transaction data, discussed in paragraph 2.6 above and Appendix 2.2, which provides detail on each payday loan issued by the 11 major lenders in the period January 2012 to August 2013, and the customers to whom these loans were issued.
[18] That is, of the 72% who were able or willing to state their income.

that for the UK population – with fewer individuals with particularly low or particularly high incomes.

2.22 Table 2.1 shows the distribution of yearly net personal income for the UK population and payday loan customers based on our transaction data, analysed further by borrowing channel. Median net individual income for all payday lending customers (£15,600) is lower than the national median (£17,100). However, the median net individual income of online customers (£16,500) is only slightly less than the national median whereas the median net income of high street customers (£13,400) is significantly less than the national median.[19]

TABLE 2.1 **Distribution of net annual income**

	Net annual income – percentile (£)				
	10th	*25th*	*Median*	*75th*	*90th*
UK*	8,800	11,700	17,100	26,300	39,000
All payday	9,200	12,000	15,600	21,600	28,800
Online	9,600	12,400	16,500	21,600	29,400
High street	7,000	10,200	13,400	17,900	23,200

Source: CMA analysis of transaction data; HMRC, Survey of Personal Incomes 2010/11.

Extent of previous credit or financial problems

2.23 We investigated whether payday lending customers had experienced any previous credit or financial problems within the last five years. 38% of customers had experienced a bad credit rating, 35% had made arrangements with creditors to pay off arrears, 11% of customers had experienced a county court judgment and 10% had been visited by a bailiff or debt collector. In total, 52% of customers had experienced one or more of these debt problems in the last five years. Customers over 45 years old and owner-occupiers were the most likely to have experienced financial problems.[20]

2.24 Customers who had used both high street and online lenders were more likely to have been turned down for credit (44% compared with 29% for all customers) in the last 12 months. This group of customers were also slightly more likely to have had no alternative form of credit available to them at the time of taking out their most recent payday loan (43% compared with 39% of all customers).[21]

[19] In the survey we similarly noted a significant difference between online and high street customers with respect to income. Whereas 60% of high street customers had a household income of less than £18,000 a year, only 28% of online borrowers fell into this category. 34% of online customers had a household income greater than £36,000 a year.
[20] TNS BMRB Survey Report, p30.
[21] ibid, p59.

How customers use payday loans

2.25 We next consider how customers use payday loans. We look at the following aspects of customer behaviour:

(a) We look first at the circumstances in which customers take out payday loans, including the reasons given for taking out a loan and the timing of loan applications (paragraphs 2.26 to 2.32).

(b) In paragraphs 2.33 to 2.42, we consider evidence on customers' repayment behaviour, including the extent to which customers repay payday loans in full on time, repay late, or roll over the loan. We go on to note the implications for customers of defaulting on repayments.

(c) In paragraphs 2.43 to 2.55 we consider whether customers' use of payday loans may be characterised as a 'one-off' event and examine the extent of repeat borrowing and customers' use of multiple lenders.

Circumstances in which customers take out payday loans

2.26 We asked customers what they had used their most recent payday loan for. 53% of customers told us that they had used the money for living expenses (such as groceries and utility bills), 10% of customers said the money related to a car or vehicle expense and 7% said general shopping such as clothes or household items.[22]

2.27 59% of customers told us that the expenditure funded by their payday loan was for something that they could not have gone without. Had a payday loan not been available, 31% of all customers said they would have borrowed from friends or family and 29% would have gone without. Of those 59% of customers who told us they could not have gone without the expenditure incurred, 24% said that had payday loans not been available they would have gone without.[23] The qualitative research suggests that customers' mindsets at the time of taking out a loan tended to push their perception towards apparent need, exaggerating their need for a loan, but in retrospect, customers thought that the expenditure could have been forgone or delayed.[24,25]

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[22] ibid, p68. Other less common types of expenditure (where 4% or less of those surveyed made reference to them) included holidays, paying off other loans (both payday and non-payday), rent and mortgage payments, presents and gifts, replacing broken household items and socialising.
[23] ibid, p72.
[24] ibid, p73.
[25] The qualitative research suggests an explanation that the apparent contradiction between the necessity of the expenditure the loan funded and the customer's likely action had credit not been available can be understood that a customers' initial claim that they could not go without could reflect a customer's mindset at the time of taking out the loan. The research suggested that customers may be justifying their need for a loan to themselves

2.28 When asked what the money was used for in an open question, only 2% told us that it was to pay off another payday loan, though 25% of all customers (and 36% of those who had previously had a loan) had paid off a payday loan in the previous month.

2.29 We asked customers why they had needed to take out a payday loan. 52% said the loan was linked to an unexpected increase in expenses or outgoings and 19% said the need was due to an unexpected decrease in income.[26] 93% of those who said their need was due to a change in financial circumstances thought this change was temporary, whereas 5% expected the change to be permanent.[27]

2.30 We considered whether repeat borrowers used payday loans for different purposes than other customers who used payday loans only once. Our qualitative research suggested that once a customer had taken out their first loan, the reasons for taking out subsequent loans evolved over time, shifting from paying for necessities to satisfying more general wants and desires.[28] We also noted that customers who had used three or more lenders and those who had taken out both online and high street loans were more likely to have needed to repay a previous loan in the month before. We discuss repeat borrowing in greater depth in paragraphs 2.43 to 2.55.

When are loans taken out?

2.31 Our analysis of the transaction data for the 12 months to August 2013 found that the number of loans taken out on a Friday was around three times greater than the number of loans taken out on a Sunday, and around 50% more than for other days of the week. The distribution of loans by the day on which they were issued is shown in Figure 2.3.

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at the time of taking it out, and therefore repeat this rationalisation later when asked about their reasons for getting a loan. TNS BMRB Survey Report, p74.

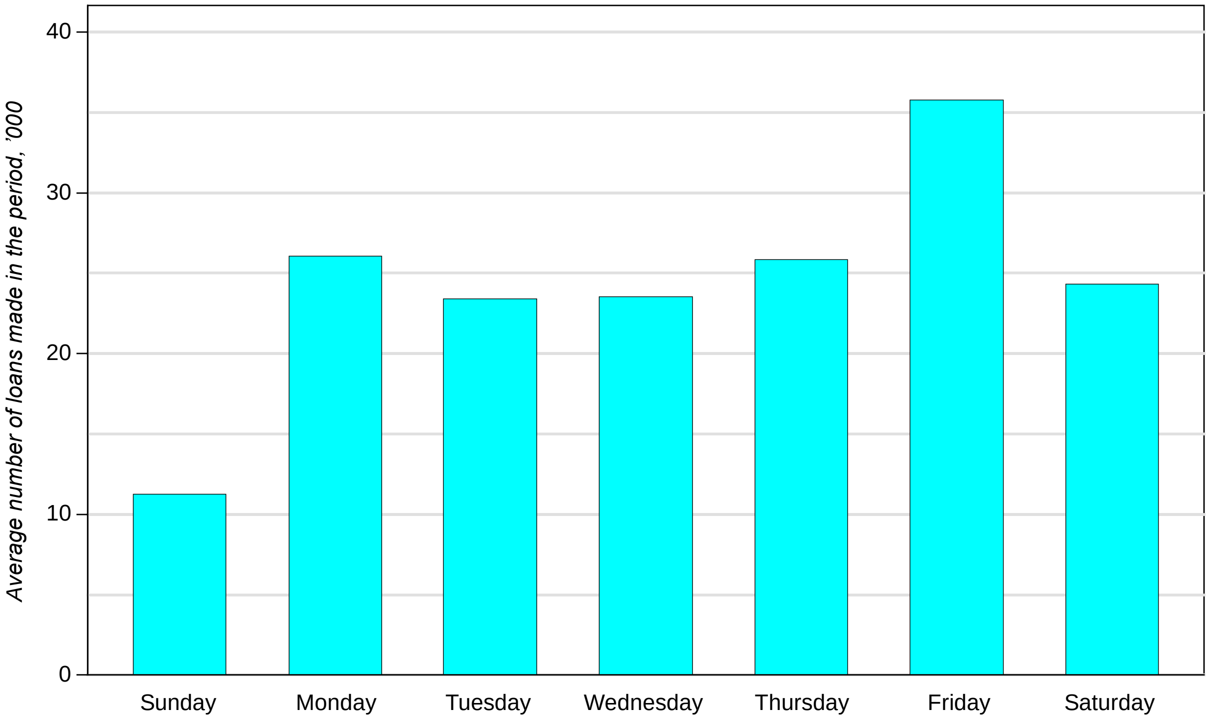
[26] ibid, p70. 31% said that their need was not linked to unexpected changes in income or expense.

[27] ibid, p70. The remaining 2% did not know.

[28] ibid, p75

FIGURE 2.3

Number of loans taken out by day of the week

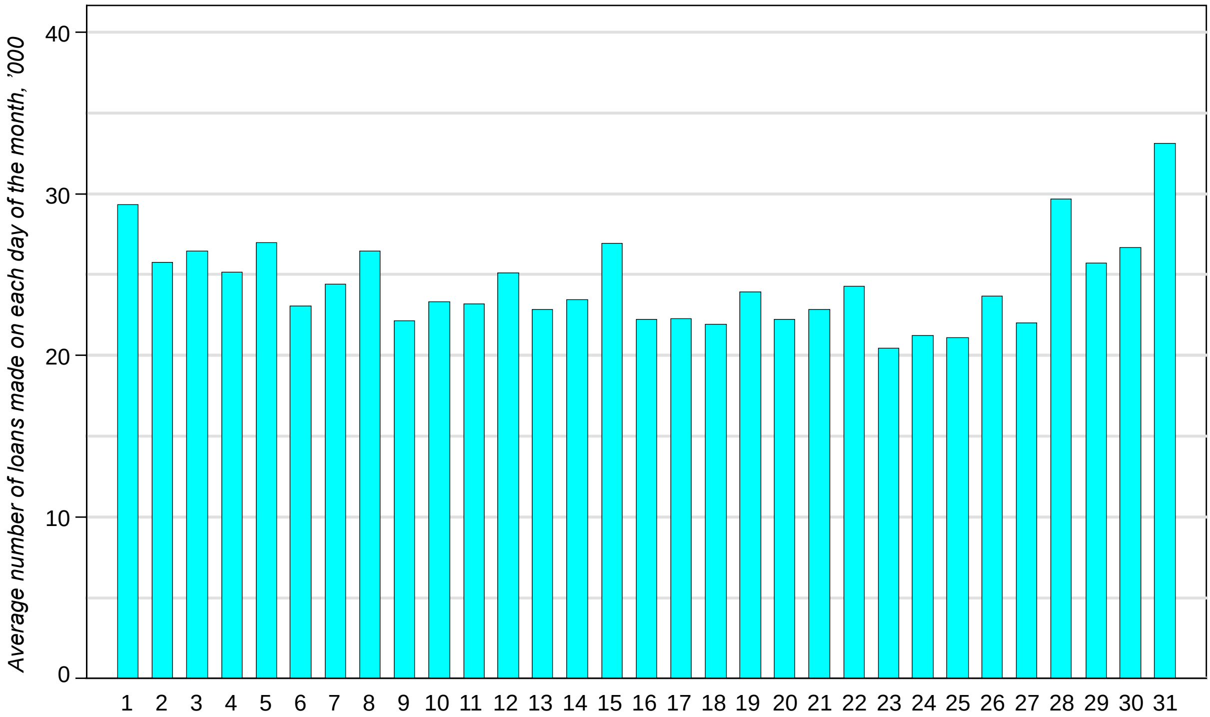


Source: CMA analysis.

2.32 We also considered the distribution of loans by the day of the month, which is shown in Figure 2.4. Although more loans are taken out at the beginning and end of a month, significant amounts of lending occur throughout the month.

FIGURE 2.4

Number of loans issued by day of the month



Source: CMA analysis.

Repayment

2.33 Our analysis of the transaction data found that 64% of payday loans issued in calendar year 2012 were repaid in full either early or on time. 22% of loans were repaid in full late (ie after the originally agreed repayment date) – often as a result of having been rolled over. 14% of these loans had not been repaid in full as at October 2013.[29]

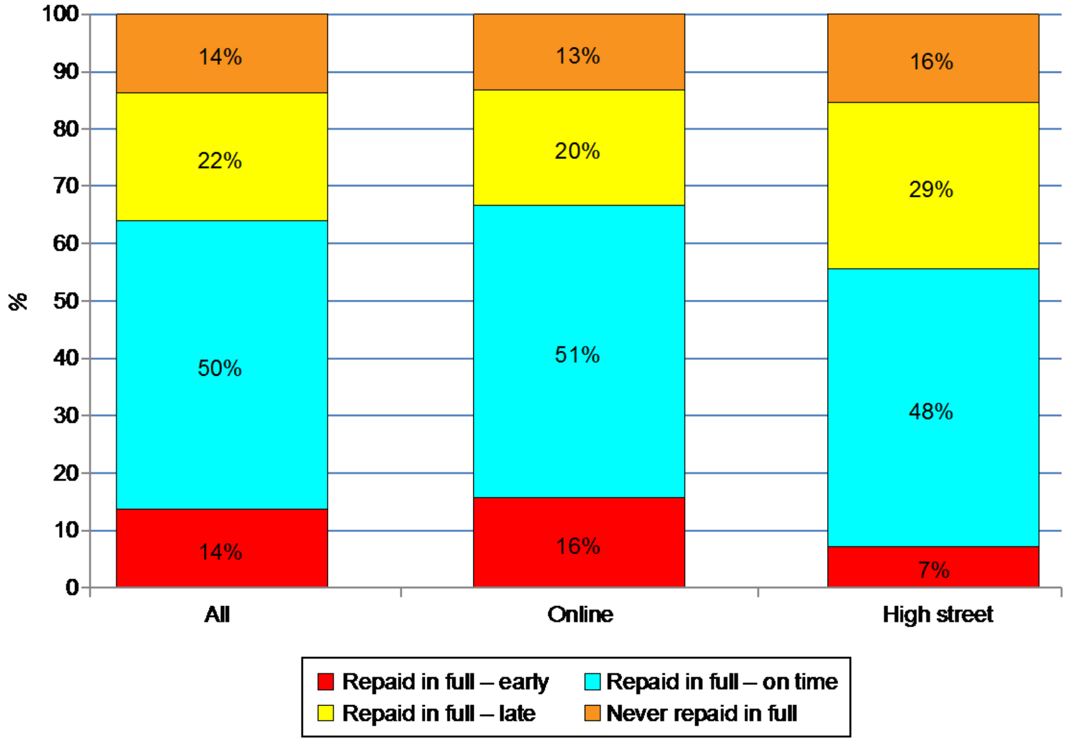
2.34 Figure 2.5 shows that 55% of high street loans were repaid in full on time compared with 67% for online loans.[30] Figure 2.6 shows that repayment rates also varied significantly by lender, with the proportion of loans being paid in full either early or on time varying from around 20% ([✂]) to 80% ([✂]).[31] 67% of repeat loans (loans taken by customers who have previously taken a loan with the same lender) were repaid in full either early or on time, which compared to 50% of new loans.[32]

[29] This will include loans where customers had either defaulted or rolled over.
[30] Customer and transaction level descriptive presentation, slide 31.
[31] ibid, slide 32.
[32] ibid, slide 33.

FIGURE 2.5

Repayment status of loans

All loans issued in 2012, status as of 1/10/2013

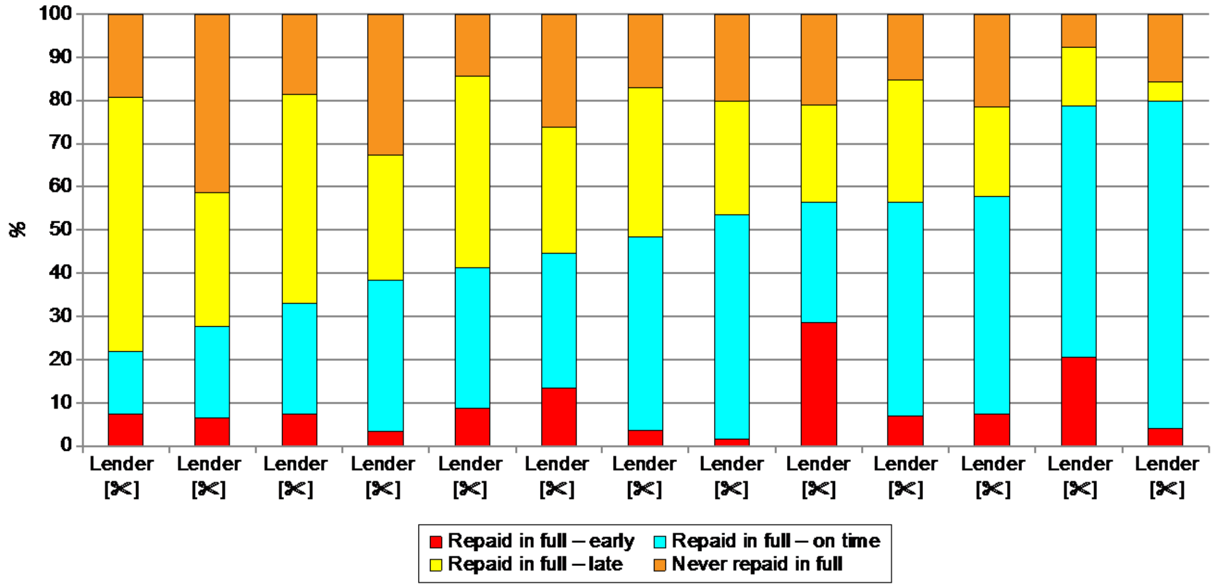


Source: CMA analysis of transaction data.

FIGURE 2.6

Repayment status by lender

Loans issued in 2012, repayment status as of 1/10/2013



Source: CMA analysis of transaction data.

2.35 Our survey found that the following groups of customers were less likely to have repaid their loan in full on or before the scheduled repayment date:

(a) customers who felt themselves not to have a good understanding of financial conditions and terms;

(b) customers with past financial problems (including having previously been refused for payday loans); and

(c) customers who had used a greater number of payday lenders.[33]

Expectation and ability to repay

2.36 When asked how confident they were when taking out the loan that they would be able to repay it by the agreed date, 80% of customers responding to our survey reported having been very confident and 15% having been fairly confident.[34]

2.37 Just over half (52%[35]) of the 18%[36] of customers who had failed to repay their loan on time stated that the total repayment amount had been more than they had expected, which contrasted with 13% of those customers who had repaid their loan in full and on time. This may suggest that either the customers most likely not to repay their loan were those customers who were not able to calculate, or misunderstood the repayment amount, or alternatively that those customers which had not repaid in full had not anticipated additional late charges (for example, as a result of not anticipating being unable to repay the loan in full on time).[37]

2.38 17% of customers reported having found getting money to repay their loan to be more difficult than expected. Certain groups of customers were more likely to find getting the money more difficult than they expected, including customers: (i) who had previously taken out payday loans in order to pay off debts to other payday lenders; (ii) with a poor understanding of financial terms and conditions; (iii) who had been refused loans previously; (iv) who had experienced debt problems in the last five years and (v) who said they took out a payday loan as a last resort.[38]

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[33] TNS BMRB Survey Report, p117.
[34] ibid, p95.
[35] ibid, p120.
[36] ibid, p117.
[37] ibid, p120.
[38] ibid, p121.

Defaulting on payments

2.39 In the payday lending sector, the implications of late payment vary from lender to lender. Typically a customer could be charged a late payment fee and would accrue interest on the outstanding balance. Often a lender will make further attempts to collect money owed from the customer in either one payment or in several amounts on a continuous basis.

2.40 Lenders could also charge the customer a missed payment fee[39] and interest would continue to accrue.

2.41 Information in relation to failed payments may affect the customer's ability to obtain credit in the future as a result of lenders informing CRAs of the default. The Consumer Credit Act 1974 (CCA), as amended by the Consumer Credit Act 2006, sets out additional requirements in relation to default:

(a) A creditor must give the borrower a notice of sums in arrears, plus an arrears information sheet at intervals of six months until the borrower is no longer in arrears, or until a judgement is made regarding the amount owed.

(b) A creditor cannot enforce an agreement during the time it fails to comply with this requirement and the borrower would not be liable to pay interest during this time.

2.42 Under the Consumer Credit Act sections 87 and 88, as amended by the Consumer Credit Act 2006 section 14, it is necessary to serve a Default Notice and give the customer 14 days to remedy the breach of the agreement specified in it. This applies to all notices served after this date, regardless of when the agreement was made or the default occurred. It must set out what action it intends to take if the borrower fails to make the payment.

Repeat borrowing

2.43 Our analysis suggests that customers' demand for payday loans is typically recurring, and that a large proportion of customers return to the same lender for further credit after taking out their first loan. We consider first repeated borrowing with the same lender before considering borrowing across multiple lenders.

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[39] See Appendix 4.1, Tables 3 & 4, for details of additional charges.

Repeat borrowing with a single lender

2.44 Looking at repeat borrowing from a single lender, our analysis suggests that more than 80% of all loans (excluding rollovers) issued by the major lenders in 2012 were to customers who had previously borrowed from them. Considering a customer taking out a loan with a lender for the first time in the first 8 months of 2012:[40]

(a) 60% took out at least one further loan from the same lender during the subsequent year;

(b) 21% took out more than five additional loans from the same lender during the subsequent year; and

(c) the average number of additional loans that a customer went on to take out from the same lender within a year of the first was 3.6.

2.45 Furthermore, we found that around 40%[41] of customers of the 11 major lenders had a borrowing relationship with that lender of more than one year.[42] The extent to which customers return to a lender for further loans varies considerably across lenders. Figure 2.7 shows the proportion of each of the major lender's loans in 2012 which were to repeat customers. This proportion ranges between 27% ([✂]) and 89% ([✂]). Notwithstanding this variation, it is worth noting that for most lenders more than half of all loans are to repeat customers – and for many lenders the proportion is much greater than this.

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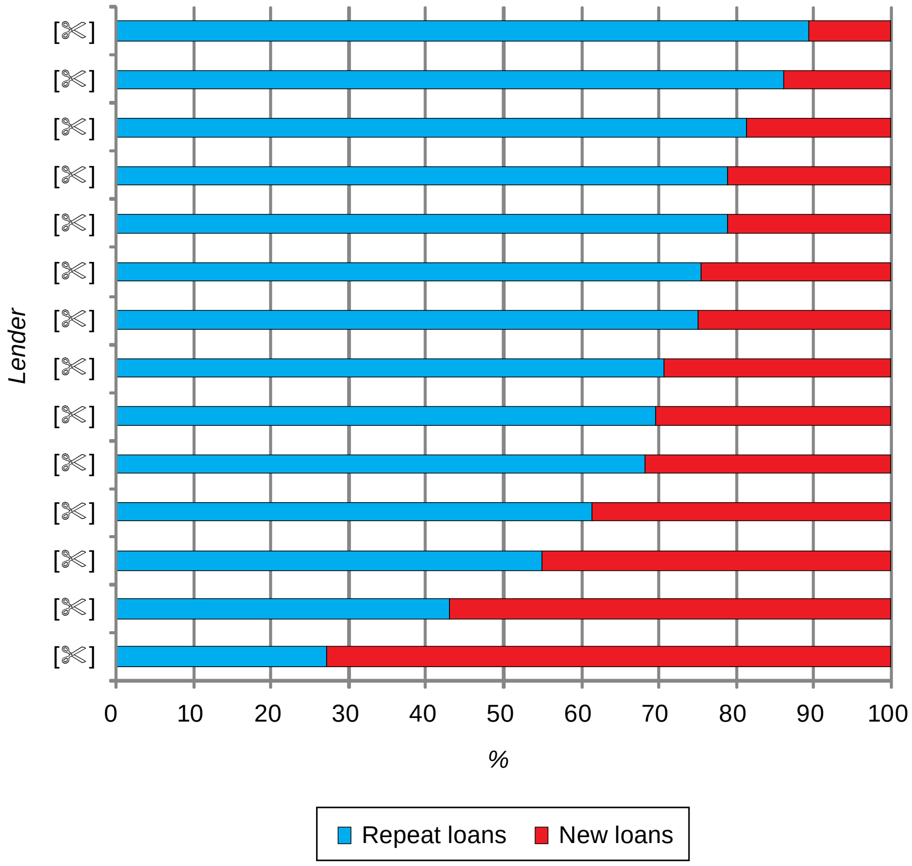
[40] See 'Repeat customers—presentation based on analysis of the transaction data' for further details.
[41] As of August 2013.
[42] We discuss this in more detail in Section 7.

FIGURE 2.7

New customers vs repeat customers – number of loans



Source: CMA's analysis on lenders' transaction data.

2.46 Some of the repeat borrowing that we observe in the payday market takes the form of 'top-ups' (where lenders[43] offer customers the ability to borrow additional amounts by topping up an outstanding loan to a predefined credit limit – see Appendix 2.1 for further details). For example, [✂].[44]

Borrowing across multiple lenders

2.47 Many payday loan customers borrow from more than one lender, suggesting that the extent of repeat borrowing among payday loan customers is greater than indicated by our analysis of an individual lender's transaction data.

2.48 To estimate the extent to which customers borrow from multiple lenders, we selected a sample of over three thousand loans at random from the transaction database (see Appendix 6.2 for further details of this sample).

[43] Facilities of this type are offered by Wonga, CashEuroNet (Pounds to Pocket and QuikQuid Flexicredit), Dollar (Payday Express and Instant Cash Loans), SRC, The Cash Store, Pay Day Loans and KwikLoan (H&T) and SRC (SpeedyCash Flex Loan).
[44] [✂]

Each customer identified within our sample was matched across lenders using a combination of their surname, postcode and date of birth. Information on the loans issued to these customers by smaller lenders was then added by matching in data provided by a number of CRAs.

2.49 A reweighting exercise was then carried out so that the sample was representative of payday loan customers in 2012.[45] Using this reweighted sample, we estimated that 76% of payday loan customers took out more than one loan in 2012 either with the same lender or with different lenders. 41% took out 2 to 5 loans, 20% took out 6 to 10 loans and 15% took out more than 10 loans. On average, a payday loan customer took out 5.7 loans in 2012.

2.50 Around four in ten customers (38%) in the sample borrowed from at least two different lenders during the year. 27% of customers borrowed from two or three lenders and 11% borrowed from more than three lenders. On average, a customer borrowed from 1.9 lenders.

2.51 These findings are broadly consistent with the results of our customer survey (as well as the submissions of various lenders[46]) which found that 45% of all customers interviewed had ever used more than one lender; 79% had taken out more than one loan and around a third had taken out more than five loans.[47]

2.52 Our survey also suggested that there may be some relationship between a customer's financial behaviour and the extent to which they take out more than one loan and/or use multiple lenders (see Figure 2.8 below):

(a) 85% of payday loan customers who had used sources of credit other than payday loans in the last 12 months had taken out more than one loan

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[45] Reweighting was required because the sample was constructed by selecting loans issued in 2012 at random, rather than customers, and so borrowers taking out relatively few loans in the period would otherwise have been relatively unrepresented. Each customer was assigned a weight according to their probability of being included within the original sample. These weights were generated using the ratio of the total number of customers who took out a given number of loans in the population, divided by the number of such customers in the sample. So, for example, if customers taking out one loan in the period made up 5% of the population but 1% of the sample, then these individuals would receive a weight of 5. Note that the weights applied differ to those underpinning the analysis reported in the presentation on *Customers' use of multiple lenders*, publish 9 April, explaining the difference in the estimates presented in that paper and those reported here.

[46] For example, Wonga told us that [✂] of its inactive customers were using other payday lenders (see Wonga's response to the annotated issues statement (paragraph 1.16)). CashEuroNet submitted the results of a survey ([✂]) which asked respondents about the lender that customers had used before taking out their loan with QuickQuid. [✂]% of respondents reported having used another payday lender, higher than the proportion of customers who reported having previously taken out a loan from QuickQuid itself ([✂]). Dollar submitted that the evidence resulting from the analysis of transaction data and customer survey suggested high rates of churn (See Dollar's response to the annotated issues statement, paragraph 7.13).

[47] Broadly similar results were also found when, instead of sampling, we simply matched all loans in the transaction database on the basis of the customer's surname, date of birth and postcode. Although a lower proportion of customers were found to have used more than one lender (30%) and on average customers were estimated to have taken out fewer loans (5.2) using this approach, this would be expected given that the transaction data does not include any loans issued by smaller lenders.

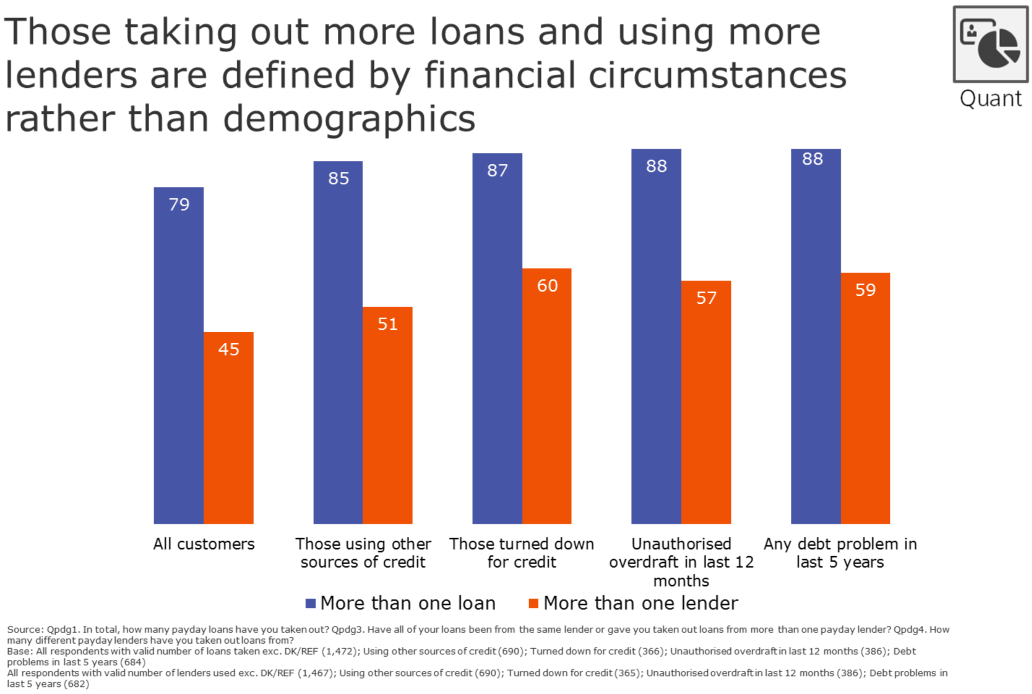
compared with 73% of customers who had not used other sources of credit in this period.

(b) Customers who experienced credit or debt problems[48] were more likely than average to have had more than one payday loan and were also more likely than average to have used more than one payday lender.

(c) Customers with an unauthorised overdraft, who had been turned down for credit in the last year, or who had a debt problem in the last five years, had used an average (median) of two payday lenders whereas the average (median) number of lenders used across all customers was one.

FIGURE 2.8

Customers' financial behaviour and use of multiple lenders – CMA customer survey



Source: CMA customer survey.

Rollovers

2.53 In addition to taking out new loans, many borrowers extend the duration of their credit from their current lender by rolling over an existing loan (see paragraph 2.14).[49] Our analysis of the transaction data found that in 2012,

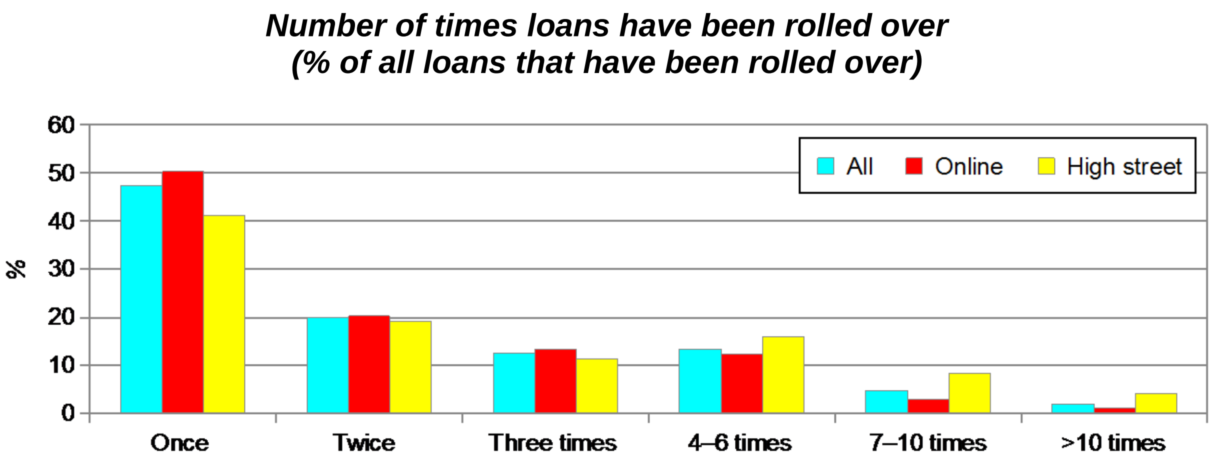
[48] Customers who had been turned down for credit, who had an unauthorised overdraft in the last 12 months, and / or who had a debt problem in the last five years.
[49] Some lenders charge a fee for rolling over a loan; however, interest rates remain the same as during the original term of the loan.

around 20% of the loans taken from the 11 major lenders were subsequently rolled over – with 16% of online loans and 26% of high street loans rolled over.[50]

2.54 Figure 2.9 shows that of those loans that were rolled over, about 50% of online loans were rolled over more than once, compared with around 60% of high street loans.[51] On average, loans which were rolled over were rolled over 2.5 times.

FIGURE 2.9

Distribution of the number of times a loan is rolled over



Source: CMA analysis of transaction data.

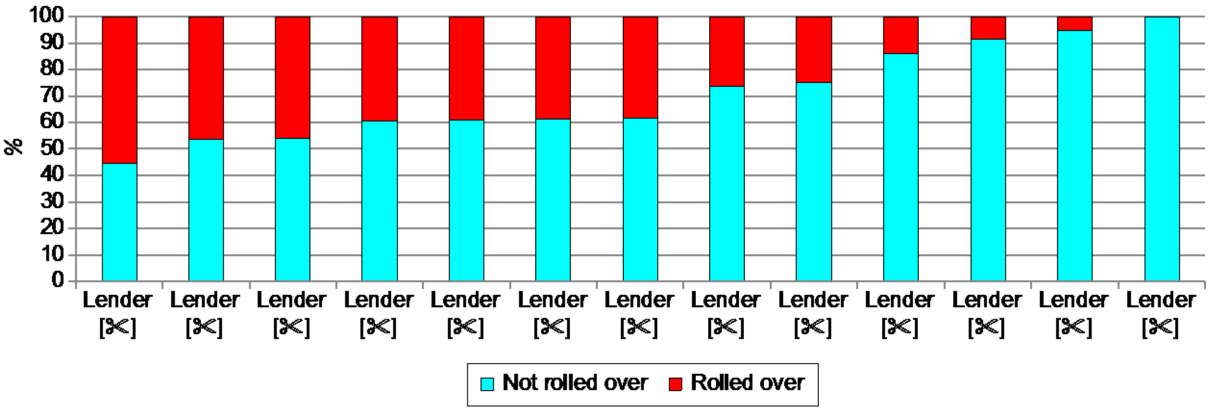
2.55 Again, the extent to which customers roll over their loans varies significantly across lenders. Figure 2.10 shows the proportion of loans that have been rolled over by lender. The proportion of loans rolled over varied from 0% to 55%.

[50] Customer and transaction level descriptive presentation, slide 42.
[51] ibid, slide 44.

FIGURE 2.10

Proportion of loans rolled over by lender

Proportion of loans issued in 2012 that have/have not been rolled over



Source: CMA analysis of transaction data.

2.56 We considered the significance of rollovers to payday lenders' revenue. To do this, we took all loans issued by the 11 major lenders in 2012, estimated the total value of fees and interest charged on those loans (with certain exceptions due to data limitations – see footnote), and calculated the proportion of these charges that was accounted for by rollover fees and interest.[52] We estimated that that this proportion was 32% for online lenders, and 40% for high street lenders.

2.57 One limitation of this approach is that it reflects revenues accrued, rather than revenues received by a lender, and so does not take into account differences in the extent to which customers that rollover their loan actually repay the amount owed. To allow for this, we adjusted the estimates to take into account the difference between the proportion of rolled-over loans which were never repaid in full compared with the proportion of loans that were not rolled over which were never repaid in full. This resulted in slightly lower estimates of the importance of rollover fees and interest: 29% for online lenders and 36% for high street lenders.[53]

High street and online distribution channels

2.58 Payday loans can be taken out either from an online lender or on the high street. Payday loans issued online are taken out by customers visiting a

[52] This estimate excluded late fees and interest, top-up charges and some discounts (eg for early repayment), because complete and consistent information on these charges/discounts were not available in our data set.
[53] These estimates were derived by deflating the proportion of charges accounted for by rollovers using the difference in the proportion of loans which were rolled over which were never repaid in full, and the proportion of loans which were not rolled over which were never repaid in full.

lender's website[54] having accessed the site directly or through an Internet search, or through intermediaries such as brokers, lead-generators or other advertisers: each of these routes is considered in paragraphs 2.120 to 2.139 below. Customers applying online then complete an application form, though the process may differ if the customer is matched to a lender through an intermediary. High street customers visit retail premises where a member of staff may lead the customer through the application process and customers may be required to provide physical evidence of income and identity. The nature of the loans issued by the two channels do not differ, but the ways in which lenders attract customers and process customer applications do. These are discussed in greater detail in the following section.

2.59 Most payday loan customers borrow online. Our survey found that 83% of payday lending customers have taken out a loan online and 29% of customers have taken out a payday loan on the high street.[55] There is some overlap, with 12%[56] of customers having used both channels. Of those individuals who have used both channels, a clear majority (78%) mainly use online loans.[57] The average amount borrowed on the high street (£180) was lower than that borrowed online (£290).[58]

2.60 Our survey found that 78% of customers used online lenders either exclusively or as their main payday loan provider. We found that a higher proportion of men,[59] younger customers, those in full-time work, those educated to degree level or above, and those on middle or higher incomes were likely to have used online lenders as their main or only payday loan provider.[60] The extent of these groups' use of online lenders is shown in Table 2.2.

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[54] Either using a PC, tablet or a smartphone
[55] TNS BMRB Survey Report, p41.
[56] 71% of customers only used online and 17% only used high street.
[57] TNS BMRB Survey Report, p42.
[58] Customer and transaction level descriptive presentation, slide 21.
[59] This difference was relatively small, and our analysis of lenders' transaction data did not find a difference in the gender balance of high street and online customers (weighted by the number of loans) – see customer and transaction level descriptive presentation, slide 8. Gender information is missing from the transaction data for around one-third of all records.
[60] TNS BMRB Survey Report, p48.

TABLE 2.2 **Customer groups more likely to use online lenders**

Customer group	*% of that group using online lenders*
All customers	78
Gender	
Men	82
Age:	
18–24	88
25–34	86
Employment status	
Full-time worker	84
Level of education	
Higher	84
Income	
Middle	83
Higher income	90

Source: TNS BMRB Survey Report, p48.

2.61 Customer groups which were significantly more likely to have used high street lenders exclusively or as their main payday loan provider included: women; older customers; social renters; those in part-time work or unemployed; lone parents; those with no academic qualifications; and those on low incomes. The extent of these groups' use of high street lenders is shown in Table 2.3.

TABLE 2.3 **Customer groups more likely to use high street lenders**

Customer group	*% of that group using high street lenders*
All customers	20
Gender	
Women	23
Age	
45+	26
Housing tenure	
Social Renters	29
Employment status	
Part time worker	26
Unemployed	29
Household composition	
Lone parents	24
Level of education	
No qualifications	37
Income	
Low	31
Access to banking facilities	
No bank account	30

Source: TNS BMRB Survey Report, p49.

2.62 As set out in paragraph 2.22, high street customers generally had lower incomes than online customers or the population as a whole. Our analysis of lenders' transaction data found that the median net individual income of a high street borrower was £13,400, some £3,100 lower than for online borrowers (£16,500).[61]

[61] Customer and transaction level descriptive presentation, slide 10.

2.63 Coding of respondents' residential postcodes using the ACORN classification system indicated that high street customers are more likely than online customers to come from areas classed as 'urban adversity' or 'financially stretched'.[62]

2.64 More detailed comparisons of the characteristics of users of different channels are included in the Survey Report and in the underlying tables.[63] We discuss customers' perceptions of different distribution channels in Section 5.

The process of applying for and taking out a payday loan

2.65 In Appendix 2.4, we describe the loan application and approval processes of online and high street lenders.

2.66 The nature of the application process is necessarily different for online and high street lenders, although both collect similar types of information during the application process. There is also some variation in the approach taken by different lenders within each distribution channel. For example, some online lenders (such as Wonga) operate an almost exclusively automated process for verifying customer details and assessing customers' creditworthiness, whereas others (such as WageDay) will use a combination of automated and manual techniques.

2.67 Generally lenders collect the following information from an applicant:

(a) the amount of the loan requested;

(b) personal details, including name, address, residential status, date of birth, email address and telephone number;

(c) income details, such as employment type, net monthly pay, pay frequency, pay date, employment sector and time at current job;

(d) personal expenditure details (discussed further in paragraph 2.69);

(e) bank details, ie account name, sort code, account number; and

(f) debit card details, including card type, card number, expiry date and security code.

[62] In addition, the use of high street lenders is particularly prevalent in London, which accounts for 24% of customers of high street lenders, as compared with 14% on online customers. Source: TNS BMRB Survey Report, p57.
[63] www.gov.uk/cma-cases/payday-lending-market-investigation#cc-commissioned-research.

2.68 For verification purposes, high-street lenders usually require sight of a customer's ID and proof of address while online lenders require a customer's mobile phone number.

2.69 We found that there was generally greater diversity in the nature and quantity of information required about a customer's expenditure (including credit commitments and existing debt balances) than in the other types of information requested. Some lenders do not require applicants to provide any information on expenditure or existing commitments.

2.70 The minimum eligibility criteria applied by all lenders are that a customer must be a UK resident and over 18 years of age. Individual lenders specify different additional requirements. An assessment of eligibility is included in the application process.

2.71 Having collected information from an applicant and established their eligibility, lenders will consider the individual's creditworthiness and their likelihood of successfully repaying the loan. To perform credit risk assessments, lenders typically analyse information collected during the loan application process, any information held about the applicant internally (eg their repayment history if they are a returning customer), and relevant third party information sources (eg information purchased from CRAs). Most lenders have developed their own automated risk models, of varying degrees of sophistication, to help them make decisions about the creditworthiness of potential applicants, developed using historical customer information. These models may support, or in some cases largely replace, manual assessments of a customer's creditworthiness.

2.72 For online customers an application form generally takes 5 to 10 minutes to complete. Once submitted, the lender verifies customer details and completes affordability and risk assessments. The time taken to do this will be determined partly by the extent to which manual checks are also required (eg confirming the customer's employment details). The customer will then either be approved or declined.

2.73 Once a customer's application has been approved, the funds will be transferred to the customer's bank account. In most cases this takes place on the same day, often in a couple of hours, though some lenders offer a basic service using a BACS transfer which may take up to two to three days (typically these lenders also offer a same-day transfer, for which they charge an additional fee).

2.74 We discuss the loan application and approval process in greater depth in Appendix 2.4.

Market size and structure

2.75 We collected information about the size and structure of the payday loan market by issuing detailed questionnaires to 11 major payday lenders and a further shorter questionnaire to 213 parties which had been identified as possible payday lenders.[64] Further details of this exercise and our analysis are set out in Appendix 2.5. Based on this analysis, we estimated that there were at least 90 payday lenders offering loans to UK customers as of October 2013.[65]

Size of the market

2.76 As shown in Table 2.4, during the 2012 financial year, total payday loan revenue was around £1.1 billion, with lenders issuing approximately 10.2 million payday loans (excluding rollovers), worth £2.8 billion.[66] These figures represented a 35 to 50% increase on the preceding financial year (depending on the way in which the size of the market is measured) though more recent data indicates that this rate of growth has reduced substantially in 2013. We estimate that there were around 1.8 million payday loan customers in 2012.[67]

TABLE 2.4 **Total revenue, value and number of payday loans issued, financial years* 2011 and 2012**

Totals	*2011*	*2012*	*Growth %*
Number of loans (million)	7.4	10.2	37
Value of loans advanced (£m)	1,926	2,810	46
Revenue earned (£m)	755	1,091	44

Source: CMA analysis.

*See Appendix 2.5 for a description of how different lenders' financial years have been treated. For each lender in each financial year, payday loan revenue refers to the total income generated by each lender's payday lending operations, payday loan volume refers to the number of new loans issued by each lender and payday loan value refers to the total loan amount issued by each lender.

[64] The list was drawn up from a range of sources including: companies in a list of lenders compiled by the OFT, members of the BCCA, Consumer Credit Trade Association (CCTA) and the Consumer Finance Association (CFA) trade associations, a desktop review; and lists of competitors provided by lenders in response to our initial letter.
[65] This figure may underestimate the total number of lenders to the extent that not all lenders responded to our questionnaire, or we were unable to identify all relevant potential lenders. However, we would expect any lenders that are missing from this list to be limited to firms with very small-scale lending activities, such that their omission would not materially affect our assessment of the market size or structure.
[66] The figures for revenue, volume and value may not always correspond because not all lenders could provide full information on all these metrics.
[67] We derived this estimate by dividing the total number of loans issued in 2012 in Table 2.4 (10.2 milllion) by our estimate of the average number of loans held by a payday lending customer in a 12-month period as set out in paragraph 2.49.

Shares of supply

2.77 Table 2.5 reports estimated total payday revenue and shares of supply for the ten largest payday lenders. In 2012, Wonga—the largest payday lender—had a [20–30]% share of total payday revenue, a [30–40]% share of all loans (excluding rollovers) by volume and a [40–50]% share of all loans (excluding rollovers) by value.[68] The three largest lenders by revenue had a share of just under 70% of total payday revenue, over 65% of payday loans issued and over 75% of loan value; the ten largest lenders by payday revenue accounted for more than 90% of total payday revenue, 85% of loans issued and just under 95% of loan value.

2.78 We note that the different characteristics of lenders' products may drive differences between a lender's share of revenue, value and volume. For example, all else equal, a lender offering an instalment product might be expected to issue higher-value loans on average compared with a lender offering a 30-day fixed term product – and hence have a higher share of total loan value and revenue, relative to the total number of loans issued – because of the longer repayment period.

TABLE 2.5 **Shares of supply of the ten largest lenders, financial year* 2012**

%

Lender	*Share of 2012 total loan revenue*	*Share of 2012 total loan value (excl rollovers)*	*Share of 2012 total loans issued (excl rollovers)*
CashEuroNet†	[10–20]	[10–20]	[5–10]
CFO Lending Limited (CFO Lending)	[0–5]	[0–5]	[0–5]
Cheque Centres Group Limited‡	[0–5]	[5–10]	[5–10]
Dollar	[20–30]	[10–20]	[20–30]
Global Analytics	[0–5]	[0–5]	[0–5]
MYJAR	[0–5]	[0–5]	[0–5]
Oakam	[0–5]	[0–5]	[0–5]
PDL Finance	[0–5]	[0–5]	[0–5]
SRC	[0–5]	[0–5]	[0–5]
Wonga§	[20–30]	[40–50]	[30–40]
Other lenders	[5–10]	[5–10]	[10–20]
Total	100.00	100.00	100.00

Source: CMA analysis.

*See Appendix 2.5 for a description of how different lenders' financial years have been treated.
†Pounds to Pocket instalment loans are included in CashEuroNet's total figures.
‡Cheque Centres instalment loans are included in Cheque Centres total figures.
§Wonga has undergone a corporate restructuring which may affect the extent to which its year-on-year figures are comparable with other lenders.

Concentration in online and high street lending

2.79 In the 2012 financial year, online lenders issued £2.3 billion of loans, which is around 81% of all loans by value, with high street lenders issuing the

[68] Wonga's share of revenue relative to its share of the value and volume of loans issued appears to be driven by the payment behaviour of its customers. The possible causes for disparities in shares of revenue, value and volume are discussed further in paragraph 2.78.

remaining £0.5 billion of loans. Online lenders also accounted for similar proportions (70 to 80%) of total loan revenue and volume of payday loans. These proportions did not change significantly relative to the previous financial year though there has been a longer-term trend towards online lending.

2.80 Looking just at the online payday lending sector, we estimate that the largest lender – Wonga – has a [30–40]% share of total online payday lending revenue; the three largest online firms by payday lending revenue have just under a 75% share and the five largest online firms by payday lending revenue have over an 80% share. Since 2008 Wonga's share of payday loan revenue among the five[69] largest online lenders has increased substantially, CashEuroNet's share has also increased, while Dollar's share of online payday lending revenue has fallen considerably.

2.81 Focusing on the high street, we estimate that Dollar Financial UK Limited (Dollar) – the largest high street lender – had a [50–60]% share of total high street payday lending revenue, the three largest high street firms by payday lending revenue have over an 80% share and the five largest high street firms by payday lending revenue have over a 90% share.

Payday loan providers

2.82 All payday loan providers seek to attract potential customers and issue loans. However, in addition to the choice of whether to issue loans online or on the high street, the methods that lenders use to attract customers (which are described below in paragraphs 2.119 to 2.139 in other market participants), and the profile of those customers may vary across lenders. We discuss price and non-price competition and profitability of lenders in Section 4. Further, each lender will experience different levels of default (see Section 7), rollovers (paragraphs 2.53 to 2.55) and repeat borrowing (paragraphs 2.43 to 2.46).

2.83 In this subsection, we set out information on 14 payday loan providers arranged broadly by size into three groups:

(a) First, we set out detailed descriptions of the top three payday lenders:

(i) CashEuroNet UK, LLC (CashEuroNet);

(ii) DFC Global Corporation (DFC), trading in the UK as Dollar; and

(iii) WDFC UK Ltd (Wonga, formerly Wonga.com Limited).

[69] Dollar acquired Payday Express in the 2007 financial year.

(b) Secondly, we describe eight other major lenders to which we sent detailed market and financial questionnaires. These companies offer a range of single repayment and instalment loans which fall within our definition of a payday loan and include the largest online and high street brands outside the top three companies referred to above:

(i) Ariste Holding Limited (Ariste);

(ii) The Cash Store (UK) (The Cash Store);

(iii) CFO Lending Limited (CFO Lending);

(iv) Cheque Centres Group Limited (Cheque Centres);

(v) Global Analytics Holdings, Inc (Global Analytics);

(vi) Harvey and Thompson Limited (H&T);

(vii) MYJAR; and

(viii) SRC Transatlantic Limited (SRC).

(c) Finally, we provide details of three further lenders with annual payday lending revenue over £10 million:

(i) Oakam Limited (Oakam);

(ii) PDL Finance Limited (PDL Finance); and

(iii) Think Finance (UK) Limited (Think Finance).

2.84 The three groups of companies are presented below in alphabetical order. We estimate that the 11 lenders which comprise the first two groups accounted for around 90% of revenue generated from payday lending in the UK in financial year 2012. Diagrams of the corporate structures of the largest three lenders are set out in Appendix 2.6.

CashEuroNet

2.85 CashEuroNet is the UK operation of US finance company Cash America International Inc (Cash America). Established in 1984, Cash America is listed on the New York Stock Exchange and has a market capitalisation of approximately $1 billion. It operates within the USA, UK, Australia, Canada and Mexico, offering a variety of loan products including pawnbroking loans, payday loans, line of credit accounts and instalment loans.

2.86 Cash America has developed three online lending products which it offers to UK customers through its subsidiary CashEuroNet: QuickQuid, a payday loan service launched in 2007; Pounds to Pocket, an instalment loan product launched in 2010; and FlexCredit, a running account credit facility[70] launched in 2013. Cash America does not have a physical presence in the UK, with no high street stores; all online operations are managed from Chicago.

2.87 CashEuroNet generated total revenue of £[✄] million in 2012, with £[✄] million of that attributable to payday lending. Net profit for the same period was £[✄] million.

DFC/Dollar

2.88 DFC is a NASDAQ-listed company with its headquarters in the USA, with a market capitalisation of $400 million. In addition to publicly-listed equity, it also issued senior convertible notes[71] of $660 million in 2007 and 2012, as well as $600 million senior notes through its Canadian subsidiary in 2009.[72] DFC operates throughout Europe and North America, including the UK, USA, Canada and Spain, offering a variety of short-term lending products.[73] In April 2014 DFC Global Corp announced that it was to be acquired by Lone Star Funds for $1.3 billion.[74]

2.89 The UK operations of DFC are collectively known as Dollar. These include three subsidiaries offering payday loans within the UK:[75]

(a) Instant Cash Loans Ltd (ICL), trading as The Money Shop, is a high street outlet. ICL was purchased by Dollar Financial UK Limited (Dollar) in February 1999, at which time it was operating 11 stores. Since then it has opened more than 500 stores throughout the UK, offering cheque cashing, pawnbroking, prepaid debit cards, foreign exchange and

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[70] With this type of product, a customer applies for a credit facility of a given value. The customer can then request any amount of money up to the value of the approved facility to be transferred to their bank account. Customers then repay over ten months but are able to repay earlier and reduce the outstanding balance. Interest is charged on the outstanding balance. However, if customers have made repayments according to their payment schedule they can request another transfer of money to increase the balance outstanding up to the original value of the facility.

[71] Notes of $200 million were issued June 2007, repayable in 2027; $120 million of convertible notes were issued in December 2009, repayable in 2028, in exchange for an equal face amount of the 2027 notes; $230 million of convertible notes were issued April 2012, repayable in 2017. The 2027 and 2028 notes can be repaid in cash at the company’s discretion on or after 31 December 2014 and 5 April 2015 respectively; the 2017 notes may not be repaid early at the company’s discretion. At redemption or conversion (if certain triggers are met), the notes can be repaid in cash or in exchange for stock at the company’s discretion. In addition, note holders may convert the notes into stock if certain trigger thresholds are met. All the notes are unsecured obligations. *DFC annual report*, 2012.

[72] DFC 10K, 2012.

[73] Source: 10K.

[74] *The Guardian*, 2 April 2014, ‘Money Shop owner Dollar Financial to be sold to Lone Star for $1.3bn’.

[75] DFC also owns several pawnbroking shops in Scotland and England, including Suttons and Robertsons.

overseas money transfers. In 2013 the company generated total revenues of £[✂] million, [✂], and a net profit of £[✂] million.

(b) MEM Consumer Finance Limited (MEM), trading as PaydayUK, are both online operations. The original MEM business was founded in 2003 and acquired by DFC in 2011 for $195 million.[76] It only offers a payday lending product through the website www.paydayuk.co.uk. Total revenue for 2013 was £[✂] million and net profit £[✂] million.

(c) Express Finance (Bromley) Limited (EFL), trading as Payday Express, is an online operation. EFL is an online lender which began operating in 1999 and was purchased by DFC in 2009 for $[✂] million. Lending through its website www.paydayexpress.co.uk, EFL had total revenue of £[✂] million in 2013 and net profit of £[✂] million.

Wonga

2.90 Wonga was founded in October 2006 by Errol Damelin and Jonty Hurwitz and launched its short-term consumer loans product, 'Little Loans', in 2007. As an online-only business, without any high street stores, it has developed its own loan approval technology.

2.91 Wonga is a subsidiary of Wonga Group Limited, itself a privately-held company registered in the UK. Since 2006 it has completed several rounds of equity financing and currently has three key shareholders: Balderton Capital (21%), Accel London II LP (14%) and Greylock Partners (12%).[77] Wonga Group Limited is thus the parent company and UK payday loans are made through its subsidiary WDFC UK Ltd (Wonga – formerly Wonga.com Limited).

2.92 The majority of Wonga's business is in the UK; it has also begun lending operations in Canada, Poland, South Africa and Spain. To promote this growth, subsidiaries for support services such as customer service and technology development have been opened in the Republic of Ireland, South Africa and Switzerland.

2.93 Wonga currently offers three credit products in the UK: Little Loans, a short-term loan falling within our definition of a payday loan product; PayLater, a credit offering for online shopping; and Everline, a loan for small businesses. The latter two products were only launched in 2012, therefore the majority of Wonga's 2012 revenue of £305 million relates to Little Loans. Net profit for the year was £59 million for Wonga and £62 million for Wonga Group Limited.[78] In

[76] 2012 DFC Global Corporation 10K.
[77] 31 December 2013 figures provided by Wonga.
[78] Wonga Group Limited Annual Report, 2012.

March 2014 Wonga announced that it was trialling six-month instalment loans and withdrawing the PayLater product.[79]

Other major lenders

Ariste

2.94 EZCORP is a NASDAQ listed company with a $900 million market capitalisation. It is based in Austin, Texas, and operates throughout the world in the consumer lending industry. In the UK, it owns one-third of Albemarle & Bond Ltd[80] and approximately one-third of credit provider Cash Converters UK Limited.[81] Its primary UK payday lending operation is a wholly-owned subsidiary, Ariste, trading as Cash Genie.

2.95 Cash Genie began offering payday loans in October 2009 and was partly acquired by EZCORP in 2012 and fully in 2013 for a total of $43.5 million. Cash Genie is an online business providing payday loans. Total revenues for the 2012 financial year were £12.8 million with a net profit of £1 million.

The Cash Store

2.96 The Cash Store Financial Services Inc is a Canadian company which was listed on both the New York Stock Exchange and the Toronto Stock Exchange, with a market capitalization of CAD 34 million.[82] In 2010 it began operating in the UK through its subsidiary The Cash Store Financial Limited, the parent company of The Cash Store.

2.97 The Cash Store currently has 27 stores in the UK through which it offers payday loans and a small amount of cheque cashing. The company generated total revenue of £6.2 million in 2012 and a net loss of £5.2 million.

CFO Lending

2.98 CFO Lending is a privately-held company registered in the UK. Founded in 2008 as Capital Finance One, it offers payday loans online through the brands

[79] *The Guardian*, 26 March 2014, 'Wonga looks beyond payday to try out longer loans'.
[80] In early December 2013 Albemarle & Bond commenced a formal sales process for the company. Operating primarily in the gold-buying and pawn loan industries, profitability and net debt have been significantly impacted by the unexpected fall in gold prices, increased competition and lower supply of gold for sale. Refinancing is required in order not to breach loan covenants; a rights issue was unable to proceed after discussions between EZCORP and other related parties, and the company failed. (Albemarle & Bond Annual Report.)
[81] EZ Corp annual report 2013.
[82] In April 2014 it announced that its shares would be delisted from the Toronto Stock Exchange effective on 23 May 2014 as a result of failing to meet the exchange's listing requirements.

CFO Lending and Payday First. The company generated total revenue of £19.6 million in 2012, with a net profit of £0.1 million.

Cheque Centres

2.99 Cheque Centres operates two payday lending companies in the UK: Cheque Centres (high street) and Cheque Centre (online) (formerly The Loan Store). Cheque Centres is a wholly-owned subsidiary of Axcess Financial Services Limited (Axcess) (which in turn is part of CNG Financial Corporation), a privately-registered US company which also operates as a payday lender throughout the USA.

2.100 Cheque Centres (high street) was established in 1996 by a small group of Edinburgh business people and sold to Axcess/CNG Financial Corporation group in 2006. Its 433 stores throughout the UK offer a variety of services including payday loans, cheque cashing, foreign exchange and gold buying. With total revenues of £356 million, £[✂] million from payday loans, the company recorded a net [✂] in the 2012 financial year.

2.101 Founded in 2008, Cheque Centre (online) entered the payday loan market in 2011 to provide online short-term loans. [✂] of its revenue, however, has been derived from its other activities of foreign exchange and gold. Revenue from payday lending was £[✂] million in 2012 with total company turnover of £12 million. The company generated net [✂] in 2012. Cheque Centre (online) stopped offering payday loans in January 2014 and, following an agreement with the FCA, Cheque Centres (high street) have now ceased offering single instalment payday loans.[83]

Global Analytics

2.102 Global Analytics is a privately-held company based in San Diego, California (USA). It operates in the UK through its wholly-owned subsidiary Lending Stream LLC (Lending Stream), which began offering payday loans in 2008.

2.103 Lending Stream LLC trades using the brand Lending Stream. It previously also traded as Zebit between 2012 and 2014.[84] For this investigation both are considered payday loan products. Total revenue for Lending Stream LLC was £49 million in 2012, with £47 million coming from payday loans. A net loss of £3.7 million was recorded. This was the fifth consecutive yearly loss for the company.

[83] For more details refer to Voluntary Application for Imposition of Requirement: Cheque Centres Limited.
[84] As at June 2014 www.zebit.com directs visitors to the Lending Stream website.

H&T

2.104 H&T Group plc offers payday loans through its subsidiary H&T, which operates 194 stores throughout the UK. H&T Group plc has been listed on AIM since 2006 and has a market capitalization of £60 million. It was previously owned by Cash America, which founded H&T's payday lending operation.

2.105 H&T's core business is pawnbroking and gold buying, with a small amount of payday and instalment lending performed in-store and online. However, H&T has recently altered its product offering, ceasing online lending to new customers in February 2014 and offering only one product in store to new customers from September 2013, an instalment loan of up to £1,000 over a period of up to 24 months. Total revenue for the company for 2012 was £130 million, of which payday lending contributed £5.8 million. Net profit for the same period was £12.9 million.

MYJAR

2.106 MYJAR, formerly known as TxtLoan Limited, provides online payday loans. Founded in 2008, it began lending in March 2009, offering open-ended loans with a minimum term of 18 days. Since then it has provided over 1 million loans to customers throughout the UK. Total revenue has grown over the prior four years, reaching £33.4 million in 2013; however, the company recorded a net loss of £1.8 million in 2013, the first since 2009.

2.107 From October 2010 MYJAR has been part of Txt Holdings Ltd, a privately-held holding company based in Jersey. MYJAR operates solely in the UK and has headquarters in London with an internal technology and support team in Estonia. The company is funded through intercompany and shareholder loans.

SRC

2.108 SRC is a wholly-owned subsidiary of Speedy Cash Intermediate Holdings Corp. This is itself a wholly-owned subsidiary of Speedy Group Holdings Corp, a privately-held US company.

2.109 SRC operates two payday companies within the UK: high street and online business Speedy Cash; and the online-only WageDayAdvance Limited (WageDayAdvance).

- *Speedy Cash*

2.110 SRC, trading as Speedy Cash, was opened by its parent company in November 2010 and has since grown to 23 branches throughout the UK. Speedy Cash offers two credit products: a payday loan and an instalment-based 'flex loan'. Both products are considered payday loans, contributing £11 million to total revenue of £12.2 million in 2012. The net loss for Speedy Cash for the same period was £9.4 million.

- *WageDayAdvance Limited*

2.111 WageDayAdvance began offering payday loans in December 2006 as Cash 4 Compensation Ltd. Changing its name to WageDayAdvance in February 2008, it was one of the first online payday lenders. Offering one payday loan product, and a small cheque-cashing operation, WageDayAdvance had total revenues of £39 million and a net profit of £15 million in 2012.

2.112 In February 2013, WageDayAdvance was acquired by SRC, becoming a fully-owned subsidiary. Prior to this the company had been privately held by six equal shareholders who provided the majority of funding.

Other lenders

Oakam

2.113 Oakam offers payday loans both online and through high street stores. Since launching in 2007 it has opened 20 stores across London and the Midlands with a call centre serving the whole of the UK.[85] It currently offers two loan products: 'The Bonus Loan' for periods between three and six months; and 'The Big Plus Loan' for 6 to 36 months. Both products are eligible for cashback rewards for on-time repayments.

2.114 The company is privately held and registered in the UK. It has one major shareholder, CS Capital Partners III LLP,[86] which also provides funding for the business. The majority of its total revenue for 2012 of £19.9 million and net profit of £2 million was generated by The Bonus Loan product.[87]

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[85] Annual report 2012.
[86] ibid.
[87] ibid.

PDL Finance

2.115 PDL Finance is a privately-held UK company offering payday loans via its online service 'Mr Lender'. The payday loan is the only loan product offered with customers able to borrow between £80 and £500 for up to 30 days.

2.116 SDJ Enterprises Ltd is the parent company and primary funder of PDL Finance; it is also registered in the UK. PDL Finance generated total revenue of £17.5 million in 2012, with net profit of £2.4 million.[88]

Think Finance

2.117 Think Finance offers credit products under the names quid.co.uk and Sunny. A subsidiary of US firm Think Finance, Inc, both companies are privately held and backed by venture capitalist firms Sequoia Capital and Technology Crossover Ventures. In 2012 the UK company generated total revenue of £[✂] million, making a £[✂] million net loss.[89]

2.118 Think Finance, Inc entered the UK payday market in 2011 with the acquisition of Fortress Capital, a provider of one-month loans. It had previously purchased an instalment loan company, quid.co.uk, in 2009. In the UK, it has withdrawn the 1 Month Loan product and was planning to do the same with its other line of credit product (quid.co.uk), leaving just its Sunny product, a line of credit where customers may borrow up to £1,000 and repay within five months.

Other market participants mainly active in the online sector

2.119 In this section we outline briefly the role of a number of third parties mainly active in the online payday lending sector. In turn we consider lead generators, price comparison websites, search engines and credit reference agencies.

Lead generators and affiliates

2.120 As well as approaching a payday lender directly, customers may also be directed to online payday lenders by one or more intermediaries, such as lead generators and affiliates:[90]

(a) Lead generators are companies that contract with payday lenders to provide potential customer applications (or 'leads') in return for a fee for

[88] PDL Finance annual report 2012.
[89] Think Finance annual report 2012.
[90] See Appendix 3.1 for a discussion of relevant regulation.

each lead provided. Like credit brokers more generally, lead generators are required to hold a consumer credit licence (as they ‘introduce individuals seeking credit to businesses that provide credit’).

(b) Affiliates[91] are companies that generate traffic using, for example, banner advertisements or a price comparison website, and then pass these customers on to lenders or to lead generators, who then seek to collect from these individuals customer information which can be sold to a lender.

2.121 We discuss first the role of lead generators and then the use of affiliates by both lead generators and lenders. In Section 7 we set out the expenditure across the market on different acquisition channels (Table 7.2) and how this varies between lenders (Figure 7.3) with some larger lenders focusing their customer acquisition expenditure more heavily on television and non-digital advertising which contrasts with the greater use of lead generators by other smaller lenders.[92]

Lead generators

2.122 A significant proportion of new customers applying for a payday loan online do so via the website of a lead generator.

2.123 As noted, lead generators generate income by selling customer details to lenders. To do this, lead generators operate websites which ask customers to complete a form that captures information needed by lenders to make a lending decision. Where a lead generator supplies details to multiple lenders, customer details are then sold through an auction mechanism referred to as a ‘ping tree’.

2.124 At a high level, the ping tree operates as follows:

(a) lenders specifying the characteristics of potential customers which they wish to buy ‘leads’ on (that is, have the opportunity to offer credit to directly) and the number of leads that they wish to purchase;

(b) the lender which bids the most for a certain type of customer will be offered matching leads first; and

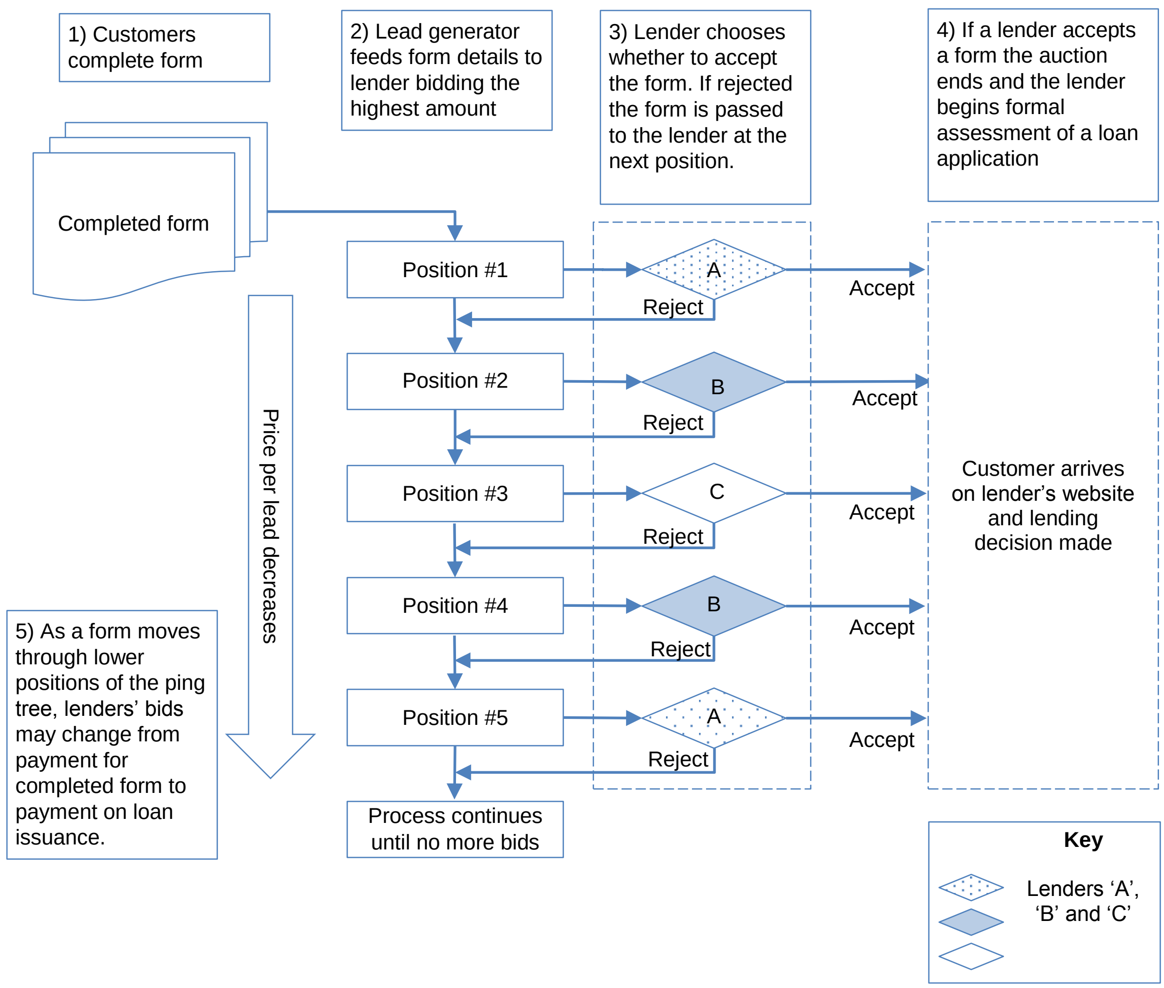
[91] The use of the term affiliate relates to ‘affiliate marketing’, whereby an ‘affiliate’ receives commission for directing traffic to supplier (or additionally on conversion of that traffic to a sale) and does not indicate any control or shared ownership by a parent entity.
[92] However, the cost per customer acquired will vary by both lender and by channel employed.

(c) the lender then undertakes a risk assessment and must decide whether to purchase the lead at the bid price. If the lender chooses not to purchase the lead, the lender with the next highest bid is offered the lead.[93]

2.125 The operation of the ping tree is shown diagrammatically (with three lenders, A, B and C) in Figure 2.11. When a lead is offered to a lender, the lender has a short window of a few seconds to undertake its initial risk assessment to decide on whether to accept the lead. This restriction is imposed by the lead generator to ensure that a customer is passed to a lender before the customer decides to abort the process.

FIGURE 2.11

Diagrammatic representation of the ping tree



Source: CMA analysis.
Note: In this example there are three lenders: 'A', 'B' and 'C'. Both lenders 'A' and 'B' occupy two positions each and the placing of these positions is based on the bid price for that customer's form.

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[93] Passing on leads in this way is known as going down towards the bottom of the ping tree.

2.126 PDB, one of the largest lead generators, told us that lenders may occupy three to five pricing points on the ping tree.[94] For the best-quality leads, payment is on the basis of any lead purchased; lower-quality leads, sold lower down the ping tree, are bid for on the basis of whether a customer ultimately takes out a loan.

2.127 PDB told us that on average approximately 20 to 25% of leads entering the ping tree were ultimately purchased by any lender on a 'cost per accepted lead' basis. The top lenders generally accepted 1 to 2% of the customers they were offered. These lenders were relatively stable in their activity in the ping tree. They typically operated towards the top of the tree and paid per accepted lead. [✄]

Use of affiliates by lenders and lead generators

2.128 Lead generators (and to a lesser extent lenders) typically rely on a large network of sources to generate their leads. In addition to generating leads directly through their own activities (eg websites advertising payday loans, such as purplepayday.co.uk), most lead generators generate some proportion of their business through affiliates though this proportion varies. PDB told us that its two largest websites generated the great majority of its leads.

2.129 In contrast to PDB, T3, another large lead generator, told us that the majority of its leads came through affiliates which operated websites, where they would have forms where consumers could input their details, authorise the sharing of their data and apply for loans. When the forms were filled in the data was passed to the lead generators (such as T3). The affiliates must have a credit licence and sign agreements with the lead generators. Affiliates may work with multiple lead generators.

2.130 Lenders generally rely on affiliates to a lesser degree than lead generators. In particular, we note that affiliates account for only 2.2% of all advertising spending by lenders; around one-third of all advertising spending in the market is on lead generators (see Figure 7.2 for an analysis of all customer acquisition channels). As noted above in paragraph 2.121, the relative expenditure of different lenders on the various acquisition channels varies significantly.

[94] That is, a lender may target three to five different types of customer and bid accordingly.

Price comparison websites

2.131 In many online markets for financial products, comparison websites play a key role in helping customers to compare the offering of different suppliers. A number of websites exist (or existed previously) allowing visitors to carry out some comparison of the terms of different payday lenders, although the traffic generated by these websites (and lenders' reliance on them for new customers) is very limited. One of the largest financial services price comparison websites, moneysupermaket.com, operated a payday loan comparison site until spring 2013. This service was withdrawn in response to the increasing level of media and political scrutiny into payday lender practices, and the perception of non-compliance in the sector.

2.132 The range and selection of 'lenders' listed and the functionality of these sites may affect their utility to customers. For example, some such as money.co.uk and whichwaytopay.com include brokers/lead generators as well as lenders, whereas others such as allthelenders.co.uk include only lenders. In each case only a relatively limited subset of lenders is included. Typically these sites will provide basic information on the loan products such as the representative APR, the loan amount, the possible duration and the total amount repayable for a £100 loan for a given lending period (which could vary by lender[95]) but do not allow a customer to input their specific loan requirements.

2.133 We discuss some of the limitations of the price comparison websites operating in the payday lending sector in greater detail in Section 6.

Search engines

2.134 Customers can research and identify payday lenders using web search engines such as Google, Yahoo! and Bing.

2.135 An individual using Google to search for a payday lending related term will be presented with links to the websites of a number of lenders in the organic search results, as well as a number of pay-per-click advertisements for payday lenders and brokers. In 2013, the term 'payday loans' was searched for between 200,000 and 300,000 times a month on Google. Customers also search for individual lenders, with searches specific to the products of Wonga and CashEuroNet being searched for more times each month than the more generic term 'payday loans'.

[95] For example, the cost for a month-long loan is calculated by different lenders using a period of 28, 30 or 31 days on some comparison sites.

2.136 Our analysis of search results on Google's first page for a number of payday-loan-related terms[96] on a number of dates in 2013 and 2014[97] found that of the top 10 organic search results generated by each of these searches on each of these dates, 39% were lenders' websites, 15% were comparison websites, 5% brokers'/lead generators' websites and the remaining 41% included news websites, advice websites and editorial content.[98]

2.137 Our analysis of pay-per-click advertisements[99] found that lenders' websites were the most common links presented alongside payday related search terms (67% of the advertisements), followed by lead generators (26%[100]) and comparison websites (4%).[101]

2.138 The proportion of each lender's customers that reach that lender's website by using a search engine varies significantly,[102] and this may in part relate to each lender's expenditure on pay-per-click.[103]

2.139 Search engines may require lenders who use pay-per-click advertising to comply with specific requirements on the content and presentation of financial information on lenders' websites. Advertising that is found not to comply with these requirements could then be excluded from appearing on search results pages. In addition, search engines may limit the range of search terms which payday lenders are permitted to advertise their products alongside – for example, Google limits payday lenders to advertising alongside search terms specific to payday loans.[104]

Credit reference agencies

2.140 Most payday lenders – both online and high street – purchase information from CRAs regarding applicants when carrying out a credit risk assessment. The three largest CRAs are Experian, Equifax and Callcredit. These CRAs hold large databases of individuals' personal information, past credit history and current credit commitments. This shared data is available on commercial terms to lenders.

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[96] Namely: compare payday, payday, payday lenders, payday loan direct, payday loan lenders, payday loans and payday UK.
[97] Specifically on 4, 6, 8, 11, 13, 15 and 18 November 2013, and 29, 30 and 31 January 2014.
[98] Lenders' website appeared more frequently (49%) in January 2014's search results than in November 2013's (35%) whilst links to 'others' were more common in November 2013 (47%) than in January 2014 (28%).
[99] Both those placed at the top and those placed on the side of Google's page.
[100] Which is considerably greater than their presence in organic search results.
[101] These figures are roughly similar in November 2013 and January 2014. The remaining 2% related mostly to financial products other than payday loans.
[102] We discuss this further in Section 6.
[103] We discuss expenditure on customer acquisition by different channels in Section 7.
[104] For example, ensuring that any only search terms relating directly to payday lending and not credit in general can be used.

2.141 Lenders are not required to use information from CRAs in making a lending decision but should do so 'where necessary'.[105] Different lenders purchase information from (and share information with) different CRAs, and so no single CRA will hold complete records of borrowers' use of payday loans. Many lenders will purchase information from more than one CRA when making credit-risk assessments.

2.142 Currently, lenders most commonly provide information to the largest CRAs on a monthly basis, with CRAs making the information available to other customers shortly after its receipt and validation.[106] Two of the three largest CRAs (Callcredit and Experian) have publicly announced that they are developing systems to allow lenders to provide and access information in real time or near real time.

2.143 The FCA has stated that it would like the industry to identify and remove any blockages to real-time data sharing as a matter of urgency but that if the industry cannot overcome the obstacles, and the FCA is best placed to bring about data sharing, the FCA would not hesitate to act.[107]

2.144 CRA data is available (on commercial terms) to lenders under the Principles of Reciprocity (developed and administered by the Steering Committee on Reciprocity whose membership includes lenders and CRAs). The Principles (at a high level) require lenders to share with CRAs the same categories of data to those which they receive from the CRA, which maintains the accuracy of customer credit information. We discuss lenders' views on the utility of CRA data in Section 7.

2.145 We discuss lenders' use of CRA data in the application process in Appendix 2.4.

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[105] CONC 5.2.1 (3) R.
[106] Although smaller CRAs exist – for example, LendingMetrics – whose records are updated in real time.
[107] FCA, Policy Statement PS14/3, February 2014.

3. The regulation of payday lending

3.1 In this section we describe the regulatory framework that applies to the payday lending sector. The regulation of this sector has evolved significantly over recent years, so we first describe the reasons for this, before describing the current regulatory regime and forthcoming changes.

Background to development of current regulatory framework

3.2 As part of its response to the financial crisis of 2008, the Government made important changes to the regulation of financial services and banking in the Financial Services Act 2012. This resulted in the abolition of the Financial Services Authority and the transfer of its functions to two new bodies: the FCA and the Prudential Regulation Authority. That Act also enabled the transfer of regulation of consumer credit from the OFT to the FCA (see paragraph 3.6).

3.3 In December 2012 the National Audit Office (NAO) published its report on regulation of consumer credit by the OFT[1] drawing attention to the plight of the poorest borrowers in particular and concerns about the impact of payday lending on some of these borrowers. It also expressed concern about the effectiveness of the enforcement regime in driving better behaviour from market participants due to a lack of sufficient resource focused on enforcement. At the same time there were concerns being expressed by debt charities, such as Citizens Advice and StepChange, about how the rapid expansion of payday lending appeared to be fuelling debt problems for some borrowers.

3.4 Against this background, the OFT undertook a review of compliance by payday lenders, publishing an Interim Report in November 2012 and its Final Report in March 2013. This highlighted a significant degree of non-compliance with consumer credit legislation and OFT regulatory requirements. A key passage of the OFT's conclusions is quoted below:

> Our evidence paints a general picture of poor compliance with the law and guidance across the market and throughout the lifecycle of payday loans, from advertising of loans to debt collection:
>
> - Lenders compete by emphasising speed and easy access to loans, but borrowers are not getting a balanced picture of the costs and risks of taking out a payday loan.

[1] www.nao.org.uk/report/office-of-fair-trading-regulating-consumer-credit/.

- Across the sector, there is evidence that the majority of lenders are not conducting adequate affordability assessments and their revenue streams rely heavily on rolling over or refinancing loans. Around one in three loans is repaid late or not repaid at all.

- Many lenders are not treating borrowers in financial difficulty with understanding or forbearance. Many are promoting rollovers when borrowers would be better served by a repayment plan. Continuous payment authorities are poorly explained to consumers and their misuse is causing distress to a considerable minority of consumers, in some cases leaving them with insufficient funds to cover their most basic needs.

- A number of firms are using aggressive debt collection practices which fall far below the standards we have set out in our Debt Collection Guidance.

- Across the industry we have seen evidence of poor internal procedures and processes, including a failure to put in place effective complaints handling systems.

This is causing real harm and the problem has grown. In the first quarter of 2009/10 only one per cent of Citizens Advice Bureau debt casework clients had at least one payday loan – in the same quarter of 2012, 10 per cent had at least one payday loan. In November 2012 StepChange Debt Charity reported that the proportion of their clients with payday loan debts had increased from 3.7 per cent in 2009 to 17 per cent in 2012.[2]

3.5 The further developments to the regulation of payday lending described below arose out of these concerns and similar concerns expressed by other bodies about the operation of the payday lending market.

3.6 In addition, as part of the Government's changes to the arrangements for competition, consumer protection and consumer credit regulation, the OFT closed on 31 March 2014, and its work and responsibilities passed to a number of different bodies. On 1 April 2014, the FCA became the regulator for the consumer credit industry and the CMA brought together the CC and the competition and certain consumer functions of the OFT in a single body. The

[2] http://webarchive.nationalarchives.gov.uk/20140402142426/http://oft.gov.uk/shared_oft/Credit/oft1481.pdf

CMA is now the principal enforcer of the Unfair Terms in Consumer Contracts Regulations 1999.[3]

3.7 In this section we consider the regulation of payday lending as it applies from 1 April 2014. We first describe the key elements of the regulatory framework that is now in place, and then discuss the main regulatory requirements applicable to credit agreements. Further details of the regulatory framework may be found in Appendix 3.1.

The regulatory framework

3.8 We consider below the key aspects of the regulatory framework of payday lending, namely:

(a) the Consumer Credit Act 1974 (CCA);

(b) the Irresponsible Lending Guidance, published by the OFT in 2010;

(c) the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012;

(d) the Financial Services (Banking Reform) Act 2013; and

(e) the role of self-regulation in the payday lending sector.

The Consumer Credit Act 1974

3.9 The CCA is the principal piece of legislation regulating lending and credit-related activities in the UK and since 1 April 2014 it has been partially replaced and supplemented by FSMA and FCA rules. The CCA lays down rules requiring information to be given to borrowers before entry into a consumer credit agreement. New regulations requiring information to be given to borrowers before entry into a credit agreement came fully into force on 1 February 2011, implementing provisions of the Consumer Credit Directive (CCD).

3.10 For the purposes of the CCA, payday loans are either ‘fixed-sum’[4] or ‘running-account’[5] credit agreements (see Appendix 3.1).

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[3] See Appendix 3.1 for further details.
[4] Fixed-sum credit is any other facility under a consumer credit agreement whereby the borrower is enabled to receive credit (whether in one amount or by instalments).
[5] Running-account credit is a facility under a credit agreement whereby the borrower is enabled to receive from time to time, from the lender, cash to an amount or value such that, taking into account payments made by the borrower (or payments to be credited to the borrower), the credit limit stipulated in the agreement (if any) is not at any time exceeded.

The Irresponsible Lending Guidance

3.11 Under section 25 of the CCA, the OFT had a duty to ensure that licences are held only by businesses that are fit to hold them (known as the 'Section 25 Test'). In March 2010, the OFT published its Irresponsible Lending Guidance.[6] The foreword of the Irresponsible Lending Guidance states:

> The primary purpose in producing this guidance is to provide greater clarity for businesses and consumer representatives as to the business practices that the [OFT] considers may constitute irresponsible lending practices for the purposes of section 25(2B) of the CCA. It indicates types of deceitful or oppressive or otherwise unfair or improper business practices which, if engaged in by a consumer credit business, could call into consideration its fitness to hold a consumer credit licence.

3.12 The guidelines set out the expectation that lenders will conduct a reasonable assessment of affordability and monitor repayments. If customers fall into difficulties with their repayments, the lender is expected to show forbearance in resolving the problem. These principles and the accompanying expectations of firms have been brought forward into the new regulatory framework.

The Financial Services and Markets Act 2000 and the Financial Services Act 2012

3.13 Consumer credit lending is now a regulated activity within section 22A of the Financial Services and Markets Act 2000 (FSMA). Firms with existing consumer credit licences must have applied to the FCA for an interim permission before 1 April 2014. Consequently no person may carry on that activity by way of business unless that person holds either an interim permission from the FCA (replacing a former OFT consumer credit licence) or has been authorised by the FCA through its standard gateway. Over the next two years, firms will be invited to apply for full authorisation during designated authorisation periods, which will be based on risk.

3.14 Like other firms regulated by the FCA, all firms providing consumer credit loans will have to comply with the high level rules in the CMA's Handbook, for instance with regard to treating customers fairly and cooperating with the regulator.

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[6] www.oft.gov.uk/shared_oft/business_leaflets/general/oft1107.pdf.

The Financial Services (Banking Reform) Act 2013

3.15 Following an announcement in November 2013, the Government introduced legislation to impose a duty on the FCA to place a cap on the charges which may be imposed in relation to payday loans. The Financial Services (Banking Reform) Act 2013 amended the FSMA to place a duty on the FCA to implement such a price cap no later than 2 January 2015.[7]

Self-regulation

3.16 Self-regulation has also played a role in the payday lending sector. Following discussions between the Department for Business, Innovation & Skills (BIS), and four trade associations representing over 90% of the payday and short-term loan industry, a Good Practice Customer Charter[8] was published by the four trade associations representing payday lenders in July 2012: CCTA, CFA, BCCA and FLA[9] (the trade associations).

3.17 The trade associations have committed their members to explaining how loans work and the costs involved; increasing transparency about loan repayments so that consumers can make informed decisions and are not surprised by hidden payments; providing help for customers in financial difficulty by freezing charges and interest; undertaking robust credit and affordability assessments to ensure that loans are suitable for the customer's situation; and effective compliance monitoring by the trade associations to root out poor practice in the industry. The CFA's Code of Practice required its members to operate a limit of three rollovers per customer.[10] This practice has since been limited to a maximum of two rollovers by the FCA.[11]

3.18 Under the Good Practice Charter, the trade associations require their members to provide an annual statement of compliance and to be subject to periodic independent compliance visits. Failure to comply with the Charter could result in firms being subject to written warnings, recommendations as to future conduct and expulsion from the trade association for more serious breaches.

3.19 In relation to BCCA, any issues of non-compliance are raised with the lender to take action. If agreement cannot be reached members can face disciplinary

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[7] Section 137C(1A) of the FSMA 2000, inserted by section 131 if the Financial Services (Banking Reform) Act 2013.
[8] www.cfa-uk.co.uk/assets/files/PD&STL_Charter.pdf.
[9] FLA has only one member in this sector, which is Wonga.
[10] www.moneyshop.tv/CFA_Lending_Code_for_Small_Cash_Advances_25_July_2012.pdf. Point 4.6.4 of the Code of Practice: 'Members shall not allow customers to extend a short term loan on more than three occasions'.
[11] See Appendix 3.1.

action. The CCTA's[12] and the CFA's[13] Codes of Practice state that they would possibly suspend or expel any of their members who fail to comply with the code.

The requirements applicable to credit agreements

3.20 A number of regulatory requirements currently apply to payday loan agreements, or will do so in the near future. These may be considered under the following headings:

(a) existing provisions of the CCA which have been replicated as FCA rules;

(b) obligations under distance marketing regulations;

(c) new conduct of business rules put in place by the FCA; and

(d) from 2 January 2015, a price cap on the Total Cost of Credit.

CCA provisions replicated as FCA rules

3.21 Most of the conduct-related provisions in the CCA and its secondary legislation will remain in place after 1 April 2014.

3.22 The provisions that are to be repealed will be 'replicated' as FCA rules and guidance without being 'substantially changed'; indeed, some will be copied out, word for word**.** These include the CCA provisions on:

(a) pre-contractual explanations (section 55A of the CCA);

(b) assessment of creditworthiness (section 55B of the CCA);

(c) assignment of creditor's rights to a third party (section 82A of the CCA);

(d) the method of calculating APR;

(e) credit intermediaries (section160A of the CCA);

(f) procedures relating to events of default, termination or early settlement; and

(g) credit advertising.

[12] Annex C Code of Practice for bills of sale lenders (paragraphs 2.4 & 2.5): www.bis.gov.uk/assets/biscore/consumer-issues/docs/g/11-516-government-response-proposal-ban-bills-of-sale.
[13] www.moneyshop.tv/CFA_Lending_Code_for_Small_Cash_Advances_25_July_2012.pdf.

Distance marketing regulations

3.23 The Financial Services (Distance Marketing) Regulations[14] apply where the borrower enters into a credit agreements at a distance – over the phone or online. The regulations require the lender to provide the following information:

(a) name and address of the creditor;

(b) description of the main characteristics of the credit agreement;

(c) total price payable for the credit;

(d) arrangements for payment; and

(e) information regarding a right to cancel.[15]

Conduct of business for consumer credit rules

3.24 The FCA has made additional rules for high-cost short-term credit lenders (effectively payday lenders) and debt management firms (see Appendix 3.1 for further details).

3.25 These new CONC rules and guidance apply to firms from 1 April 2014. However, the enforcement of some of these measures is subject to a six-month transitional period. This transition period does not affect the substance of the conduct standards that are in place from 1 April 2014. This means that if firms can prove that they comply with the corresponding provision or guidance in specified OFT guidance, CCA provisions or CCA secondary legislation that is substantially similar in purpose and effect to the relevant provision in CONC, then they are deemed to comply with that provision.

3.26 Key elements of these conduct of business rules are as follows:

(a) The CONC replicates pre-existing OFT wording, but some of the material in the Irresponsible lending guidance and other guidance has been rendered as Rules and the remainder has been reproduced largely as Guidance so as to create more regulatory certainty for firms.

(b) Irresponsible lending – new Rules and Guidance in CONC cover the verification of creditworthiness and affordability and impose post-contract requirements.

[14] SI 2004/2095 Financial Services (Distance Marketing) Regulations 2004.
[15] See regulations 9–11. The customer has a right to cancel within 14 days after conclusion of the contract and if the rights are exercised is liable only for charges in respect of the service actually provided.

(c) Credit brokers and intermediaries – references to requirements to assess affordability have been removed as these apply to the lender.

(d) Rollovers – as from 1 July 2014, lenders may not refinance, or roll over, loans more than twice so that charges do not continue to escalate. Once a loan can no longer be refinanced, the lender must pursue collection of the amount due. The definition of 'refinance' in CONC reflects the language used in the FCA's earlier policy statement of October 2013 in respect of rollovers.[16]

(e) CPA – when taking out a payday loan, it is common for the lender to request the borrower to grant a CPA. Once agreed, a CPA allows the lender to take a series of payments using a customer's debit card or credit card without having to seek express authorisation for every payment. The lender is able, in practice, to collect the payment at any time from 5am on the promise date. FCA rules provide that from 1 July 2014 no more than two unsuccessful attempts to take a payment with a CPA can be made and a CPA must not be used to take part-payment.

(f) Risk warnings – the FCA, in conjunction with the Money Advice Service (MAS), has reduced the length of the risk warning to be used by firms at the outset of a high-cost short-term loan, and has created an information sheet to guide consumers in financial difficulty to free debt advice.

Price cap

3.27 The FCA plans to consult separately in July 2014 on its new price-capping obligations, which must come into force no later than 2 January 2015.

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[16] In its policy statement, the FCA considers that:

> a loan is rolled over if the period over which loan repayments are to be made has been extended, or if the due date for any loan repayment has been moved to a later date, whether by means of an agreement that replaces, varies or supplements an earlier loan or otherwise (excluding any forbearance by the lender where the firm does not receive any consideration in connection with the rollover and the effect is that no interest or other charges (other than where a charge is a reasonable estimate of the cost of the additional administration required as a result of the customer having rolled over the agreement) accrue from the date of the rollover).

4. Market outcomes

Introduction

4.1 In this section, we consider market outcomes in the payday lending sector.

4.2 Outcomes of the competitive process in a market – eg prices and profitability, levels of innovation, product range and quality (including levels of customer service) – can provide evidence about its functioning. Evaluating these outcomes helps the CMA determine whether there is an AEC and, if so, the extent to which customers may be harmed by it, ie the degree and nature of 'customer detriment'.[1]

4.3 The remainder of this section is structured as follows:

(a) In paragraphs 4.4 to 4.104, we consider evidence about the pricing of payday loans.

(b) In paragraphs 4.105 to 4.187, we consider the profitability of payday lending companies.

(c) In paragraphs 4.188 to 4.213, we consider evidence of non-price competition between payday lenders.

(d) In paragraphs 4.214 to 4.217, we set out our provisional conclusions on outcomes in the payday lending market.

Pricing of payday loans

4.4 In markets subject to effective competition, firms will be constrained to keep their prices down in order to win new business and retain existing customers. Pricing patterns can therefore help us to understand the effectiveness of competition in a market. In this subsection, we:

(a) consider the evidence on:

(i) the different components of payday loan prices, and the amounts that different lenders charge for their loans (paragraphs 4.5 to 4.41);

(ii) indicators of the extent of price competition between payday lenders (paragraphs 4.42 to 4.70); and

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[1] *CC3*, paragraph 103.

(iii) customer sensitivity to variation in prices (paragraphs 4.71 to 4.98); and

(b) describe our provisional conclusions relating to the pricing of payday loans (paragraphs 4.99 to 4.104).

The price of borrowing using a payday loan

4.5 We begin with a description of the main pricing structures used by payday lenders, and a comparison of the prices at which payday loans are offered to customers.

The structure of payday loan pricing

4.6 The price paid for a payday loan usually consists of several distinct charges or fees, which may include some or all of the following:

(a) an interest or finance charge, calculated based on the agreed principal and duration of the loan;

(b) a compulsory flat fee;

(c) optional fees paid at the borrower's discretion in return for services such as faster transfer of the principal;

(d) top-up fees, charged when a borrower chooses to 'top up' their loan during its originally agreed term;

(e) 'rollover' fees and/or additional rollover interest charges when the loan is extended, with agreement by the lender, beyond the originally agreed repayment date; and/or

(f) fixed late payment, default or termination fees and/or late interest charges, incurred by the borrower when a repayment is missed and/or an outstanding balance remains overdue beyond certain thresholds defined by the lender.

4.7 A detailed account of the individual charges, their levels and structures is provided in Appendix 4.1. Paragraphs 4.8 to 4.13 below provide a brief summary of the most common and important aspects of payday loan pricing structures.

4.8 The interest or finance charges of payday loans are typically based on simple interest rates charged per day or per month. For most products that charge a monthly rate, the borrower incurs the interest or finance charge for the full month even if the loan is repaid within a shorter period (for example, a borrower taking out a 'chequeless' payday loan with The Money Shop (Dollar) will pay monthly interest of £29.99 per £100 borrowed, irrespective of whether the loan is taken out 10 days or 20 days before their payday). Products with daily interest rates are often flexible around the issue of a customer's repayment date (for instance, allowing early repayment without a penalty).

4.9 Some lenders charge compulsory flat fees at the point at which a loan is taken out (for example, borrowers taking out a loan with Wonga pay a £5.50 'transmission fee'). Such fees are typically included in (and subtracted from) the issued principal and are therefore themselves subject to interest charges. Additional optional fees are also applied to many products, for example in some cases where the loan is extended or 'topped up', or the borrower opts for the lender to transfer the loan principal using Faster Payments Service.

4.10 While it has not historically been common practice for lenders to vary their prices for different customers with the same borrowing requirements, there are some exceptions to this: most notably via the use of risk-based pricing or price promotions. Under risk-based pricing, the interest rate paid by a borrower depends on their risk of default as assessed by the lender, with less risky customers paying lower interest rates. For example, CashEuroNet classifies customers of its QuickQuid Payday product into three risk tiers: 'average', 'good' and 'excellent'. Customers assigned to the highest-risk tier are charged the highest finance charge of £29.50 per £100 borrowed, while the lowest-risk customers pay £20 per £100 borrowed.[2] Think Finance similarly offers reduced rates to lower-risk borrowers who make successive timely repayments, or participate in training on financial awareness.

4.11 None of the other payday lenders that we spoke to charge different prices to borrowers of different risk. However, several of the major lenders indicated that they either had considered or were considering introducing some type of risk-based pricing.[3] One potential drawback associated with risk-based pricing which was highlighted by some lenders is the resulting increase in the complexity of prices.[4]

4.12 In addition to some providers offering lower rates to lower-risk customers, sometimes lenders offer certain customers promotional interest rates, or waive certain fees. The discounts offered, which are used to varying degrees

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[2] Risk-based pricing is not currently available for borrowers using CashEuroNet's FlexCredit product, which now represents over [✄]% of CashEuroNet's issued loans to new customers. [✄]

[3] For example, [✄]. SRC told us that it might be able to develop a risk-based product in the future but that the customer response to its previous experiments with risk-based pricing had not been strong enough for it to be profitable.

[4] For example, Dollar told us that its customers appreciated the transparency of its pricing model. Wonga highlighted the fact that risk-based pricing could come at the cost of being less simple for the customer if it was structured in such a way that it meant they could no longer see upfront exactly how much the loan would cost.

by different lenders, are often for substantial amounts. These promotions are targeted at various different customer groups, although broadly speaking, the coverage of the price promotions used by payday lenders is limited, and in many cases most customers will either be unaware or unable to avail themselves of these discounts. To give an example of a promotion used by a large lender, Wonga waives its £5.50 transmission fee to [✂] and – until June 2013 – customers referred to Wonga by MoneySupermarket. Further details of the price promotions used by payday lenders – and in particular the size of these discounts and the targeted customer groups – are provided in paragraphs 4.53 to 4.59.

4.13 Late payment fees refer to flat fees and/or interest or finance charges incurred by the borrower when they fail to make a repayment by the previously agreed time and/or date, without having agreed an extension. For example, The Cash Store charges customers £25 where a loan is not repaid on its due date. Almost all products carry flat late payment fees. In addition, many products also charge late interest that is calculated based on the amount of the outstanding loan. The pricing structure of late interest charges tends to vary across lenders, and these charges:

(a) may be calculated at the same or a different rate to the original loan;

(b) may apply to the principal only or to the full outstanding balance;

(c) may or may not be subject to a limit in terms of days, after which additional interest is frozen;

(d) may be subject to forbearance, whereby lenders waive their late fees and/or late interest under certain conditions such as the customer's agreement to a repayment plan; and

(e) may be avoided where the borrower requests a loan extension or rollover that is approved by the lender. This can be a cheaper option depending on the level and structure of late charges on a particular product and the length of time the borrower expects their final repayment to be overdue.

Analysis of lenders' prices – methodology

4.14 Given the differing pricing structures outlined in paragraphs 4.6 to 4.13, the cost to a payday customer of taking out a payday loan can depend on several factors, including:

(a) the desired loan amount, duration and instalment structure;

(b) whether the borrower expects to repay their loan on time, extend their loan and/or top up their loan;

(c) whether the borrower decides to avail themselves of optional services such as faster payment;

(d) the borrower's risk profile, as assessed by the lender; and

(e) the availability of discounts and price promotions.

4.15 The large number of possible combinations of these characteristics means that it is not possible to calculate prices for every possible combination. On the other hand, only calculating an 'average price' would not allow for the identification of price patterns that are specific to particular borrowing scenarios.

4.16 Instead, in order to understand the prices of payday lenders, we consider the cost of borrowing using different lenders' products in a number of 'representative customer scenarios'. The idea behind this approach is to:

(a) select specific scenarios that are representative of the different types of borrowing scenarios in which payday loans are taken out;

(b) analyse different lenders' prices, and the extent of variation in these prices in each of those scenarios; and, thereby,

(c) generate an understanding of pricing and price variation in the payday lending sector.

4.17 The process used to determine the representative scenarios used for our analysis is described in Appendix 4.2. We identified four scenarios which we consider to be representative of key patterns of borrowing behaviour among payday customers,[5] namely:

(a) a customer takes out a £100 loan for 28 days, which is repaid in full on time;

(b) a customer takes out a £100 loan for 14 days, which is repaid in full on time;

[5] Loans that are equivalent to one of these four borrowing scenarios account for around 6% of all loans in our transaction data set. We consider that these examples allow us to understand the pricing of lenders in a much larger proportion of short-term borrowing scenarios, however, given that the prices of different lenders will typically vary linearly with the amount and duration of a loan. Further details of the sensitivity of our findings to variation in these parameters are provided in paragraph 4.32.

(c) a customer takes out a £100 loan for 28 days, which is rolled over for an additional 28 days before being repaid in full; and

(d) a customer takes out a £100 loan for 28 days, which is repaid in full 11 days late (the median overdue period among loans repaid late).

4.18 In each of these scenarios, we make the assumption that where they are given the option, customers opt to pay for faster payment, as opt-in rates for faster payment are high across the products considered in our analysis. We do not include any promotional rates in our analysis, as these discounts are generally available only to limited groups of customers (the extent of price promotions in payday lending is discussed in greater detail in paragraphs 4.56 to 4.59).

4.19 The measure we use for price in all four of these scenarios is the total cost of credit (TCC). The TCC is the total amount in pounds that a customer would pay if they took out and repaid a loan under the circumstances described in the relevant scenario.

4.20 We examined the pricing of the payday lending products offered by 11 major payday loan companies as of October 2013. A list of these products is provided in Appendix 2.1, Table 4.1. For ease of analysis and comparability, we have grouped certain products that are offered by these lenders together, and excluded others from our review (although these exclusions do not have a material impact on our overall findings). These steps are explained in Appendix 4.1.

Analysis of lenders' prices – findings

4.21 In this subsection, we set out our key findings on the level and dispersion of different lenders' prices across different borrowing scenarios.

4.22 Table 4.1 summarises the prices of the different products of the 11 major lenders in each of the four scenarios in our review as of autumn 2013. Figures 4.1 and 4.2 illustrate at a more granular level the prices of each lender for a £100 loan repaid on time after 28 and 14 days respectively. Similar charts corresponding to Scenarios 3 and 4 are shown in Appendix 4.2.

TABLE 4.1 **Descriptive statistics for TCCs* of £100 loans across representative borrowing scenarios**

£

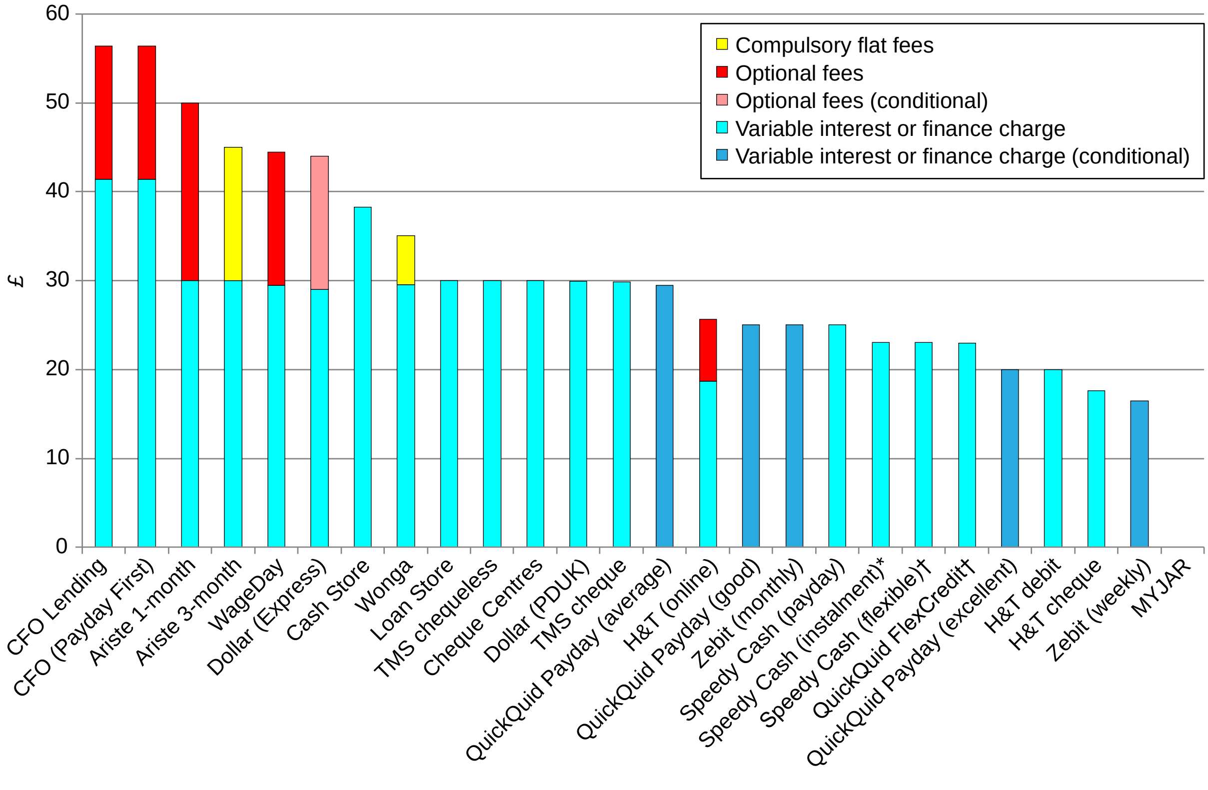
Scenario	*Median*	*Mean*	*Minimum*	*Maximum*	*Range*	*Median deviation from median*
Scenario 1 – 28 days repaid on time	30	33	18	56	39	7
Scenario 2 – 14 days repaid on time	30	29	11	56	45	10
Scenario 3 – 28 days, 28-day rollover	60	62	35	92	57	14
Scenario 4 – 28 days, 11 days late	59	61	32	107	75	19

Source: CMA analysis.

*Values rounded to nearest £.
Note: Where products' prices depend on customers' characteristics, the price used for those products in calculating these descriptive statistics is the weighted average price, with weights derived from data on the proportion of customers with the relevant characteristic. The 'median deviation from median' measure is explained in paragraph 4.29. We include the mean and the median to show that the average prices are not excessively driven by outlying values.

FIGURE 4.1

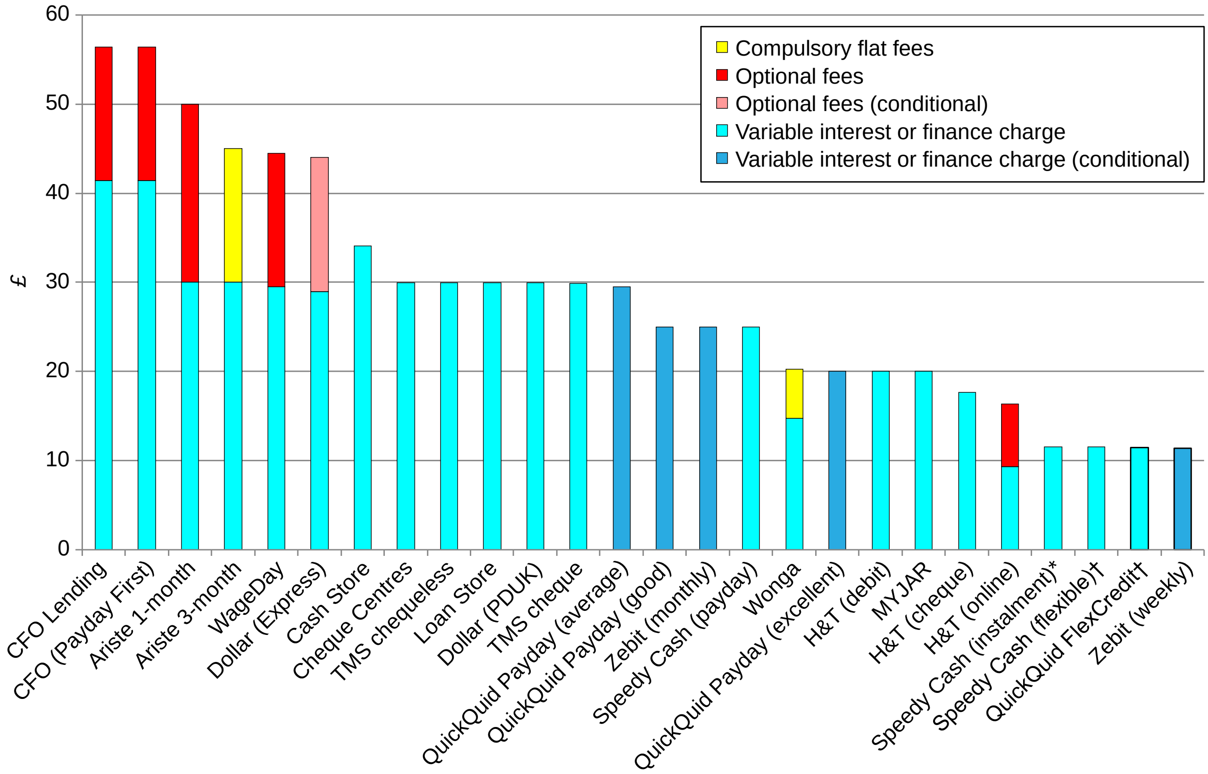
Total cost of credit for a £100 loan over 28 days (Scenario 1)



Source: CMA analysis of lenders' responses to the market questionnaire.
*Long-term instalment products for which this scenario implies prepayment by the customer – see Appendix 4.1.
†Flexible open-ended credit agreements with a flexible draw-down structure.
Note: The maximum duration of MYJAR's product is 18 days and was therefore excluded from this analysis. Products whose prices vary depending on customer are shaded lighter red, namely Payday Express (whose faster payment fee does not apply to new customers), and darker blue, namely QuickQuid Payday (for which the price depends on the customer's risk tier) and Zebit (for which the repayment structure, and therefore price, is determined by the customer's pay cycle).

FIGURE 4.2

Total cost of credit for a £100 loan over 14 days (Scenario 2)



Source: CMA analysis of lenders' responses to the market questionnaire.
*Long-term instalment products for which this scenario implies prepayment by the customer, see Appendix 4.1.
†Flexible open-ended credit agreements with a flexible draw-down structure.
Note: Products whose prices vary depending by customer are shaded lighter red, namely Payday Express (whose faster payment fee does not apply to new customers), and darker blue, namely QuickQuid Payday (for which the price depends on the customer's risk tier) and Zebit (for which the repayment structure, and therefore price, is determined by the customer's pay cycle).

4.23 Looking across the products of the 11 major lenders, we observe that the prices of many products are the same whether a customer borrows for 14 or 28 days due to their 'per month or part-month' interest rate structure. The products that are cheaper in the 14-day scenario than in the 28-day scenario are products with daily interest rates.

4.24 There is a degree of clustering around a headline price of £30 for a £100 loan for customers borrowing for a month or less (further commentary on how this pattern emerged is provided in paragraph 4.46). In both the 28- and 14-day scenarios, the average price of a £100 loan among the products in our review is close to £30. In addition, several different lenders charge monthly interest around this price, including some of the largest lenders in the market: Dollar (for both its online and high-street products), Cheque Centres and CashEuroNet (for customers using its QuickQuid Payday product and falling into the 'average' risk tier).

4.25 Several products that have TCCs that are above £30 for a £100, 28-day loan nevertheless also carry headline interest rates of approximately 30% a month or 1% per day. For example, excluding the £5.50 compulsory fee, Wonga's product is priced at 1% per day; MYJAR's interest charge for its 18-day fixed-term loan works out at 1.11% per day; and excluding optional faster payment fees, WageDayAdvance charges 29.5% and Ariste charges 30% interest per month or part-month.

4.26 Wonga told us that pricing must generate sufficient revenue to allow for a reasonable profit margin above the level of costs and risk borne by the lender and that this might lead to a £30 price point (taking into account 30-day loan lengths for many payday lenders). CashEuroNet told us their pricing reflected the risk of their customers and their operating model.

4.27 Dollar told us that price clustering had been driven to £30 per £100 by customer demand and response. It also highlighted [✂]. SRC similarly told us that the market had identified a price that customers were willing to bear, that reducing prices would eventually cause lenders to lose margin and that lenders instead competed on customer service, convenience and speed. MYJAR told us that customer feedback suggested that £1 per £100 per day was a price that was acceptable to customers.

4.28 Despite a number of lenders charging amounts close to these averages, we observe some significant variation in the total cost of credit incurred by customers borrowing from different lenders, with products available which cost customers substantially more or substantially less to borrow the same amount for the same period. This is illustrated by the large difference between the cheapest and most expensive alternatives available on the market – a gap of £39 in the price of borrowing £100 for 28 days, and £45 when borrowing £100 for 14 days.

4.29 The significant price dispersion is not solely driven by outliers. We calculated the median price deviation across all products from the median price. We used the median as our measure of the average price as the mean is susceptible to being disproportionately affected by a small number of extreme prices. For a 28-day, £100 loan we found the median price to be around £30, but half of all products in the market were £7 or more away from this price. For a 14-day, £100 loan, the median price was also £30, but half of all products in the market were £10 or more away from this price.

4.30 Turning to the other borrowing scenarios, most lenders' interest charges do not change when a loan is rolled over, and so we find that the average price for a 28-day, £100 loan is around £60 when extended for an additional 28 days – twice the average of the on-time borrowing scenario.[6] Looking across the different products, the average price of taking out a £100 payday loan for 28 days and then repaying 11 days late is around £59.

4.31 We found that there was again significant price dispersion in the event that a customer rolled over their loan or repaid late. The difference between the price of the most expensive and cheapest products in our review is £57 for a 28-day, £100 loan rolled over for 28 days, and the gap is £75 for a 28-day loan repaid 11 days late. In the 28-day rollover scenario the median deviation is high, at £14 from the median price of £60. The late repayment scenario shows the most significant dispersion (in absolute terms) of all of the scenarios: half of all products are at least £19 away from the median price of £59 for a £100, 28-day loan repaid 11 days late.

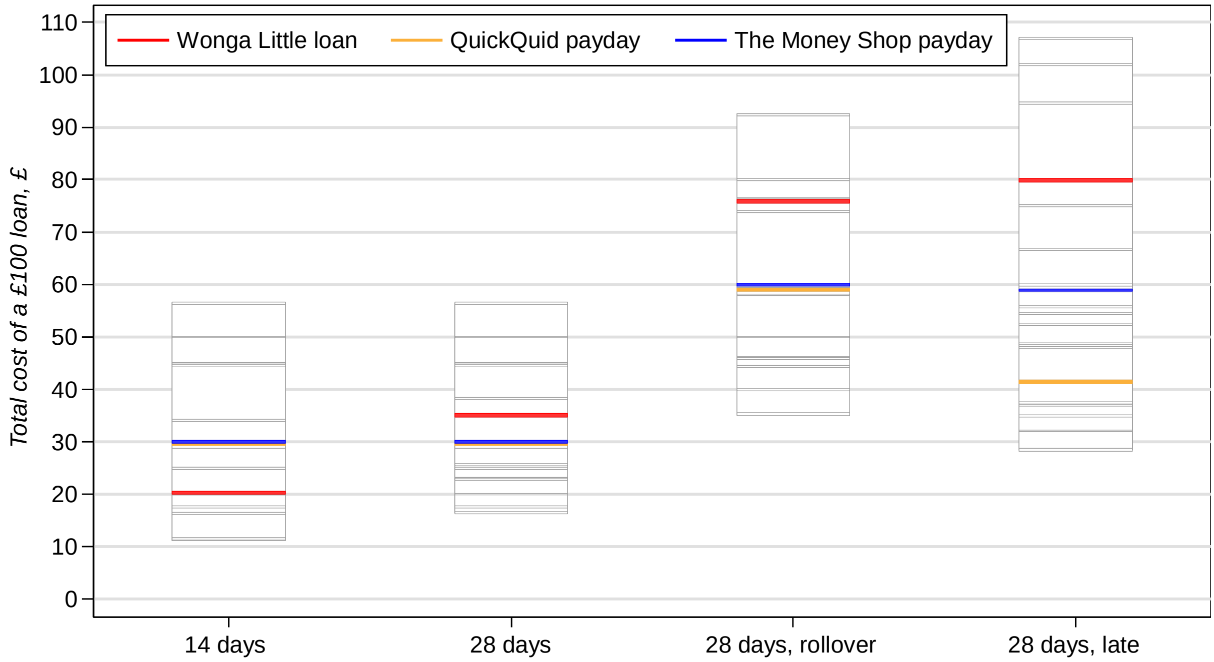
4.32 We also observe variation in the relative prices of different lenders' products across scenarios. That is, a product that is relatively cheap in one scenario may be relatively expensive in another. This is driven by some lenders' use of daily interest rates (which cause their products to be relatively cheap at shorter loan durations, more expensive at longer durations), as well as by variation in the size of the late and other fees charged by different lenders.

4.33 To illustrate this variation in relative prices, Figure 4.3 shows the price of borrowing £100 using products of three of the largest lenders – Wonga, CashEuroNet and The Money Shop – under each of the four borrowing scenarios. The cost of borrowing using each of these products (indicated by the coloured lines) is shown in the context of the range of prices observed across the products of all 11 of the major lenders (the grey bars). The figure shows that borrowing with Wonga is considerably cheaper when taking out a 14-day loan, but more expensive for a 28-day loan or if the loan is rolled over. If the loan is repaid late, CashEuroNet's QuickQuid Payday product becomes significantly cheaper than the other two alternatives.

[6] However, it should be noted that lenders generally require part payment of the outstanding balance before approving a rollover. The components that must be repaid vary across products.

FIGURE 4.3

The relative price of borrowing £100 using the products of Wonga, QuickQuid and The Money Shop, under four borrowing scenarios



Source: CMA analysis.
Note: The grey bars show the range of prices offered by the 11 major lenders, the grey lines show the prices of other lenders.

4.34 We considered the extent to which our findings regarding lenders' prices are sensitive to the parameters of the representative scenarios chosen. We found that:

(a) Price dispersion will tend to be higher when considering loans with shorter durations. This is because the TCCs of products with daily interest rates – which tend to be relatively cheap – become cheaper for shorter loans, while the TCCs of traditional 'monthly' products do not change when the duration is less than one month. The pattern of clustering around a price of £30 per £100 is not sensitive to duration, as most of the products priced at this level are traditional 'monthly' products.

(b) The scale of price dispersion tends to fall in relative terms when considering larger loans. This is because where flat fees apply (affecting eight of the products in our review), these fees will become smaller in relative terms for larger-value loans.

(c) The TCC of a loan repaid late is likely, for some lenders, to vary significantly depending on the length of the overdue period due to both daily late interest, and flat late fees which are incurred after a specific number of days. Nevertheless, because of the wide range of different late

interest fees and charges used by lenders (see Appendix 4.1), we would expect to continue to observe significant dispersion in the TCCs of late loans under alternative assumptions regarding how late a loan is repaid.

Analysis of lenders' prices – the role of risk in explaining price dispersion

4.35 We considered the extent to which the differences in prices that we observed might reflect variation in the credit risk of the customer groups targeted by different lenders.[7]

4.36 We began by noting that payday lenders generally do not explicitly target their products at high- or low-risk payday customers in their marketing materials or on their websites. Nevertheless, it is possible that lenders might target different risk groups in deciding their thresholds for which applications to accept or reject.

4.37 We considered the strength of the relationship between different lenders' default risk and their prices. A strong, positive correlation between lenders' average default costs and average prices would support the hypothesis that dispersion in lenders' prices reflects variation in the risk profile of their borrowers. On the other hand, a weak correlation may suggest that default costs are not the primary driver of lenders' prices.

4.38 When considering lenders' prices, rather than selecting any single borrowing scenario, we computed each lender's average revenue across all loans issued in financial year 2012, and then compared this with the lender's average default rate.[8] We sought to control for differences in lenders' loan profiles, by dividing each lender's revenue by the average loan value, and the total duration of all loans issued by that lender.[9]

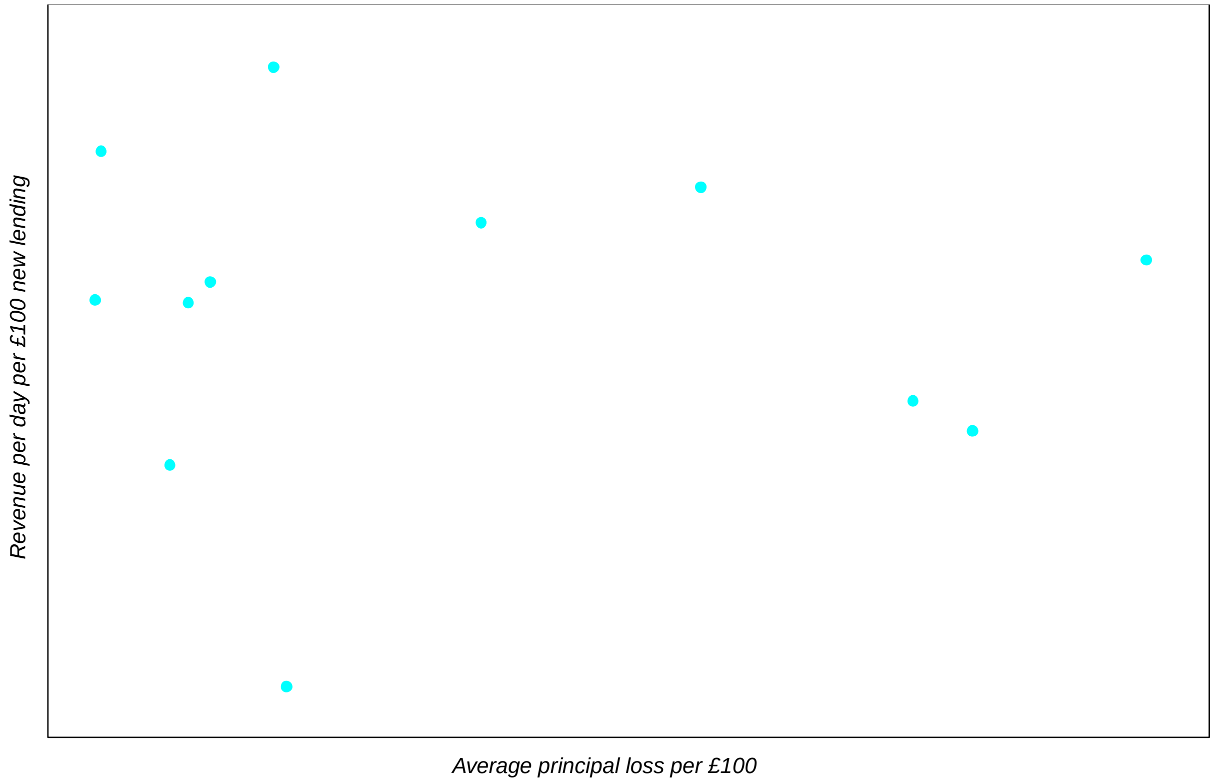
4.39 Figure 4.4 sets out the results of our analysis. It shows that there is significant dispersion both in lenders' average prices and in principal loss rates. However, we do not find a clear correlation between the two. In particular, some lenders with relatively high average daily revenues enjoy relatively low

[7] CashEuroNet said in paragraph 4.3 of its response to the annotated issues statement that 'wide price dispersion may simply reflect payday lenders to some extent serving different types of customers (by risk profile)'.
[8] As the financial years of lenders do not always coincide, so the revenue and default rates that we calculate for each lender relate to overlapping but not identical periods.
[9] For a given lender, the average revenue earned per day per £100 lent is given by its total accounting revenue divided by its total value of new principal lent, all divided by the average duration of its loans. Total accounting revenue includes all revenue earned from interest income, origination fees, optional fees and penalty fees. Average duration is calculated as the average difference between the date of the loan agreement and the date of the final repayment. This measure of average revenue effectively describes the amount of revenue, on average, that a lender generates for every day £100 of principal has been issued and remains outstanding.

default rates, and there are substantial differences in average daily revenues among lenders with similar default rates.

FIGURE 4.4

Price versus default costs



Source: CMA analysis.

4.40 One potential limitation of this approach is that there may be other cost factors which also affect lenders' prices, and that any relationship between prices and default costs would only emerge when controlling for these other factors. However, in this respect we note that the pattern of weak correlation remains when we consider Figure 4.4 and restrict our attention to:

(a) traditional payday loan products with no instalment or flexible line-of-credit structure;

(b) payday loan products that do not offer short durations and/or daily interest rates; and

(c) online products.

4.41 Our full analysis of the relationship between lenders' revenues and their costs is set out in the subsection on profitability, starting from paragraph 4.105.

Price competition between payday lenders

4.42 We next considered the extent to which payday lenders compete with each other on prices. We first discuss the way in which prices have evolved during the past seven years. We then discuss lenders' use of pricing promotions. Finally, we consider some recent developments in payday lenders' pricing.

Evolution of prices in the period 2007 to 2013

4.43 This subsection discusses our findings based on evidence from the historical evolution of prices. We first discuss our findings in relation to headline prices (paragraphs 4.44 to 4.49) before separately describing the evolution of late fees (paragraphs 4.50 and 4.51). These findings are drawn from our analysis of the payday loan prices of each of the major lenders over the period 2007 to 2013, which is presented in detail in Appendix 4.3.

4.44 Headline price changes are infrequent. Many lenders have either made one change to their products' headline rate since 2008, or have never changed their prices. For example, following some early adjustments to its transmission fee, the price of borrowing with Wonga for loans repaid on time did not materially change in the period from 2009 to 2013.[10]

4.45 Where price changes have taken place, they have tended to be price increases and, correspondingly, the trend has been for the average price for a loan repaid on time to increase over the period.

4.46 Many of the price increases that we observe reflect lenders adjusting their prices from a lower level up to an interest rate of approximately 30% per month, giving rise to the cluster of prices around 30% per month (or 1% per day) described in paragraphs 4.24 and 4.25. This 'cluster' emerged over a number of years, as follows:[11]

(a) In 2008, Wonga launched its product with an interest rate of around 1% per day. It introduced a transmission fee of £5.50 in mid-2008. At the point of Wonga's entry, all other payday lenders in our review charged monthly interest rates below the 30% level.

(b) In 2009, CashEuroNet increased the interest rate on loans to its highest-risk customers – [✂] – to 29.5% per month. At the end of this year, Ariste

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[10] The only change was made in 2013, when Wonga changed its daily interest rate by a very small amount, from [✂]% to 1.0% per day [✂].

[11] We are aware that price changes towards a TCC of £30 for a £100, one-month loan have also taken place since the period considered in our review. For example, in 2014, SRC increased the interest rate of its payday loan products to 29% per month and the daily interest rate on its Flex Loan product to 0.95% per day.

entered the market with a headline interest rate – excluding optional fees – of 30% per month on four different products.

(c) In 2011, WageDayAdvance increased its headline interest rate, excluding optional fees, to 30%. In the same year, Cheque Centres introduced its online Loan Store product with an interest rate of 29%. It also began increasing the interest rate on its high-street product – this rate reached 30% in 2013.

(d) In late 2011 and early 2012, Dollar increased the headline rates of its online products, Payday Express and PaydayUK, to 29% and 30% per month respectively.

(e) In 2013, Dollar also increased the interest rate on its high-street products to close to 30% per month.

4.47 There were very few instances of headline price reductions in the period. Since 2007, reductions in the TCCs of loans that are paid on time – ie reductions in interest charges, compulsory fees and/or optional fees – were only observed on six of the products considered in our review.[12] All but one of these reductions applied to products whose prices were already relatively high – ie costing at least £33 for a £100, 28-day loan – and none took the lenders' prices materially below the £30 mark.

4.48 The other price reduction was associated with the introduction of risk-based pricing by CashEuroNet in 2009, albeit this price reduction applied only to the subset of its customers qualifying for its lowest-risk price tier. In particular, this represented a price reduction from £25 to £20 per £100 for these customers while, at the same time, prices were increased from £25 to £29.50 for customers in the highest-risk tier. For comparison, the lowest-risk tier accounted for [✂]% of new customers and [✂]% of repeat customers using this product in July 2013, while the highest-risk tier represented [✂]% of new customers and [✂]% of repeat customers.

4.49 We saw two examples in the period where existing lenders introduced new products with low prices relative to other payday lenders, namely Speedy Cash's Flex Loan and Flex Account, and CashEuroNet's FlexCredit product.

(a) Since 2011, Speedy Cash has introduced two new products:

(i) The first of these was 'Flex Loan', a 12-month instalment product with a price of around £21 for a 28-day, £100 loan. In 2013, the Flex

[12] Dollar's Payday Express, CashEuroNet's QuickQuid Payday, Cheque Centres' Loan Store product, CFO Lending's two payday loan products and the Cash Store's payday loan.

Loan was changed to an 18-month instalment product with a higher price of £23. Recent information on the Speedy Cash website indicates that the price of the Flex Loan for a one-month, £100 loan has increased to £29. SRC told us that more than 90% of its customers now chose the Flex Loan.

(ii) The second of these was the 'Flex Account', an open-ended credit agreement with a price of around £23 for a 28-day, £100 loan. SRC suspended this product in July 2013 as the take-up rate was low.

(b) Towards the end of the period, CashEuroNet introduced QuickQuid FlexCredit. This product is priced at a relatively low level of around £23 for a £100, 28-day loan repaid on time. We consider the introduction of FlexCredit alongside other recent developments in payday lenders' pricing in paragraphs 4.60 to 4.70.

4.50 We also considered how charges on loans that are repaid late had changed in the period. We found that changes to late fees and interest are similarly uncommon: 6 of the 11 lenders we considered had kept their charges unchanged during the period. This includes one of the three largest lenders, CashEuroNet.

4.51 Where lenders have changed their late charges, those changes have been infrequent, rarely occurring more than once per year, and are almost always substantial increases. To summarise the changes in the period:

(a) Two lenders introduced new late charges during the period, PaydayUK (a £15 flat late fee) and H&T (which introduced a daily late interest charge for its high-street products equivalent to the monthly interest rate).

(b) WageDayAdvance's late interest rate increased in 2011. While the daily rate was decreased in 2013, the flat fee of £12 has recently been increased to £20.

(c) Wonga increased its 'day one' late fees on a number of occasions over the period, trebling its charges from a £10 flat fee in October 2007 to a £30 flat fee in August 2013;[13]

(d) The Money Shop reduced the late fee on its cheque-based loan from £25 to £16 in 2012, but then increased this fee to £29 in August 2013. The late fee on its 'chequeless' loan was increased from £25 to £29 in 2012.

[13] Wonga reduced this late fee to £20 in April 2014.

(e) CFO Lending's late interest rate has fluctuated over the period in line with its product's headline interest rate, while its flat late fee of £25 has not been changed.

4.52 We also considered lenders' commentary on their price changes. Several lenders told us that they adjusted their prices or products' characteristics to win customers from other payday loan providers. In general, we saw little evidence to support this, although there was a limited number of relevant examples, which are discussed elsewhere in this sub-section Notably, four lenders told us that they did not adjust their prices or products' characteristics to win customers from other payday loan providers:

(a) Cheque Centres told us that it was not aware of how other payday loan providers affected its business and that it had not responded to other lenders' activity by changing the features of its product. It also told us that its Loan Store business did not overtly compete with other payday lenders, that it did not track their pricing or changes to their offering and that other competitors' stances did not drive its own activity, pricing or profitability.

(b) MYJAR told us that other lenders' prices were not a key factor in its pricing and that it set its price at a level that customers saw as fair and that gave it an economic return. It also indicated that it took no actions to win customers from individual competitors, except to adjust the criteria for leads and the price it paid to 'introducers'.

(c) Ariste told us that it had not taken any actions to win customers from, or reacted to the competitive actions of, its competitors, but that it would not rule out this approach in the future.

(d) The Cash Store told us that it had not been in a position where it needed to react to specific competitive actions of other lenders.

Use of price promotions

4.53 In this subsection, we discuss the extent to which payday lenders discount their headline rates for specific groups of customers.

4.54 Price promotions are used to varying degrees by all three of the largest lenders. Where offered, these promotions typically involve a substantial discount – for a £100, 28-day loan repaid on time, the discounts offered by these lenders ranged in value from around £4 to around £10. In particular:

(a) Wonga's discounts typically consist of waiving its £5.50 transmission fee (and, therefore, also the additional interest charges that apply when this

amount is included in the principal). This reduces the price of a £100, 28-day loan by £7.04.

(b) CashEuroNet told us that the average discount from its promotions given to new customers was 32% during the period June to August 2013. Depending on the customer's price tier, this average discount corresponds to a discount of £ 6.40, £8.00 or £9.44 on a £100, one-month loan repaid on time.

(c) Dollar's PaydayUK and Payday Express businesses both offered a discounted 25% interest rate to some customers, amounting to a saving of £4 and £5 respectively on a £100, one-month loan repaid on time.

(d) Dollar's Money Shop has offered promotional interest rate reductions of between [30–40]% and [50–60]% to some new customers of its cheque-based loan product between 2010 and 2013. However, no such discount has applied since the price increase to £29.95 per £100 in 2013.

4.55 These promotions are targeted at a number of different customer groups, commonly including:

(a) repeat/existing borrowers

(b) customers referred by comparison websites; and

(c) customers responding to specific advertising campaigns.

4.56 The coverage of these promotions – ie the proportion of loans sold at the relevant promotional price – is generally quite small. In particular, promotional prices applied to [✂]% of Wonga's loans and [✂]% of cheque-based loans provided by The Money Shop. In August 2013, the proportion of new customers paying discounted interest rates [✂] was [✂]% for PaydayUK and [✂]% for Payday Express (although these figures averaged [✂]% and [✂]% respectively in the months after the discount began but before the closure of the payday loans section of moneysupermarket.com).

4.57 However, two of the promotions offered by the largest lenders have a broader coverage. In particular:

(a) CashEuroNet told us that its promotional discounts applied to [✂]% of loans issued to new customers in the period June to August 2013. These price promotions generally required applicants to enter a discount code

advertised via affiliate websites, direct emails to customers, and pay-per-click and television advertisements.[14]

(b) Dollar's discounted interest rate of 25% (described in paragraph 4.54*(c)*) was applied to around [✄]% of the loans made by PaydayUK to existing customers in August 2013, and around [✄]% of the loans made to existing customers by Payday Express. This 'discount' is a legacy of the price increases introduced by Dollar's online subsidiaries in December 2011 to March 2012, which were applied to new customers only, such that existing customers continued to be offered the pre-2012 interest rate.

4.58 Apart from the largest lenders, CFO Lending, Cheque Centres, H&T and WageDayAdvance all told us that they did not use price promotions. Ariste, The Cash Store, Global Analytics and MYJAR all offered price promotions that were small in terms of the coverage of loans.

4.59 SRC offered a substantial price promotion which applied to a large proportion of loans issued through its 'Speedy Cash' high-street chain. This promotion offered zero interest on the first £200 borrowed by new customers and applied to over [✄]% of loans to new customers in August 2013. However, the total volume of loans issued to new customers was small relative to the total market.[15] The customer response to this promotion is discussed in paragraph 4.73*(d)*.

Recent developments in pricing

4.60 In this subsection we discuss some particularly significant recent developments in payday lenders' prices that we have been informed of during the course of our market investigation. In particular, we consider the introduction by CashEuroNet – the second largest online lender – of the FlexCredit product in June 2013, and then go on to discuss some further developments in the market subsequent to the launch of this product.

4.61 CashEuroNet introduced FlexCredit in June 2013. This is an open-ended, revolving credit product, which charges a daily interest rate of 0.82% and has no compulsory fees or faster payment fees. The price of a 28-day, £100 loan repaid on time is therefore around £23.The introduction of FlexCredit warrants particular consideration because it is one of very few (perhaps the only) examples of one of the largest lenders significantly reducing the prices that

[14] CashEuroNet also clarified that it offered discounts when customers indicated that they had shopped around and were considering switching to a cheaper product from another lender.
[15] In the month immediately following the introduction of the promotion on each of its products, SRC issued around 1,300 traditional payday loans and around 60 'Flex Loans'.

borrowers are charged for their loans.[16] Available data suggests that the product has, since its introduction, [✄].

4.62 CashEuroNet told us that its decision to launch FlexCredit arose from its loss of customers for loans with durations of around 15 to 17 days, because QuickQuid Payday was expensive relative to [✄] over this duration. It also told us that the decision to introduce FlexCredit was informed by market research, which showed that its 'target audience' ranked loan cost, flexibility and perceived chance of approval as key drivers of payday loan choice.

4.63 Where other payday loan products have previously been offered with a headline interest rate significantly below 30% per month or 1% per day, there is evidence to suggest that these lenders have been unsuccessful in attracting customers through these low prices (see paragraphs 4.73 and 4.76), and in many cases the price of the relatively cheap products have subsequently been increased, or the products have been withdrawn.[17]

4.64 Generally speaking, the introduction of the FlexCredit product does not to date appear to have resulted in the other major payday lenders responding by reducing their prices. For example, Speedy Cash has increased the price of its traditional payday loan and Flex Loan[18] since the introduction of FlexCredit. While Dollar has introduced a £5 promotional discount applying to all loans repaid on time, this offer was only open between October 2013 and April 2014. WageDayAdvance has introduced 'FlexAdvance', a new instalment loan product. However, this is priced significantly above CashEuroNet's FlexCredit product: borrowers are typically charged 0.97% per day with a £15 optional faster payment fee (implying a 28-day, £100 loan repaid in one instalment would cost around £42 including the faster payment fee).

4.65 [✄]

4.66 [✄][19]

4.67 Figure 4.5 presents [✄].

[16] In each of the four scenarios considered in our analysis, FlexCredit is among the cheapest products, and is cheaper than all of the products offered by the three largest lenders.
[17] For example, Speedy Cash's Flex Loan had an interest rate of 0.72% per day, but this was increased to 0.82% per day (equalling FlexCredit) in July 2013 and most recently to 0.95% per day. H&T withdrew its high-street products for new customers in June 2013.
[18] See paragraph 4.49*(a)*(i).
[19] [✄]

FIGURE 4.5

[✂]

Source: [✂]
Note: [✂]

4.68 [✂]

4.69 Figure 4.6 compares [✂].

FIGURE 4.6

[✂]

Source: CMA analysis.

4.70 [✂]

Customer sensitivity to prices

4.71 We next discuss evidence on the extent to which payday customers appear sensitive to differences in price, either between lenders or over time. We begin by setting out evidence from lenders' submissions on how customers have responded on those occasions where they have changed their prices in the past. We then discuss the extent to which the products that customers choose appear to reflect the relative prices of the different alternatives on offer.

Evidence from lenders' submissions on customers' responsiveness to price changes

4.72 We begin this subsection by considering evidence on customers' responsiveness to changes in headline prices, before separately considering responsiveness to late fees.

4.73 Several lenders' commentary indicated that customers were not responsive to changes to headline prices, and that lenders charging relatively low prices had not been particularly successful in attracting new business. For example:

(a) [✂] told us that it increased its [✂] interest charge from [✂]% to [✂]%, in order 'to increase revenue as [it was] getting no appreciable marketing benefit by undercutting competitors on price'. It said that there were two main reasons for the weak response by customers to that change: [✂].

(b) Furthermore, [✂] told us that it increased its [✂] price after it 'looked at the market and … determined that [it] wanted to be competitive in that market but that there was room for some increase in price'.

(c) Similarly, H&T told us that media coverage suggested that all payday lenders were 'as bad as each other' and, therefore, customers did not understand the potential savings from shopping around. It told us that its efforts at being cheaper failed to 'gain any traction', despite charging significantly lower prices than some competitors.

(d) SRC told us that it did not think price was a key factor in customers' choice of product, mainly because of the relative urgency with which they required a loan. It did not believe it would get more volume if it lowered prices and that its interest-free loan offer had only led to a marginal pick-up in volume (despite the size of the discount that was offered).

(e) SRC also said that the absence of risk-based pricing arose partly because the lower rate offered to low-risk customers would not result in sufficient retention of customers to make the price reduction profitable. It said that this may be the result of relatively poor availability of price comparisons, compared with other financial products such as credit cards and auto loans.

(f) [✂] told us that it did not consider that 'the evidence is overwhelming that [price promotions have] an enormous impact' and that price promotions were therefore not a primary driver of its business. It told us that this was 'one of the reasons why [✂]'.

4.74 There was some indication that customers may be more responsive to increases in monthly interest rates above 30%. In particular, Dollar told us that the increase in Payday Express interest rates from 30 to 33% per month or part-month in September 2013 was reversed because [✂]. It told us that [✂]. It said that [✂].

4.75 Wonga told us that its internal analysis showed a relatively sensitive response by customers to an increase in its price from [✂] to 1% in June 2013. [✂] It interpreted this price response as implying a price elasticity of [✂].[20] We noted the potential for variation in Wonga's applications over time for reasons unrelated to its own prices, which was not controlled for, and therefore did not consider that this estimate could be relied upon. Moreover, the price was advertised as 1% per day both before and after the price change, ie even when Wonga charged the slightly lower price of [✂]% per day. In addition, the price change was accompanied by a substantial increase in the representative APR (from 4,214 to 5,853%) which reflected not just the price change but also changes in Wonga's representative loan amount and

[20] [✂]

duration. As such, any customer response that did take place may have been driven by a large perceived change in price despite the actual change being marginal.

4.76 We also consider evidence from lenders' submissions on the extent of customer responsiveness to late fees. Again the evidence that we saw suggested that customers were insensitive to changes. In particular:

(a) Wonga told us that it did not notice any difference in the take-up of loans following the increase in its late loan fee from £20 to £30, although it also told us that it did not track the response closely.

(b) [✄] said in an internal document that it [✄].

(c) [✄]

(d) SRC, which increased its late payment fee substantially for both its Speedy Cash and WageDayAdvance products in December 2013, did not mention any significant impact on its volume following the price increase.

4.77 Finally, there was some evidence from the way that pricing promotions were used by payday lenders to suggest that certain groups of customers may be perceived as being more sensitive to prices than others. In particular, Dollar told us that when it increased its monthly interest rate from 25 to 29%, it applied the increase to new customers coming through lead generator or organic search channels, while excluding existing customers and customers coming from the moneysupermarket.com website, because that [✄]. We also observed a number of other lenders targeting discounts at customers using price comparison websites. Further, CashEuroNet told us that it offered coupons to customers when they indicated at point of purchase that they were considering a competitor's product (see paragraph 4.55*(e)*).

Analysis of customers' responsiveness to headline prices

4.78 In this subsection we consider the correlation between lenders' shares of supply and their prices in different borrowing scenarios, so as to understand the extent to which customers' choice of payday loan product in different scenarios reflects the relative prices of the loans that are available.

4.79 We begin by examining lenders' shares of loan volume within our two main scenarios – a £100 loan taken out for 14 or 28 days and repaid on time.[21] For each scenario, we examine all loans in the transaction data that were taken

[21] See Appendix 4.2 for a discussion of the representativeness of these two borrowing scenarios.

out for the relevant amount and duration (or similar) and calculate the shares of total loan volume in the period 1 April to 9 June 2013 achieved by each product. Appendix 4.4 provides further details of our methodology.

4.80 Figures 4.7 and 4.8 show the results of our analysis. There is some evidence to suggest that those products which are relatively low-cost in a scenario account for a greater share of the market – in particular, the proportion of loans of around 14 days which are accounted for by products with pricing structures which make them cheaper for short loan durations (such as those of Wonga and MYJAR) is greater than the shares of longer-duration loans accounted for by such products.

4.81 Nevertheless, in both scenarios we find that a substantial proportion of customers take out relatively expensive products despite the presence of cheaper alternatives. For instance, during the period, while customers seeking a loan of £100 for 14 days could pay £17 when borrowing from MYJAR, around half of all customers taking out a loan of similar amount and duration choose a product with a TCC of around £20 or more, and around a quarter of all customers choose a product with a TCC of £25 or more. Similarly, while the price of a £100 loan for 28 days lay between £16 and £25 for the seven cheapest products, a large majority (over [✂]%) of customers choose products with a TCC of more than £25, and more than a fifth of customers choose products with a TCC of over £35.

FIGURE 4.7

Price by market share for loans of £100 for 14 days (and similar)

[✂]

Source: CMA analysis.
Notes: [✂]

FIGURE 4.8

Price by market share for loans of £100 for 28 days (and similar)

[✂]

Source: CMA analysis.
Note: [✂]

4.82 One possible explanation for the observation that a substantial proportion of customers take out loans where cheaper alternatives are available is that some customers are unable to identify the best-value product for themselves. We discuss possible barriers to shopping around and switching which may lead to this result in detail in Section 6.

4.83 There are, however, other possible explanations, including:[22]

(a) Customers may be unable to choose cheaper products, because of the credit constraints that they face.

(b) Certain customers may prefer more expensive products because of the non-price features of those products, such as a lender's level of customer service, and whether the lender is an online or high-street lender.

4.84 We consider each of these other possible explanations in turn below.

- *Customer responsiveness and credit constraints*

4.85 We considered the extent to which customers may choose more expensive products because they are unable to take out better-value loans, given their credit histories.

4.86 In order to test the extent to which credit availability may be driving the patterns that we observed in paragraph 4.79, we analysed variation in [✂] risk scores of different lenders' customers. These scores were available for customers of [✂]. Table 4.3 sets out statistics describing the distribution of [✂] scores for accepted loans for each of these products during the period January 2012 to August 2013.

TABLE 4.3 **[✂] risk scores for accepted loans by product, January 2012 to August 2013**

Lender	*Product*	*Mean*	*Median*	*Standard deviation*	*Minimum*	*Maximum*	*Range*	*Inter-quartile range*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis.

Note: The interquartile range describes the range of all values excluding the top and bottom quartiles. This measure is useful when considering differences in the distributions of risk scores without the potential for those differences to be driven by a small number of outliers.

4.87 [✂]

4.88 We then assessed the relationship between different lenders' prices and their market shares for a subset of low-risk customers (defined as customers within the top decile of [✂] scores in the sample, corresponding to all customers with a score of at least [✂]). In general, we would not expect these low-risk customers to be constrained in the lenders that they could borrow from (or at

[22] In principle, customers may also prefer products with higher headline rates if they anticipate a risk that they will default on their loan, and the products that they choose have lower fees in this eventuality. However, we note that this is unlikely given the limited extent to which customers appear to base their loan decision on late fees (see Section 6).

least, we would expect a smaller proportion of these customers to be constrained in their choice of lender). The top panel of Figure 4.9 illustrates each lender's share of customers taking out loans for £100 for 14 days across all customers for whom [✂] scores are available, while the bottom panel shows those shares among only the top decile of low-risk customers. Figure 4.10 does the same for loans of around 28 days.

FIGURE 4.9

Prices by market share for loans of £100 for 14 days (and similar) among customers of all risk ratings (top panel) and low-risk customers (bottom panel)

[✂]

Source: CMA analysis.
Note: [✂]

FIGURE 4.10

Prices by market share for loans of £100 for 28 days (and similar) among customers of all risk ratings (top panel) and low-risk customers (bottom panel)

[✂]

Source: CMA analysis.
Note: [✂]

4.89 These charts show that a material proportion of customers continue to take out products that are significantly more expensive than others available on the market when we restrict our attention to low-risk customers (ie customers with high [✂] scores) that are unlikely to be constrained in their choice of lender. For example, Figure 4.8 shows that [✂] of these customers use [✂] when taking out a loan [✂], even though [✂] offers [✂] interest that is much cheaper. Figure 4.9 shows that [✂]% of low-risk customers taking out a loan for around a month take out a loan with [✂], even though [✂] offer products that are £[✂] cheaper for a £100 loan. This strongly suggests that the patterns that we observe cannot be fully explained by the credit constraints faced by customers.

- *Customer responsiveness and non-price characteristics*

4.90 We also considered the extent to which differences in the non-price characteristics of different lenders' products might drive the patterns that we observe. Specifically, certain customers may prefer more expensive products because of the non-price features of those products, such as the degree to which the product offers repayment flexibility, or a lender's quality of customer service.

4.91 Testing the extent to which this is the case is difficult, given that each lender's service will be unique in some way, and the difficulty in both quantifying the extent of any non-price differences that do exist and their value to customers. Notwithstanding this, we note that at their core, payday loans are a relatively homogeneous product (in that the underlying service received by all online customers is exactly the same – a deposit in the applicant's bank account).

4.92 One of the key dimensions across which payday loans differ is in terms of customers' ability to repay in instalments. However, we considered that a willingness among customers to pay more for the ability to repay in instalments was not likely to explain the substantial proportion of customers found in our analysis to choose relatively expensive products (as presented in paragraphs 4.79 and 4.80, and Figures 4.7 and 4.8), based on the following observations:

(a) For most products offering repayment by instalment, those instalments occur at monthly intervals (eg QuickQuid Payday, the monthly Lending Stream Loan and Ariste's three-month Cash Genie Loan). Therefore, these products do not offer additional repayment flexibility relative to traditional payday loan products when the customer's borrowing requirements are for durations of one month or less, as is the case in the analysed scenarios.

(b) Those products that do allow for relatively flexible repayment on short-term loans (ie by offering either instalments that can be made more frequently than once a month, or at the discretion of the borrower[23]) have [✄] small market shares in the analysed scenarios.

(c) Those products that are relatively expensive but nevertheless have substantial shares of loan volume (eg [✄]) do not offer repayment by instalment, although we note that [✄].

4.93 Another key difference between the products of different lenders is whether they are offered online or on the high street. In order to assess the extent to which this might be driving the patterns that we observe, we replicated the analysis previously presented in Figures 4.7 and 4.8 for online products only in Figure 4.11.

[23] eg Speedy Cash Flex Account and Flex Loan, and the weekly Lending Stream Loan.

FIGURE 4.11

Prices by market share for loans of £100 (and similar)—online products only

[✂]

Source: CMA analysis.
Note: [✂]

4.94 We find a similar pattern to that observed previously: a material proportion of customers taking out online loans use products that are significantly more expensive than others that are also available online. For example, while the price of a £100 loan for 14 days from MYJAR was £17, [✂]% of online customers with similar borrowing requirements borrowed using a product with a TCC of around £20 or more (a relative difference in prices of over 18% for a £100 loan), and [✂]% of customers chose a product with a TCC of £25 or more (a relative difference in prices of over 47% for a £100 loan). Similarly, while a number of online lenders offer loans for 28 days with TCCs ranging from £20 to £30, [✂]% of customers chose products with TCCs of £35 or more and [✂]% of customers chose products with TCCs of over £45, between 1.5 and 2 times the price of some other online loans.

4.95 Next, we noted that if the reason that a relatively expensive product holds market share in one scenario is because it has a non-price characteristic that causes the product to be preferred by customers, we would not then expect to see that product 'lose' market share to other, considerably more expensive products in a scenario where it is relatively cheap.

4.96 However, the evidence suggests that this is not the case. In particular, Figure 4.10 shows that Wonga holds [✂]% of total online loan volume in the 28-day scenario, while cheaper products PaydayUK and QuickQuid Payday hold a combined share of online volume of [✂]%, [✂]. If demand is being driven by superior non-price dimensions of Wonga's product, then we would expect that in the 14-day scenario, customers would always prefer Wonga (which would have both better non-price characteristics, and would be considerably cheaper) to these alternatives. However, we find that in the 14-day scenario PaydayUK and QuickQuid Payday have a share of online volume around [✂]% [✂].

4.97 We also examined the relationship between market shares and price, restricting the sample to customers taking out their first loan from a given lender, to examine whether the patterns that we observed might be driven by customers deciding to go back to a more expensive lender on the basis of a previous positive experience. However, Figure 4.12 shows that relatively expensive products capture a share of first-time loans that is at least as high as when considering new and repeat customers together, suggesting that the patterns that we observe cannot be explained by customers' previous experience with a lender.

FIGURE 4.12

Prices by market share for loans of £100 (and similar) – borrowers who are new to the lender

[✂]

Source: CMA analysis.
Note: [✂]

4.98 Although we cannot discount the possibility entirely, taken together the evidence presented above suggests that the price dispersion we have observed is unlikely to be driven primarily by any differences that exist in the non-price characteristics of different payday loan products.

Provisional conclusions on pricing

4.99 Payday lenders use a variety of different pricing structures, and the amount that a customer pays for a loan will usually consist of several distinct charges or fees. Among other factors, prices will typically depend on the desired loan amount, duration and instalment structure; whether the loan is repaid on time, extended or topped up; and whether the customer opts for faster payment.

4.100 We found that there is a degree of clustering around a headline price of £30 for a £100, month-long loan. The lenders charging monthly interest around this level include some of the largest in the market. In addition, several products with prices that are above £30 for a £100 month-long loan nevertheless carry headline interest rates of approximately 30% a month or 1% per day. This clustering in prices has emerged over time as increasing numbers of lenders have increased their prices to this level.

4.101 Despite a number of lenders now charging headline prices close to this average amount, we continue to observe some significant variation in the prices that different lenders charge in a number of representative borrowing scenarios. For example, the difference between the cost of borrowing £100 for 28 days using the cheapest product included in our review and the most expensive alternative is £39. The extent of price dispersion is even greater in the event that a customer repays their loan late.

4.102 Headline price changes are infrequent, and many lenders have either made only one change to their products' headline rate since 2008, or have never changed their prices. Price reductions are particularly uncommon. The most notable exception is CashEuroNet's recent introduction of its FlexCredit product, which is priced significantly below £30 per £100. To date, we have not seen other lenders responding by similarly reducing their own prices, and we note that in the past lenders which have offered headline interest rates significantly below 30% per month or 1% per day have generally been unsuccessful in attracting large volumes of new customers and have in many cases subsequently increased their price or withdrawn their product.

4.103 There is some evidence of competition between lenders taking place via the use of price promotions. However, the coverage of the price promotions used by payday lenders is generally limited. Among the largest lenders, the main exception to this is again CashEuroNet, for whom a higher proportion of customers (around a [✄] of new customers) benefit from significant discounts. In addition, before it closed its payday service, a significant number of customers searching for a loan via the price comparison website moneysupermarket.com were offered discounts by several lenders.

4.104 Customer demand appears unresponsive to variations in prices. Where lenders have changed their prices, this does not generally appear to have resulted in a significant customer response, and lenders that have offered substantially lower rates have not been particularly successful in attracting new business. There is evidence to suggest that customers may be particularly unresponsive to changes in late fees. In addition, we observe a material proportion of customers taking out loans that are significantly more expensive for their given borrowing requirements than similar payday loan products available on the market. The evidence suggests that the substantial shares of loan volume captured by relatively expensive products is not simply driven by the credit constraints faced by customers, or by any differences in the non-price characteristics of the different products on offer.

Profitability

Introduction

4.105 Having considered the evidence on pricing behaviour, we now analyse the profitability of the main payday lenders.

4.106 By combining evidence on lenders’ revenues and their costs, profitability analysis complements our assessment of lenders’ pricing, helping us to form a view of whether an effective competitive process is driving prices down towards the costs of provision, or whether there are indications of shortcomings in the competitive process. Profitability analysis also provides one way of assessing whether prices are high compared with a competitive benchmark. We consider whether prices of payday loans are high relative to other forms of borrowing in Section 5.

The Guidelines

4.107 The Guidelines[24] set out how consideration of the economic profitability of the business activity being investigated may be used as an indicator of competitive conditions in the market.

4.108 In practice, a competitive market would be expected to generate significant variations in profit between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. Firms in a competitive market would generally earn no more than a 'normal' rate of profit where the rate of return on capital employed (ROCE) for a particular business activity would be equal to the opportunity cost of capital for that activity. In competitive markets, characterised by free entry and exit, companies are expected in the long run to make profits that equal the minimum returns required by investors (the opportunity cost of capital). Hence returns that are persistently in excess of the cost of capital can be an indication of market power or a lack of competition in a market.

4.109 Differences between returns and the cost of capital may sometimes be explained by innovation and successful risk-taking by firms. Our Guidelines recognise that at particular points in time the profitability of some firms may exceed what might be termed the 'normal' level. There could be several reasons for this, including cyclical factors, transitory price or other marketing initiatives, and some firms earning higher profits as a result of past innovation, or superior efficiency.[25]

4.110 In measuring profitability, the Guidelines refer to the use of a meaningful measure of profitability, usually in terms of rates of return on capital, and refer to both return on equity (ROE) and ROCE.[26]

4.111 Our consideration of the profitability of payday lending comprises four sub-sections as follows:

(a) Market-specific factors: we begin by considering market-specific factors affecting the methodology adopted for analysing profitability in payday lending (see paragraphs 4.112 to 4.126).

(b) ROCE analysis based on updated accounting information: we then consider the views of parties on our preliminary profitability analysis[27] and

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[24] *CC3*, paragraphs 114–120.
[25] *CC3*, paragraph 117.
[26] *CC3*, paragraph 9.
[27] Our preliminary profitability analysis was published in our Profitability of payday lending working paper.

set out our approach to estimating levels of ROCE based on updated accounting information submitted by lenders (see paragraphs 4.127 to 4.153).

(c) Provisional findings on ROCE: we then consider the treatment of asset values and set out our provisional findings on historic ROCE after adjustments for intangible assets (see paragraphs 4.154 to 4.164).

(d) Interpretation of ROCE findings: we then consider the issues associated with interpreting the levels of profitability observed, and the estimation of the relevant cost of capital for payday lenders for use as a benchmark for assessing profitability (see paragraphs 4.165 to 4.185).

(e) Finally, we set out our conclusions on profitability analysis (see paragraphs 4.186 and 4.187).

Specific considerations for conducting profitability analysis in payday lending

4.112 In addition to the general considerations normally associated with conducting profitability analysis in market investigations, we sought to assess any industry-specific aspects of the payday lending market relevant to conducting such analysis. We identified three areas: *(a)* the time period analysed and how this relates to the industry life cycle; *(b)* the relevance of different business models to the analysis of profitability in payday lending; and *(c)* cost issues, in particular relating to measuring doubtful debt expenses.[28]

Time period analysed and industry life cycle

4.113 We analysed detailed information from the major lenders for the period 2008 to 2012[29] (see Appendix 4.5 for further detail on our approach). We subsequently requested data for 2013 to ensure that our provisional findings took into account more recent levels of profitability.[30]

4.114 Most lenders made no submissions regarding this approach. Wonga, Dollar and CashEuroNet raised concerns regarding the time period chosen and the developmental stage of the industry under review, which we discuss below.

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[28] The doubtful debt expense is an item in the profit and loss statement for the relevant financial year that reflects the expected (and actual) value of debt that will not be recovered. The name and method of calculation of this expense can vary depending on the accounting framework used. For details on how this expense is calculated, see Appendix 4.5.
[29] Aggregated data for 2012 is based on the financial years ended July to December 2012 and January to June 2013.
[30] 2013 includes financial years ended July to December 2013 and January to June 2014 and therefore figures for Dollar on a full-year basis were not available.

- *Parties' views on the time period analysed and industry life cycle*

4.115 Wonga submitted that 'the significant competitive and regulatory changes which have occurred since 2012 mean that financial performance over the period 2008 to 2012 provides no meaningful insight as to the current state of competition in the market'.[31] Wonga commissioned a report from its economic consultants, AlixPartners UK LLP (AlixPartners), which examined the profitability of Wonga and the industry. AlixPartners stated that many aspects of Wonga's business model were novel or unproven at the outset and the performance of the business could have turned out very differently. AlixPartners said that we should therefore be more cautious about interpreting the results of profitability analysis in this sector compared with the more mature markets typically investigated.[32]

4.116 Dollar instructed economic and accounting firm FTI Consulting (FTI) to review the data that it had previously submitted to us. FTI said that:

> we consider that ROCE and ROE are not appropriate measures of assessing profitability in this investigation. These measures are only appropriate for capital intensive industries, and we consider that Dollar is not. [✂][33,34]

4.117 CashEuroNet said that:

> In a new and rapidly developing sector, subject to fierce competition, one would expect to see both businesses failing and businesses making substantial profits. This is exactly what we observe in the CC data on payday lenders. It will be very difficult to draw any meaningful conclusions about the state of competition in such a market based on such a wide distribution of outcomes (over a relatively short period of time).[35]

- *Our position on time period and approach*

4.118 We considered these views and the time period analysed. Whilst the short-term credit sector – including payday loans – has been established in some form for many years, there are several elements of the payday lending business model which have been introduced more recently, including: the ability for customers to apply online, automated risk processing, rapid funding

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31 Wonga response to profitability working paper, paragraph 1.1.9.
32 AlixPartners report, paragraph 3.1.11.
33 [✂]
34 [✂]
35 CashEuroNet response to profitability working paper, paragraph 1.5.

of customer accounts and collection via CPA. We recognise that the time period chosen may not incorporate the full business cycle of these more recent industry changes, measured as either from peak to trough or from initiation to ex-growth steady state (which is sometimes regarded as indicative of industry maturity). However, there was clear evidence that the time period reviewed covered the full life cycle of the largest underlying asset of the business – a payday lender's loan book.

4.119 In a competitive market, innovative and efficient firms may earn superior returns on investments for a period of time. However, we would normally expect excess returns to be competed away as rivals introduce competing innovations and/or improve efficiency. We agree with AlixPartners and Wonga that there was uncertainty in the early part of the period over the likelihood of future success. This situation does not differ, however, from any other new project in any other industry subject to uncertain demand and/or supply conditions. Uncertainty does not prohibit effective profitability analysis. It is possible to examine the issue of the higher level of uncertainty faced by Wonga and other start-up firms within such an analysis by, for example, considering the effect of higher risk on the required return. We discuss issues relating to the relative immaturity or maturity of the industry when interpreting the level of profitability observed in paragraphs 4.165 to 4.185.

4.120 We therefore concluded that the period chosen and our overall approach to profitability analysis was valid and note further that we have considered as full a time period as practicable by updating our analysis to include data from financial years up to 31 December 2013.

Different business models

4.121 In evaluating the profitability levels of payday lenders, we have taken account of the different business models operating in the industry. The range of business models include: organic start-ups funded by venture capital (VC); organic start-ups with public equity/public debt funding; and acquisition of established lenders, either by UK or international parent companies (which may or may not have been active in the payday lending or other credit markets in the UK or overseas). Where relevant, we have considered the implications of parent company charges levied by international parent companies on UK subsidiaries. Two of the three largest lenders and four of the smaller lenders originate from the USA/Canada. The decision by an overseas lender to enter the UK market may have been undertaken to diversify the geographic risk faced by parent companies. The process undertaken for investment evaluation and hurdle rates for a strategy designed to diversify geographic risk may have differed from those used by a UK operator entering the market from scratch.

4.122 We have also noted that some of the major lenders also offer ‘non-payday’ products such as pawnbroking, buying and selling gold, foreign exchange services and money transfer. Where appropriate, we have examined revenues and costs of payday lending disaggregated from overall levels of firm profitability.

Cost issues

- *Repeat lending*

4.123 There was evidence that levels of repeat lending were monitored by management using, for example, retention curve metrics,[36] and we recognised that the profitability of payday lenders was driven by a combination of initial loans to first-time customers and repeat lending to existing customers. Initial loans to first-time customers will not be profitable unless the high levels of customer acquisition costs observed for many lenders (see Section 7) are exceeded by interest and fee revenue received from the first-time borrower concerned. If a customer’s initial loan with a lender is unprofitable due to high customer acquisition costs, the overall profitability of a lender will be dependent on the extent of repeat loans for which there is no (or a much reduced level of) customer acquisition cost.

4.124 We considered conducting profitability analysis which sought to assess the profitability of repeat lending as a subset of corporate profitability; however, we took the view that corporate profitability was the more relevant measure for our analysis. This was partly because corporate profitability could be calculated consistently for all of the major lenders. In addition, corporate profitability could be compared with the cost of capital for payday lending in aggregate and did not require the estimation of a separate benchmark against which to compare the profitability of repeat lending. Finally, on the basis of the information available to us, analysing the profitability of repeat lending would have required us to make a significant number of further, judgemental assumptions to split costs between new and repeat lending.

- *Doubtful debt costs*

4.125 We also considered issues in relation to the cost of default. Our analysis of lenders’ costs showed that the doubtful debt expense is the most significant

[36] Retention curves illustrate the extent to which borrowers are retained as repeat customers over time.

category of costs faced by lenders, and represented around 45% of total costs for all lenders in both 2012 and 2011. We were therefore careful to examine the extent to which provisioning policies were comparable between lenders. We looked in detail at the underlying assumptions and calculations of the doubtful debt expense for 2012 for the major lenders. To aid our comparison of the policies used by lenders, we created an illustrative hypothetical loan book based on the combined loan books of the major lenders at the end of their respective last reported financial years.[37] Our review of provisions policies indicated that in general terms the majority of lenders follow similar methodologies with the exception of four smaller lenders. We therefore made no adjustment to bad and doubtful debt costs contained in lenders' financial statements.

4.126 It was not possible to separate specific costs relating to payday operations from other costs in the case of Cheque Centres. Cheque Centres' submission included only doubtful debt expenses for its payday loan products. Other significant operating costs were therefore excluded, and figures for Cheque Centres were not comparable with other lenders in our analysis. We have excluded this lender from our analysis to avoid overestimating profitability levels for the major payday lenders.

Estimation of ROCE before adjustments for intangible assets

Overview of CMA approach

4.127 Our assessment of profitability took place in a number of stages. In our preliminary analysis, we considered the financial information submitted by the 11 major lenders and sought to calculate their level of profitability. This preliminary analysis was published in a working paper Profitability of payday lending alongside our annotated issues statement and analysed levels of operating profit margins, ROCE and ROE on an accounting basis using information from financial statements, management accounts and responses to our financial questionnaire and financial template.[38]

4.128 In our working paper, we made several adjustments to earnings before interest and tax (EBIT) to increase the comparability of data between lenders. We further noted that we would evaluate returns including intangible assets where there was clear evidence of a material distinction between historic and economic values. The responses from lenders enabled us to finalise the adjustments we had proposed and (other than those relating to intangible

[37] Up to December 2012.
[38] Our financial template was an Excel spreadsheet requesting financial information including profit and loss, balance sheet and simplified cash flow statements. See Appendix 4.5 for further detail.

assets) these are considered below. We analyse economic profitability taking into account intangible assets in the next subsection in paragraphs 4.154 to 4.164.

Parties' views on our preliminary profitability analysis

4.129 Three lenders made submissions regarding the profitability measures that we had considered in our preliminary analysis.

- *CashEuroNet*

4.130 CashEuroNet said that intercompany debt should be treated as a form of equity and suggested that we should use a ROCE approach (rather than ROE) as the total returns to the shareholder from intercompany debt plus equity should be considered.[39] This view is consistent with our approach below.

- *Wonga's concerns and AlixPartners' revised costs analysis*

4.131 Wonga submitted that the ROCE measure suffers from significant drawbacks when applied to the payday lending sector noting that 'Wonga's business model has relatively low capital intensity, such that even relatively modest changes in parameters such as rate of loan growth, default rates etc. can have significant effects on outturn returns'.[40] Wonga provided analysis to illustrate that if the loan loss rate had been [✂]% rather than [✂]% in 2012, the resulting level of EBIT would have been £[✂] million rather than around £[✂] million.

4.132 Wonga also expressed concerns that our preliminary estimate of its adjusted ROCE was too high because [✂].[41] We had said in our working paper that our adjusted ROCE was likely to be an overestimate, as information submitted by Wonga had not enabled us to assess accurately the proportion of the service charge which should be added back to ensure comparability between time periods for Wonga, and between Wonga and other payday lenders. For further details on the service charge, see Appendix 4.5.

4.133 AlixPartners provided updated EBIT figures which reallocated group costs to the UK business using cost drivers, thus effectively shifting costs [✂].

[39] CashEuroNet response to profitability working paper, paragraph 3.3.
[40] AlixPartners report, paragraph 7.1.3(e).
[41] [✂]

Revised figures are shown in Table 4.4. On the basis of its revised cost allocation, AlixPartners calculated accounting ROCE.[42]

TABLE 4.4 **Analysis of cost adjustments for Wonga's service charge**

								£'000
	2008	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*
[✂]								
[✂]					[✂]	[✂]	[✂]	[✂]
[✂]					[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]					[✂]	[✂]		
[✂]								
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]					[✂]	[✂]		

Source: CMA analysis.

*Forecast as at September 2013.

4.134 Wonga also submitted that [✂].[43]

4.135 AlixPartners' report presented ROCE analysis of 20 companies including Wonga, and concluded that while calculated levels of ROCE are '[✂] the cost of capital that the CC provisionally estimates, taking account of the wider interpretation issues identified in this response, including in relation to the appropriate benchmark measure they do not indicate any significant competitive concerns in the market'.[44]

Dollar's views on our preliminary profitability analysis

4.136 Dollar argued that EBIT is a more appropriate measure to use to evaluate profitability than ROCE[45] and submitted analysis from FTI comparing Dollar's EBIT margin on revised costs with the payday lending comparator companies used in our beta analysis.

4.137 FTI undertook some adjustments to [✂] of £[✂] for the years from June 2009 to June 2013.

4.138 FTI's margin analysis concluded that the weighted average EBIT margin of Dollar's retail operations during the period 2008 to 2013 was [✂]% for high-street operations and [✂]% for online operations.[46] This updated analysis contrasted with Dollar's initial submission [✂].

[42] AlixPartners' method combined uplifted values for fixed assets with working capital averaged for the financial year in question and as such was equivalent to our approach which took equity and interest-bearing debt.
[43] Wonga response to profitability working paper, paragraph 2.2.4(c).
[44] Wonga response to profitability working paper, paragraph 3.4.6.
[45] Dollar response to annotated issues statement and working papers, paragraph 6.3(iv) & (v).
[46] Dollar response to annotated issues statement and working papers, paragraph 6.3(ii).

4.139 FTI's ROCE analysis concluded that the weighted average ROCE of Dollar's retail operations during the period 2008 to 2013 was [✂]% for high-street operations and [✂]% for online operations.[47]

CMA consideration of Wonga's views on our preliminary profitability analysis

4.140 We considered Wonga's views of paragraph 4.131 carefully and took the view that the age or capital intensity of an industry were not, in themselves, problematic for the calculation of a meaningful estimate of ROCE. Despite asset intensity levels that were lower than some other industries, it was possible to calculate ROCE on reported levels of assets. As would be the case with other profitability approaches, the output of the calculation (in this case ROCE) would change with variations in the levels of inputs to the calculation (in this case the level of asset intensity/capital employed and EBIT). We did not regard the potential variability of a metric to the value of inputs into the calculation to be a valid reason for rejecting its use, and considered that the opportunity for an efficient firm to earn very high returns on a limited capital base was one of the factors that had enabled Wonga and other payday lenders to attract start-up funding and enter the market.

4.141 We acknowledge that there are high levels of asset turnover in short-term lending which means that year-end balance sheets do not capture the full flow of assets utilised during the year.[48] However, we did not regard this characteristic of payday lending as preventing meaningful profitability analysis based on ROCE, and note that returns analysis is widely accepted in industries with high levels of stock turnover and negative working capital (such as grocery retailing).

4.142 We considered the industry ROCE analysis (see paragraph 4.135) undertaken by AlixPartners acknowledging the caveats that applied to its approach. AlixPartners' ROCE analysis indicated that economic ROCE for the lenders examined [✂]. Figures included an assumption for intangible assets equivalent to the ratio calculated for Wonga and were based on a methodology which AlixPartners named MEA 1.[49,50] Whilst we had some concerns with the sample used by AlixPartners and its approach to calculating ROCE, we considered that industry economic returns were unlikely to be

[47] ibid, paragraph 6.3(ii).
[48] For example, the value of the loan book reported at year end does not reflect the level of all loans issued during the year.
[49] For MEA 1 method, see Appendix 4.5. AlixPartners' methodology in this case did not include an amortisation adjustment to EBIT due to limited cost information and therefore underestimates profitability for the purposes of our investigation.
[50] AlixPartners report, paragraph 6.2.6, footnote 48.

below the levels indicated by this work.[51] We consider the value and treatment of intangible assets in paragraphs 4.154 to 4.164.

4.143 We compared AlixPartners' revised cost allocation (of paragraph 4.133) to the analysis that we had undertaken for WDFC UK which used three methods to estimate UK costs for 2012.[52] AlixPartners' cost reallocation was somewhat lower than in our analysis; however, we accepted the adjustments proposed because the various cost drivers applied appeared to represent a reasonable approach, and one which was based on detailed information from Wonga including, for example, examination of [✄]. For further detail on AlixPartners' revised cost analysis, see Appendix 4.5.

4.144 We did not agree with Wonga's view that the [✄]. We therefore considered that the level of [✄] shown in audited financial statements was the correct level on which to base our profitability analysis.

4.145 We also did not agree with AlixPartners' use of Wonga Group asset figures for the years 2011 to 2013. This was because we had concerns that this analysis would include assets associated with Wonga's international operations and business lending products Everline[53] and PayLater, which were unrelated to its UK payday lending business. Our approach was supported by a review of subsidiaries listed in Quickbridge (UK)'s financial statements.[54] We therefore based our analysis on audited WDFC UK figures adjusted for the costs and fixed assets identified by AlixPartners, which we judged to be more representative of Wonga's UK payday lending financial information for the years 2011 to 2013.

4.146 Finally we considered AlixPartners' suggestion that we should compare the profitability of payday lending with returns over time for other industries or other VC start-ups.[55] We took the view that it would have been impractical to perform comparisons on a like-for-like basis, for example taking into account the risk profile of different industries or start-ups.

CMA consideration of Dollar's views on preliminary profitability analysis

4.147 In Dollar's initial financial template the company apportioned [✄]% of total costs for its high-street operations to payday lending, an activity which had generated [✄]% of high-street revenue in the year to June 2013. Dollar's

[51] AlixPartners included several companies not included in our analysis. We noted that these companies were small and that AlixPartners' sample did not include CashEuroNet, one of the big three lenders in our analysis.
[52] *(a)* Analysis of supplier payments submitted by Wonga; *(b)* examination of Wonga Technology Ltd financial statements and *(c)* a review of management accounts for the first nine months of 2012.
[53] Launched as Wongaforbusiness in May 2012. Wonga response to issues statement, paragraph 4.35(d).
[54] Quickbridge (UK) Limited was Wonga's holding company until 2010, after which it was renamed Wonga Group.
[55] AlixPartners report, paragraph 7.1.4.

initial cost allocation approach resulted [✂]. We said in our working paper that, whilst the methodology adopted might have aligned with Dollar's operational approach to its business, it was likely to under-represent payday lending profitability for our purposes. We reviewed FTI's revised cost analysis which used the [✂] as the basis for allocation of costs between the payday product and other high-street products (for details see Appendix 4.5) and accepted that the adjustments proposed produced a result which was more representative of the profitability of payday products within Dollar's overall high-street operations.

4.148 FTI's calculations also included holding company costs for Dollar Financial (UK) Limited comprising administration costs and interest costs. We were concerned, however, that this cost adjustment was likely to result in an underestimate of the profitability of UK payday operations for two reasons. First, Dollar's UK holding company listed 14 subsidiaries which were either international operations in Sweden, Spain, Finland and Poland, or non-payday businesses in the UK. We considered it likely that a potentially significant element of the administration and finance charges for the holding company might relate to these businesses. Secondly, [✂].[56] In view of these uncertainties we calculated Dollar's ROCE by estimating the UK portion of holding company administration costs and excluding holding company interest costs. For further detail, see Appendix 4.5.

4.149 Given that other cost adjustments proposed by FTI moved expenses from online to retail lending, or vice versa, we decided to group Dollar into one entity for the purposes of our analysis, an approach justified by the inter-dependency and potential difficulty of establishing an appropriate and accurate basis for cost and capital allocation between the three Dollar companies operating in the UK.[57]

4.150 We found the use of operating margin as a basis for comparing lenders (see paragraph 4.136) to be problematic for the purpose of our profitability analysis as we did not have a suitable benchmark for comparison. Without a suitable benchmark for levels of operating margin it was not possible to make meaningful comparisons with other markets, or to exclude the possibility that margin levels observed in the market as a whole might be the result of high prices, and might therefore include any 'abnormally high returns'.

4.151 As discussed in paragraph 4.140, we concluded that the age or capital intensity of an industry were not, in themselves, problematic for the calculation of a meaningful estimate of ROCE. We do not consider the variability of a

[56] [✂]
[57] Dollar's figures include [✂].

metric to inputs to be a valid reason for rejecting its use, and note that Dollar's proposed alternative EBIT measure would also be sensitive to changes in parameters such as default rates and growth rates. We recognise that the life stage of the industry may be relevant, however, when interpreting ROCE analysis, and discuss our consideration of this issue in paragraphs 4.165 to 4.185.

4.152 We also considered, in view of FTI's comparative margin analysis (see paragraph 4.136), whether it was valid to compare EBIT margins calculated for payday lenders with profit margins for other forms of lending. We sent questionnaires to 25 non-payday-lending credit providers and received 16 replies with data that was sufficiently comprehensive for consideration.[58] Our analysis indicated that the average 2012 EBIT margin for home credit was 16% and was 11% for credit card providers. We had concerns, however, that data was not sufficiently representative of margins from other forms of credit to enable a comparison with payday lending data. In particular, it was not practical to undertake a more detailed analysis, including the detailed review of doubtful debt policies which would be necessary for such an analysis. We therefore also concluded that this EBIT comparison was unlikely to be informative for the purposes of a competition assessment of profitability.

4.153 Whilst the updates described above relate to the specific companies concerned, we also considered if changes were relevant for other lenders and sought to maintain consistency across our analysis.

Provisional ROCE findings

4.154 We now consider the evidence for making adjustments relating to the replacement cost of assets and the potential value of intangible assets, before reaching our provisional findings on the ROCEs of the large payday lenders.

Treatment of assets within the ROCE framework

4.155 Our Guidelines recognise that evaluating profitability under a return on capital approach requires an economically meaningful value for the capital base which may not accord with the value ascribed in the financial records.[59] Hence it may be necessary to make adjustments to accounting data produced in line with UK GAAP if the historic cost of assets differs substantially from the

[58] Including: 5 banks, 3 credit card providers, 2 credit unions, 3 home credit companies, 2 store card providers and 1 log book loan lender.
[59] *CC3*, paragraph 13.

'replacement cost' or 'Modern Equivalent Asset Value',[60] which is a more economically meaningful measure for our purposes in most cases. In situations where the difference between historic cost and replacement costs would be likely to have a material effect on profitability calculations, our Guidelines state that we will consider whether replacement cost values can be derived reliably.

4.156 In the case of payday lending, we do not consider that adjustments to the book value of tangible assets are necessary. This is because fixed asset intensity is low due to the high contribution of IT assets with short asset lives, and the predominant use of leasehold sites by high-street lending firms. Additionally the loan book, which is typically the largest asset on a lender's balance sheet, is characterised by a very high level of asset turnover and frequent revaluations via the provision for doubtful debt, both of which factors are likely to eliminate any material valuation distortion. Moreover, evidence presented by lenders on asset values indicates a reduction over time in the price of IT systems in particular.[61]

4.157 Although evidence suggesting that IT costs have fallen during the period might suggest that asset values could plausibly be revalued downwards, we have not made an adjustment and our ROCE analysis, which is based on the book value of tangible assets, can therefore be seen as conservative in this regard.

4.158 The second adjustment to accounting data provided for in the Guidelines[62] concerns the possible inclusion of intangible assets where the following criteria are met:

(a) The cost associated with creating the asset must comprise a cost that has been incurred primarily to obtain earnings in the future.

(b) This cost must be additional to costs necessarily incurred at the time in running the business.

(c) It must be identifiable as creating such an asset separate from any arising from the general running of the business.

[60] These terms are used interchangeably to mean the current cost of acquiring assets which yield equivalent services to those currently used by the firm, based on the most efficient technology and optimal configuration. Source: *CC3*, Annex A, footnote 5.
[61] For example, Wonga told us that 'recent developments (for example, in relation to the quality of CRA data and the availability of loan management software) also serve to reduce certain entry and expansion costs compared with 2007 when Wonga entered (and the subsequent period of significant growth)'. Source: Response to annotated issues statement, paragraphs 7.29 & 7.37*(b)*.
[62] Criteria originally set down in the CC report *The supply of banking services by clearing banks to small and medium-sized enterprises*, March 2002.

4.159 We considered carefully parties' views on intangible asset categories and values relating to: customer acquisition costs; knowledge of the customer base; staff recruitment and training; regulatory costs; pre-incorporation costs; start-up losses; technology; and channel relationships.

4.160 Wonga, Dollar and CashEuroNet submitted views on the value of assets, as set out in Appendix 4.5. Having assessed possible intangible assets to include in our analysis on the basis of paragraph 4.158, we recognised and took account of costs relating to staff recruitment and training. Our detailed reasons for this approach are set out in Appendix 4.5. We conducted sensitivity analysis to assess the effect on ROCE of changing our approach to intangible assets for costs relating to customer acquisition and CRA data costs. The levels of ROCE indicated by this sensitivity analysis were not sufficiently different to change our conclusions on profitability.

Adjusted ROCE including intangible assets

4.161 Table 4.5 shows our estimates of adjusted ROCE for the major lenders based on capital employed including the intangible assets we have identified.

TABLE 4.5 **Adjusted ROCE including intangible assets, 2009 to 2013**

%

	2009	*2010*	*2011*	*2012*	*2013*
Ariste			[✂]	[✂]	[✂]
CashEuroNet	[✂]	[✂]	[✂]	[✂]	[✂]
CFO				[✂]	[✂]
Dollar	[✂]	[✂]	[✂]	[✂]	[✂]
Global Analytics		[✂]	[✂]	[✂]	[✂]
H&T‡	[✂]	[✂]	[✂]	[✂]	[✂]
MYJAR		[✂]	[✂]	[✂]	[✂]
SRC				[✂]	[✂]
The Cash Store			[✂]	[✂]	[✂]
WageDayAdvance	[✂]	[✂]	[✂]	[✂]	[✂]
Wonga†	[✂]	[✂]	[✂]	[✂]	[✂]
Average ROCE	34	38	44	34	28

Source: CMA analysis.

*2013 includes financial years ended July to December 2013 and January to June 2014 and therefore figures for Dollar on a full-year basis were not available.
‡Based on Group figures.
†Includes AP fixed asset adjustment to group accounts.

4.162 Our analysis indicates that annual firm-level ROCE has varied between lenders and across the period from –175% to over 160%. The highest levels of returns for the major lenders were achieved in 2011. Profitability for the largest three lenders has generally been higher than smaller lenders and was also subject to less variation at between 17% and over 95%. In 2013, of the eight major lenders for which we have data, only two lenders were not profitable.

4.163 There is evidence that returns in 2013 were generally lower than in previous years, with six lenders generating lower returns year on year and ROCE for 2013 averaging 28% compared with a peak of 44% in 2011. Factors contributing to lower levels of ROCE in 2013 include: *(a)* a slowdown in lending growth (revenue growth in 2013 was around 5% compared with historic growth rates of 40% to over 100% a year for the period 2009 to 2012), *(b)* cost increases and *(c)* an increase in retained profits at most lenders.

4.164 For the largest three lenders our analysis indicates that:

(a) The lowest ROCE achieved by CashEuroNet during the period was [✂]% in 2011 and ROCE averaged [✂]% between 2009 and 2013. Our analysis of the most recent level of profitability indicates that CashEuroNet's ROCE in 2013 was supported by a strong increase in reported EBIT of around [✂]%. In spite of a [✂] of [✂]% in loan applications in 2013, CashEuroNet's 2013 revenue [✂]% as [✂].

(b) Dollar's combined ROCE averaged [✂]% for the period 2009 to 2012 (year to June 2013), with stable returns of around [✂]% for the first two years of the period followed by lower levels in both 2011 and 2012 (year to June 2013). Figures submitted by Dollar for the six months from July to December 2013 suggest that Dollar's financial performance [✂]. It is possible, therefore, that reported figures may [✂] is affected by charges which we may review.

(c) Our analysis indicates that Wonga's ROCE averaged [✂]% during the period 2009 to 2013. Wonga's returns were [✂] in the early part of the period before [✂] for both 2011 and 2012. Wonga's profitability was [✂] in 2013 with ROCE of [✂]% due to [✂]. The [✂] appears to be driven by [✂].[63]

Interpreting the level of observed returns

4.165 We consider the interpretation of the observed levels of returns by first discussing issues relating to the variation between lenders. We then consider the relevance of innovation to interpreting levels of observed profitability. Then we discuss the outlook for profitability and the extent to which it is possible to conclude whether current levels of returns will persist. Finally, we discuss the benchmarks which we consider relevant when interpreting levels of profitability.

[63] Wonga response to profitability working paper, paragraph 2.3.11.

Variation in returns

4.166 Wonga argued that 'even where overall financial performance may be strong, variation between lenders is a strong indicator of vigorous competition'[64] and that the variation in ROCE performance was 'consistent with a competitive sector'.[65] Additionally, Wonga said that 'the dispersion of financial performance is consistent with a market where firms are competing to develop the best business model to serve the customer'.[66]

4.167 We agree that variability of returns is a relevant consideration. However, our analysis indicated that whilst there was a range of financial performance across the sector as a whole, the extent of variation among the largest operators was more limited, and levels observed for these operators were generally above the weighted average cost of capital (WACC). We considered that the presence of a very limited number of unprofitable lenders during the period did not indicate that the competitive process was working well. Rather there was evidence that the unprofitable lenders observed were earning negative returns because these firms either lacked scale as new entrants, or had experienced cost or strategic issues including IT problems or 'oversizing' the store base (building too many and/or excessively large stores).

4.168 We also noted that if there were a lack of competitive pressure on payday lenders, we might expect some of the resulting profitability to be dissipated through increased expenditure by lenders in customer acquisition channels (for example, in lead generator auctions). In this context, we noted the fierce competition (and consequentially high prices) observed to acquire leads and in pay-per-click advertisement auctions for payday-related search terms (see Section 7), and the high proportion of online lenders' costs accounted for by customer acquisition expenditure (see paragraph 7.44). Total expenditure on customer acquisition per new loan issued has increased substantially over the period, as the number of lenders active in the market has increased.[67]

Innovation

4.169 We considered that an element of Wonga's [✂] levels of ROCE in 2011 and 2012 might be explained by its position as an innovative early mover in a growing market offering differentiated flexibility to customers. During the early

[64] ibid, paragraph 1.1.8.
[65] Wonga response to profitability working paper, paragraph 1.1.10.
[66] ibid, paragraph 1.1.10.
[67] It would also be logical for lenders to increase their spend on acquisition costs, at least for a time, if the overall rate of growth in the market was slowing yet the evidence was unclear and lenders were not achieving their volume objectives.

part of Wonga's existence it innovated via its website 'slider', daily pricing, the speed of lending decisions and mobile access. Wonga introduced its faster payment service to expedite the transfer of money to customers in October 2008.[68] CashEuroNet, Payday Express, PaydayUK and CFO Lending had all introduced this facility by April 2012. Wonga was the first lender to introduce mobile access to loans in January 2010.

4.170 We considered, however, that this type of market-changing innovation had been a less significant factor in driving the high returns observed for other major lenders:

(a) In Dollar's case, UK market entry was achieved via the purchase of established firms operating with traditional high-street credit-scoring methods or the online distribution of traditional 'monthly' single payment loans.

(b) CashEuroNet established its UK business using proven operational methods from the USA and initially offered QuickQuid loans repayable in either one or two monthly instalments.[69]

- *Outlook*

4.171 Our review of 2013 data did not indicate a significant increase in regulatory costs in the context of the overall cost base of lenders. We noted that three lenders ([✄]) had increased profits in 2013 compared with 2012. It is difficult to judge the outlook for profitability given uncertainties relating to the future level of demand and effect of regulatory changes, including legislation which places a duty on the FCA to impose a price cap on the cost of payday loans by 2 January 2015. However, it is possible that overall levels of profitability seen in the period 2009 to 2013 may not persist.

Benchmark for profitability

4.172 In order to interpret levels of observed returns, it is necessary to compare profitability with an appropriate benchmark. Our Guidelines state that in assessing levels of profitability the CMA will have regard to its view of firms' cost of capital. The CMA will generally look to the capital asset pricing model (CAPM) when considering the cost of capital, since this is a widely understood technique with strong theoretical foundations. However, the CMA will have

[68] MYJAR offered expedited funds transfer from inception and began lending in March 2009.
[69] CashEuroNet's Pounds to Pocket 12-month instalment product was launched in 2010. QuickQuid Flexcredit, a revolving credit facility, was launched in June 2013.

regard to alternative models where appropriate.[70] In the light of views expressed regarding the appropriate approach to determining the cost of capital for payday lending, we considered both CAPM WACC and other potential benchmarks associated with VC financing.

CAPM weighted average cost of capital

4.173 We have derived a pre-tax nominal WACC of 7.9 to 12.7% for the UK payday lenders under consideration using CAPM (see Appendix 4.5 for details). Most lenders made no submissions regarding this approach, though some lenders expressed concerns:

(a) [✂] said: 'we consider that the CAPM may not be appropriate to estimate the industry WACC due to the riskiness of the business'.[71]

(b) CashEuroNet observed that its US-based pre-tax WACC would be [✂]% using our UK tax rate assumption of 25% and argued that the WACC estimate should also include Advance America. We recognised that including additional companies in the beta analysis could increase the accuracy of WACC estimates. However, data for Advance America indicated that our estimate of the WACC would not change if we were to include this comparator.

Venture capital returns

4.174 Wonga argued that we must adjust for the risk of 'survivorship bias' and stated that this could be done by 'looking at the returns that venture capitalists require on their successful investments so as to deliver overall returns for their portfolio consistent with the high risks they bear'.[72]

4.175 AlixPartners told us that it understood from Wonga management involved in the early development of the company that 'early-stage venture capital investment often stipulates a required return on equity investment assuming the business is successful, rather than modelling all cash flow scenarios that may materialise' and that 'this is consistent with initial finance being relatively modest and then supplemented a few years later as the business matures (which is what happened with Wonga, where significant fund raising took

[70] *CC3*, Annex A, paragraph 16.
[71] [✂]
[72] Wonga response to profitability working paper, paragraph 1.1.13.

place in 2009)'. AlixPartners also submitted that 'Wonga itself does not have direct evidence on such expectations'.[73]

4.176 In our Profitability of payday lending working paper we referenced an internal rate of return (IRR) of 15% from the BVCA[74] Private Equity and Venture Capital Performance Measurement Survey 2012 as a benchmark for returns achieved by VC funds.[75] BVCA's figure of 15% represents its long-term view of achieved returns based on both the ten-year IRR and the since-inception IRR.

4.177 Wonga told us that it 'agrees that returns achieved by the venture capital sector in particular provides a potential benchmark, but considers that the evidence on returns achieved by VC investors is more nuanced than the working paper suggests'.[76] Wonga referred to achieved returns of 41% as the annual IRR of the top-performing 10th percentile of post 1996 vintage funds.[77] We note that the equivalent figure for VC funds, as a subset within the 41% return achieved, is 9% (see Table 4.6), and that the driver of the 41% return for the top-performing funds in the overall sample was the high level of returns from the top-performing management buyout (MBO) funds.[78] We consider VC funds as the more appropriate reference point for Wonga, as this was the basis on which it had been funded, and we therefore concluded that 15% (see paragraph 4.176) was a more relevant benchmark. Given the lower levels of returns from VC funds over this period, this benchmark could be seen as conservative.

TABLE 4.6 **Ten-year IRR by investment stage and subcategory, 1996 vintage funds onwards**

% a year

	Total	*Venture*	*Small MBO*	*Mid MBO*	*Large MBO*
Number of funds in total	152	55	14	64	19
Pooled average	13.8	–4.7	14.1	25.1	29.6
10th percentile	41.2	9.0	60.0	56.4	41.6

Source: BBCA Private Equity and Venture Capital Performance Measurement Survey 2012.

[73] AlixPartners report, paragraph 7.1.3(c).
[74] The BVCA – The British Private Equity and Venture Capital Association – is the industry body for the UK private equity and venture capital industry. The BVCA had membership of over 500 and stated that it represented the overwhelming majority of UK-based private equity and VC providers and advisers as well as fund investors.
[75] BVCA report, p2.
[76] Wonga response to profitability working paper, paragraph 4.1.15.
[77] BVCA report, p42.
[78] MBO funds returned 42–60%. Source: BVCA Performance Measurement Survey 2012, p42.

Evidence for using different benchmarks at different points in the time period considered

4.178 We considered that the appropriate benchmark through the period for companies funded by public equity and debt, and with a sufficiently long trading history to discount start-up risk, was a WACC of 7.9 to 12.7%. Of the largest three lenders, we considered that both Dollar and CashEuroNet fell into this category. Dollar acquired three established companies: The Money Shop (established in 1998), Payday Express[79] (1999) and Payday UK[80] (2003). CashEuroNet set up its UK operation using know-how from CashNetUSA, which had been trading in the USA since June 2004 [✂] when CashEuroNetUK commenced operations in July 2007.[81] In our view, there is no evidence to suggest that anything other than the WACC would be the relevant benchmark in these circumstances and we note that both Dollar and Cash America have internally-generated WACC estimates.

4.179 We considered whether there was evidence indicating the relevant time period to which a higher benchmark might be appropriate to account for the higher risks inherent in the start-up phase of a company:

(a) Our analysis of the price paid by VC investors in Wonga over time indicates a significant shift in the perceived risk/reward ratio in 2010. [✂] Our analysis indicated that either investors' perception of risk reduced and/or their expectations of likely levels of future profitability increased. To perform this analysis we examined the funding transactions of 12 VCs in Wonga during the period 2006 to 2010. The 2010 price paid is equivalent to [✂] times 2010 enterprise value to earnings before interest tax and depreciation (EV/EBITDA), which is [✂] – for example, the valuation report prepared by [✂] for Dollar's acquisition of Payday UK used a range of [✂] times 2010 EV/EBITDA for [✂] deals.

(b) Evidence from Wonga on its acceptance rate[82] for new customers also indicates that 2010 may mark a shift in the risk profile of the company. We viewed the doubling of the acceptance rate in 2010 and the limited change thereafter as indicative of Wonga's increased confidence in its lending model.

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[79] Express Finance was purchased by Dollar in April 2009.
[80] MEM was purchased by Dollar in April 2011.
[81] CashEuroNet response to profitability working paper, paragraph 3.8.
[82] Acceptance rate for new customers based on the total number of applications by new customers processed by Wonga's risk engine.

TABLE 4.7 **Wonga acceptance rate for new customer applications, 2008 to 2013**

						%
	2008	*2009*	*2010*	*2011*	*2012*	*2013*
Acceptance rate	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Wonga.

(c) We note that whilst Wonga's website 'slider' was innovative when introduced, it was subsequently widely copied across the industry and therefore cannot be regarded as a continuing innovation that might justify a higher benchmark.[83]

4.180 The [✂] value paid by VCs in 2010 and the considerable step up in acceptance rates indicated that it may be appropriate to view 2010 as an inflexion point in the risk profile of Wonga as a business. In our sensitivity analysis, we therefore model a scenario in which we consider that the appropriate benchmark for Wonga for the years 2010 to 2013 is our WACC estimate for consumer lending, rather than VC returns metrics.

4.181 Our consideration of the case for a reduction in the appropriate benchmark level over time is supported by AlixPartners' view that the:

> success of Wonga's business model as well as those of other leading payday lending companies has reduced the risks facing new entrants by demonstrating the model's viability. Moreover, the proven feasibility of the model lowers the cost of finance for other market entrants, since investors would be expected to have lower hurdle rates due to a lower perceived risk.[84]

4.182 We also considered whether the high returns observed for the largest lenders were compensation for downside risks taken at the time of investment in significant innovations. We did not, however, consider that this applied to the payday lending industry because:

(a) Investments have been incremental so that whilst initial investments may have involved relatively high risks, subsequent investments could be made conditional on the success of the first. The result of this approach was that less capital was at risk in the initial, more risky stage of significant innovation.

[83] The CC considered the issue of innovation in its market investigation of Classified Directory Advertising Services and concluded that 'superior efficiency and innovation usually arise when a firm introduces, or invests in, a product or operating method that cannot be easily replicated by its competitors. If they were easily replicated, then the benefits of these products and methods would be competed out promptly'. Final report, paragraph 7.99.
[84] AlixPartners report, paragraph 3.1.15.

(b) Lenders have typically invested in short-lived assets and there is no evidence that lenders have faced significant demand risk over the life of assets in which investment has been made.

(c) The expectation that returns would converge over time towards the cost of capital applies equally to innovative markets since high ex-post returns would provide an incentive for other companies to enter the market.

(d) The relatively low asset intensity of the payday lending industry means that investment is scalable to changes in demand.

4.183 Taken together, these factors may suggest that high ex-post returns are not compensation for downside risks taken at the time of investment, but may indicate that prices are higher than could be explained by the level of costs observed, including the cost of capital for the major lenders.

Benchmark sensitivity analysis

4.184 It is possible to consider the higher level of uncertainty faced by firms in a start-up phase and higher hurdle rates set by VC capital providers by conducting a benchmark sensitivity analysis. Table 4.8 shows the calculation of weighted benchmarks under a number of scenarios that incorporate both VC returns or hurdle rates and the cost of capital for the major lenders over the period 2008 to 2012. The mid-point scenario suggests that, if we were to incorporate ex-ante VC returns expectations for VC-funded firms, the relevant benchmark would increase from 10.3% to 12.7%. This analysis indicates that returns generated by the largest three lenders are high even if we were to compare them with benchmarks which include the ex-ante expectations of VCs under successful scenarios.

TABLE 4.8 **Benchmark scenario analysis and ROCE for the major lenders**

%

Assumptions	*Low*	*Mid*	*High*
VC return	15.0	33.3	50.0
CAPM WACC	7.9	10.3	12.7
Weighted VC / CAPM benchmark	8.3	12.7	19.3
ROCE major lenders average 2009–2013	35.0	35.0	35.0
VC capital/total capital	13.8	13.8	20.2

Source: CMA analysis.

Note: Weighted by VC equity provided / capital employed

4.185 The scenarios considered in Table 4.8 are based on the low, mid and high WACCs we have estimated for the major payday lenders over the period. VC returns adopted in our sensitivity analysis incorporate the returns set out below for the low, mid and high scenarios:

(a) The low-level VC benchmark of 15% is discussed in paragraph 4.176. This VC benchmark is applied to capital invested in Wonga for the period 2008 to 2010, as indicated in paragraph 4.180, and for all VC investment in other VC-funded lenders.[85]

(b) The mid-level VC benchmark is based on submissions from [✂] which indicated a VC target return of [✂] invested capital over [✂] years and is applied to capital as in *(a)*.

(c) The high scenario adopts a VC target return of 50%, which compares with 40% as the highest cost of equity submitted by parties[86] and 41% as the level noted by Wonga as relating to the top 10th percentile of VC funds in paragraph 4.177. The high scenario adopts a VC return of 50% for VC-supplied capital for all years from 2008 to 2012.

Provisional conclusion on profitability

4.186 The evidence we have reviewed indicates that observed levels of profitability are consistent with a lack of competitive pressure. The three largest lenders have earned high and in some cases exceptional returns over a significant part of the period 2009 to 2013. Profits earned by the three largest lenders are substantially above our estimate of WACC, and are high even taking into account the evidence that VC providers used hurdle rates that were above the cost of capital derived using CAPM.

4.187 There is significant variation in the profitability of smaller lenders – with some making losses and some evidence that future profitability may be lower than recent levels, both because of a slowing down in market growth compared with historic rates and due to regulatory changes which may increase costs and/or reduce revenues.

Non-price competition and innovation in payday lending

4.188 Payday lenders' products differ not only in terms of prices but also with respect to other dimensions. As set out in the Guidelines,[87] 'prices and costs are not the sole indicators of the level of competition in a market. Poor quality, lack of innovation, or limited product ranges are prominent among other indicators of weak competition in a market'. In this subsection we discuss the extent to which we observe lenders competing for customers using non-price variables. We begin by setting out evidence on the importance of different

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85 [✂]
86 [✂]
87 *CC3*, paragraph 127.

non-price product characteristics to customers. We then look at evidence of competition between lenders in terms of access to credit, repayment flexibility and customer service.

The importance of different non-price product features to borrowers

4.189 As a guide to identifying which non-price characteristics of payday loans lenders are important to customers, we reviewed the following evidence:

(a) customer surveys investigating the factors that influence customers' decisions about which payday loan provider to choose;

(b) lenders' submissions on the non-price factors that are important to customers; and

(c) lenders' marketing and advertising strategies.

4.190 As part of our customer survey, we asked respondents to indicate the importance of various product characteristics in the choice of payday loan. 'Speed of getting the money' was cited as very or extremely important by 74% of the respondents, followed by 'being able to apply for the loan online' (for online customers) or 'in a store' (for high-street customers) (67%) and 'ease of the application process' (63%). Other factors, such as the reputation of the lender, the total cost of the loan, repayment flexibility and the amount that customers could take out, were considered very or extremely important by a smaller (though still significant) proportion of the respondents.[88]

4.191 Consumer research carried out by lenders[89] similarly highlighted the importance to customers of speed, as well as flexibility and ease/convenience. One lender, CashEuroNet, submitted that because rapid availability of money was now provided by all the main payday lenders, it was 'not a driver of choice between different online payday loan options', citing a more recent survey (August 2013) which it said suggested that different factors (especially interest

[88] See TNS BMRB survey report, p91.
[89] For example, a survey commissioned by Wonga in March 2013 found that [✂]% of its customers indicated the most appealing feature of Wonga's products 'that it is faster than other lenders'. Simplicity and flexibility (ie short-term product) were indicated by respectively 39% and 38% of the customers. Similarly, research commissioned by [✂] in 2012 found that, together with the cost of loan, speed of process, ease and convenience and flexibility of the loan terms play an important role in influencing customers' choice. [✂]% of [✂] customers indicated speed of process as the most important driver of the provider choice (more than the customers who indicated the cost of loan as the most relevant factor, [✂]%). Ease and convenience and flexibility were the most important drivers chosen by, respectively, [✂]% and [✂]% of [✂] customers. Finally, research commissioned by the Consumer Finance Association also suggested that the speed with which the money is available is the most important attribute to customers (22% of customers), followed by clear explanations of charges and fee (16%), and being treated with dignity and respect (16%).

rate [✂]) were now more important drivers of product choice than speed within the UK payday loan market.

4.192 In its submissions, Wonga highlighted customers' responsiveness to the ability to control the level of debt, access the product around the clock on various devices, the speed of lending decisions and ability to manage the loans. Similarly, MYJAR submitted that the ease with which customers could access their account, the simplicity of its offering and the way the customers were treated when they needed help were the most significant factors that customers took into account.

4.193 We also reviewed lenders' responses to our market questionnaire in relation to their marketing and advertising strategies (see also Appendix 6.3):

(a) Wonga told us that the key messages emphasised in its advertising were control, flexibility, speed and the fact that Wonga always showed the total cost of credit upfront. Some examples of texts used by Wonga in its advertising include: 'Cash loans you control', 'Short term loans on your terms', 'How much? How long? You decide', 'No hidden charges'.

(b) In its promotions, CashEuroNet has presented side-by-side comparisons with rivals' products. For example, Figure 4.13 shows QuickQuid's Pay Per Click campaign (May 2013)[90] which contained a comparison with Wonga's Little Loans. In addition to the representative APR, the comparison also stressed the differences between the two payday loan products in relation to: the fee for fast funding, the maximum amount of loan that new (and repeat) customers can borrow and the offering of a loyalty programme.

[90] This campaign was run during the OFT's consultation on referring the payday lending market to the CC.

FIGURE 4.13

QuickQuid's (CashEuroNet) May 2013 PPC campaign, with Wonga comparison

Source: Lending Stream.

(c) Zebit (Global Analytics) submitted some examples of its online pay-per-click marketing campaigns. Speed of process (‘A Zebit cash loan is initiated in 4 minutes’) and long-term repayment in instalments (‘A Zebit cash loan ... allows flexible repayments up to 7 months!’) were key messages contained in those campaigns.

4.194 Finally, we considered the product characteristics recorded for each payday product on money.co.uk – the largest comparison website currently providing information on payday loans (see Section 2 for further details). In addition to the cost (APR), the website compares products in respect of the minimum and maximum amount of loan that can be taken out, and the maximum duration of the loan.

4.195 On the basis of this review, we identified three key areas which appeared particularly important to customers, and where non-price competition may take place: *(a)* access to credit; *(b)* repayment flexibility; and *(c)* customer service. Below we discuss the extent to which we have observed innovation or competition in these product dimensions in recent years.

Access to credit

4.196 Much of the innovation that we have observed in the payday lending sector involves providers facilitating customers’ access to credit. The changes have taken various forms: *(a)* increased flexibility in the amount that can be borrowed; *(b)* faster access by speeding up the process to obtain the loan; or *(c)* making it easier for customers to access their credit.

4.197 A number of lenders have increased the maximum amount that customers can borrow using their products in the past five years. Lending Stream increased the maximum loan amount from £600 to £1,000 in November 2008. The Money Shop (Dollar) progressively increased the maximum loan size of its products, moving from £200–£250 to around £1,000 for new customers and from £350–£450 to around £1,000 for existing customers. Wonga also increased the maximum loan amount (in November 2009) for new customers from £200 to £400 and for existing customers from £750 to £1,000.[91] Wonga told us that this was a 'direct result of competition and customer demand' as at the time of the change other competitors were offering loans up to a maximum of £1,000.[92] Similarly, Dollar told us that it had modified its maximum loan to respond to the 'market advertising larger loan sizes' and to offer 'a maximum loan value in line with the competition'.

4.198 Increased flexibility has also been achieved through the introduction of facilities that allow customers incrementally to increase the loan amount up to some limit (for example, top-up facilities). There are examples of these facilities being made available both for standard-duration payday loans and for longer-term instalment products. This type of facility has been introduced in the period by Wonga,[93] CashEuroNet, Dollar, The Cash Store,[94] H&T and SRC. Some lenders ([✂]) told us that they were also considering offering a product with such characteristics. Wonga and CashEuroNet submitted that these facilities were launched in response to competition.

4.199 Innovations have also been introduced to expedite the process of approving and transferring money to customers.[95] The majority of lenders, including Wonga,[96] CashEuroNet, Payday Express, PaydayUK, CFO Lending,[97] Global

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[91] We have also observed one example of a lender increasing the flexibility of its loans by reducing the minimum amount that customers can take out. Specifically, in December 2009 Wonga told us that it reduced the minimum loan from £50 to £1 with the scope of giving customers increased flexibility and providing 'a more competitive offering'. An internal analysis carried out by [✂] suggested that one of the reasons explaining Wonga's high customer turnover was indeed its offer of smaller loan sizes.
[92] Wonga also submitted that the increase in the maximum amount of loan was made possible by the improved capability of its lending platform which enabled it to risk-assess customers at higher loan amounts with improved confidence as to the customers' ability to repay the loan on time. This was evidenced by the reduction in the principal loss rates for existing customers which Wonga achieved by early 2009.
[93] Wonga launched this facility in July 2009.
[94] These facilities are available to customers who pay back at least 50% of the outstanding principal on an existing loan. Such loans are subject to The Cash Store's overall lending limits.
[95] CashEuroNet submitted that speed of service was one of the main innovative features of online payday loans (p11 of its initial submission to the CC).
[96] Since October 2008.
[97] Since April 2012.

Analytics, Ariste, MYJAR, SRC[98] and The Cash Store, currently use Faster Payment Services (FPS)[99] to process funds transfer. CFO Lending told us that faster payments to customers became a key factor in the customers' decision on provider and that it began offering cash transfer through FPS in order to compete with other online services.

4.200 Initially a fee was charged by many lenders for the FPS. However, over time many of these lenders have removed the fee and now offer free expedited funding. MYJAR told us that it had never charged a fee for this service since its inception in 2008. CashEuroNet told us that it introduced free expedited funding in 2010 and that this action was intended to provide a competitive advantage to attract both new and existing customers. Other suppliers, such as [✂], adopted the same strategy later. Currently, among the 11 major lenders, four (CFO Lending, H&T, WageDayAdvance and The Cash Store) require a faster payment fee for some of their products.

4.201 We have also seen various examples of lenders implementing changes intended to make it easier to access their payday loans. In particular, many lenders have introduced mobile access to payday loans,[100] have improved their website functionality[101] or have extended store hours/begun offering 24/7 availability.[102] SRC told us that in its view there was a significant migration from high-street to online borrowing in the UK and that it was driven largely by mobile. It added that 50% of the people on its website were on a mobile device and, in this respect, the UK market seemed to be much further ahead than the USA.

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[98] Since June 2011.

[99] Faster Payment Services is a payment service that reduces clearing time and enables payments made via electronic telephone banking, Internet banking and standing order to be completed quickly.

[100] TxtLoan has offered the possibility to apply for loans through SMS since its inception in 2008. Wonga introduced mobile apps in January 2010, followed by CashEuroNet [✂]. Wonga and CashEuroNet told us that mobile app used showed significant growth since their launch (for example, Wonga submitted that currently [✂]% of its loans were taken out via a mobile device).

[101] Wonga told us that it had initially launched a 'My account' section on its website which was limited to reviewing loan details and updating customer details. Greater functionality was subsequently added. This included, among others: checking eligibility to apply for additional credit or to extend loan, online early repayment, using online self-service tools to create repayment plan when customers are experiencing difficulties repaying.

[102] In 2011 CashEuroNet introduced the possibility for customers to apply for loans at weekends and bank holidays with no extra costs. CashEuroNet submitted that the weekend service was a competitive necessity, suggesting that other lenders already offered weekend funding and that the CashEuroNet offer was driven by the need to catch up with the competitors. Similarly, Dollar told us that in response to competitors' action it modified store hours to be open at times more convenient to customers, including weekends (Dollar told us that opening hours for individual stores changed on an as-required basis. A central decision was made in summer 2012 to open approximately 40 stores on Sundays from 10am to 4pm).

Repayment flexibility

4.202 Flexibility in repayment terms is another area where we have observed significant changes being made by payday lenders in the past few years. A key development has been the introduction by many lenders of the ability for borrowers to repay loans in instalments. Some of the instalment products that have been introduced, such as Pounds to Pocket (CashEuroNet), Lending Stream (Global Analytics), KwikLoan (H&T), are loans specifically designed to be repaid in instalments. Others, such as QuickQuid Payday Loan (CashEuroNet), FlexCredit (CashEuroNet), Speedy Cash Flex Account (SRC), Zebit Short Term Cash Loan (Global Analytics), Cash Genie/Cash Genie Loans—3-month loan (Ariste),[103] allow customers some flexibility in deciding whether to repay the loan in a single payment or in multiple instalments.[104]

4.203 Table 4.9 shows the date on which various instalment products have been introduced. H&T was the first to launch an instalment loan in 2003. CashEuroNet's QuickQuid product was launched in 2007 (initially allowing customers to repay in either one or two monthly instalments) and Global Analytics' Lending Stream two-month instalment loan (which could be extended to eight months) in 2008, followed by CashEuroNet's Pounds to Pocket 12-month instalment product in 2010, Speedy Cash Flex Account (SRC) in 2011 and Global Analytics' Zebit instalment product, Ariste's Cash Genie/Cash Genie Loans (3-month loan), Sunny (Think Finance) and FlexCredit (CashEuroNet) in 2013.

TABLE 4.9 **Instalment products – timeline of entry into the market**

2003	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*
KwikLoan				QuickQuid Payday	Lending Stream		Pounds to Pocket's Instalment Loan	Speedy Cash Flex Account		Zebit's Instalment
										Cash Genie/Cash Genie Loans (3-month loan)
										FlexCredit
										Sunny

Source: Responses to CC's market questionnaire.

4.204 Further changes were made to some of these products after their introduction, for example CashEuroNet's QuickQuid product was extended in November

[103] Launched in June 2013.
[104] QuickQuid Flexicredit and Speedy Cash Flex Account are both revolving credit facilities. While they cannot really be explained as instalment loans as the drawdowns and repayments could be numerous and varied throughout the time the customer has the account, they allow customers to make periodic repayments.

2012 to allow customers to elect to repay over up to three monthly instalments, and the repayment term of the Lending Stream product was increased from two repayments to four, five or six repayments (depending on loan amount) in March 2009.

4.205 CashEuroNet told us that the launch of its three-period loan option was triggered by the fact that a number of competitors ([✂]) already offered longer-term products and this suggested that 'a longer term loan would be favoured by some customers'. Similarly, Ariste indicated that following the strategy adopted by competitors was part of the rationale for the launch of its instalment product. Global Analytics submitted that its Zebit instalment product was launched (in June 2013) because it saw the market opportunity as there were relatively few established competitors offering instalment products.

4.206 A number of other lenders told us that they intended to launch instalment loans or focus their strategy on this type of products:

(a) Wonga told us that [✂].[105,106]

(b) [✂]

(c) Think Finance said that its intention was to withdraw the payday-like products and to market only instalment loans and lines of credit products as it did in the USA.

4.207 SRC told us that the US market had evolved towards instalment products over the last years. While five years ago the majority of its business in the USA was generated by traditional payday loans (more precisely, two-week loans because people were paid biweekly in the USA), currently most of the loans issued by SRC are instalment loans of varying terms.

4.208 Maximum and minimum loan durations represent another important dimension across which lenders' offering differs. MYJAR increased its loan duration from 7 to 15 days in February 2011, and later in July 2013 from 15 to 18 days. It told us that these changes were driven by the analysis of customer repayment pattern which indicated that a longer-term product would suit customers' need better and allow more flexibility in ensuring that they would be able to repay on time. WageDayAdvance told us that it was considering the possibility

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[105] Wonga has recently launched an instalment product in pilot.
[106] [✂]

of extending the loan term and providing customers with longer-term repayment options.[107] We also observed examples of lenders reducing the loan minimum duration, eg Wonga decreased the minimum loan term from five days to one day (in November 2009),[108,109] and Payday UK (Dollar) and Payday Express (Dollar) reduced the minimum loan duration to seven days ([✂]).

Customer service

4.209 Our customer research suggests that existing payday loan customers are likely to attribute importance to their 'experience' with a particular lender, especially given concerns about the reputation of the market (see paragraph 6.40). This is likely to create an incentive for customers to invest in customer service, given the importance to most payday lenders' business models of repeat custom.

4.210 We saw evidence that lenders invested in customer service as a means to enhance the customer experience and retain customers with a good repayment record. For example:

(a) Wonga told us that it had taken several actions in order to improve the quality of its customer service since it had launched its Little Loans product. It mentioned, for example, an increased number of customer staff, live online customer services and improved customer contact numbers (more clarity and removal of expensive 0871 numbers).

(b) CashEuroNet said that it was the first company to have 24/7 customer service and considered the customer service it provided through a call centre to be better than that offered by other lenders.

(c) Other lenders, such as [✂],[110] The Cash Store,[111] SRC[112] and MYJAR[113], emphasised that they continuously invested in customer service as this was an important factor of differentiation between lenders.

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107 It told us that WageDayAdvance would offer the same loan terms as SRC did.
108 In discussing the rationale for this change, Wonga said in an internal document that: 'In order to prove to journalists, regulators and customers that we are completely flexible we want to be able to offer £1/1 Day loans'.
109 [✂]
110 [✂]
111 The Cash Store told us that it tried to differentiate itself from other payday lenders through superior customer service and 'the open and welcoming environment'. It also said that it believed that the overall experience it offered its customers was superior to the competitors'.
112 SRC told us that customer service was a key competitive dimension and its customers were paying a premium because they acknowledged the high-quality service provided by SRC.
113 MYJAR told us that it focused its investment 'around service and treating the customer right'. It added that its business culture and approach was to try and 'give consumers an experience that they would not ordinarily

4.211 Related to this, we were aware of some evidence to suggest that many customers were happy with the service that they received from payday lenders. For example, the consumer survey carried out by the University of Bristol's Personal Finance Research Centre found high levels of satisfaction among payday borrowers with the customer service received from lenders. Wonga highlighted the relatively high net promoter scores that it achieved compared with those of other financial services providers. A significant proportion of customers responding to our survey who had taken out multiple loans, but had only ever used one lender, reported having done so because they were happy with the service provided.

4.212 We were also aware, however, that the serious problems identified by the OFT and others about irresponsible lending and a lack of compliance with lenders' regulatory obligations clearly indicate that not all payday lending customers have benefited from good customer service (see Section 3).

Conclusions on non-price competition

4.213 The evidence we discussed above suggests that lenders have on a number of occasions introduced new products or made changes/innovations to their products in recent years. We noted in particular that:

(a) A number of lenders have launched credit products or introduced features that allow customers to draw down further funds during the term of a loan.

(b) Over the years lenders have introduced faster payment services, and these are now offered by the majority of providers. Many have also removed the fee charged for this service.

(c) Instalment loans are becoming increasingly available and a number of lenders have introduced either loans specifically designed to be repaid in instalments or the option to do so.

(d) Lenders have invested and taken actions to improve their customer service. Many payday customers report being happy with their experience with their lender, although this must be set in context of the findings of the OFT in its 2013 compliance review.

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expect from a financial services company, let alone something that is perceived as a payday lender, and see how they respond. And basically, through the service proposition, as opposed to the price proposition, see if we can actually build scale.'

Provisional conclusions on market outcomes

4.214 There is evidence from the outcomes that we have observed in the payday lending sector to suggest that lenders compete on certain non-price aspects of the product offering, and that some lenders seek to provide good customer service in order to retain borrowers. Related to this, reported levels of satisfaction among borrowers with the service provided by some payday lenders are relatively high, though these should be considered in the context of the serious problems identified by the OFT in its 2013 compliance review (see Section 3).

4.215 In a well-functioning market, as well as seeking to offer customers good customer service and to improve the non-price dimensions of their products, we would also expect lenders to compete on prices. However, our analysis of lenders' pricing behaviour indicates that there are significant limitations in how effective competition between payday lenders on prices has been, and that the competitive constraint that lenders face when setting their prices is weak.

4.216 In particular, payday loan customers can face a wide range of possible prices (particularly if they settle late) and many customers take out loans that are significantly more expensive for their requirements than others potentially available to them at the time. Aside from a small number of relatively recent developments, there is little evidence of lenders actively using the price of their loans to attract customers over the past six years, and in general customers appear insensitive where lenders have offered lower prices. The apparent weakness in the constraint that lenders face when setting their prices is consistent with our profitability assessment, which shows that the largest lenders have earned profits significantly above the cost of capital over much of the past five years, although we have observed significant variation in the level of profitability, both between lenders and over time.

4.217 In the next three sections, we seek to understand the causes of these market outcomes, by examining the potential constraints on payday lenders' pricing and any factors that may be inhibiting the effectiveness of these constraints:

(a) In Section 5, we consider the constraint on payday lenders' pricing from competition from other forms of credit, as well as setting out our definition of the relevant market.

(b) In Section 6, we examine the extent to which payday lenders' prices are constrained by customers shopping around for a better deal, or switching to a lender with a superior product offering.

(c) In Section 7, we consider the competitive constraint on established lenders from the prospect of new entry, or expansion by smaller lenders.

5. Market definition and the constraint from other forms of credit

Introduction

5.1 In this section we set out our analysis of *(a)* the competitive constraint that payday lenders face from providers of other forms of credit, and *(b)* whether competitive conditions vary for different groups of customers. In light of this assessment, we draw some provisional conclusions regarding the ‘relevant market’ – a task that flows from the statutory questions that this investigation is required to address.[1]

5.2 As set out in the Guidelines, defining the market helps to focus on the sources of any market power and provides a framework for the assessment of the effects on competition of features of a market. It facilitates our understanding of the key competitive constraints which may be faced by suppliers within the market.

5.3 We take as our starting point the definition of payday loans that is set out in Section 2: short-term, unsecured credit products which are generally taken out for 12 months or less, and where the amount borrowed is generally £1,000 or less. The first question that we then assess in this section is the extent to which payday lenders are constrained by the threat that customers will use other types of credit that fall outside of this definition (such as credit cards or overdrafts) instead of payday loans. This assessment allows us to draw some provisional conclusions on whether these other products should be included within the relevant market.

5.4 We then look at whether distinct groups of payday lending customers exist such that different classes of payday lenders face different competitive conditions. Specifically, we discuss competition between online and high street lenders, before looking at whether the competitive constraints facing lenders vary materially between different local areas. Understanding any market segmentation of this type sets the context for our examination of the effectiveness of competition between existing payday lenders to attract customers in Section 6, and the competitive constraint exerted by new or expanding providers in Section 7.

[1] The ‘relevant market’ is defined in the Act to mean the market for the goods or services described in the terms of reference given to the CC for investigation. The market definition(s) used by the CC need not correspond with the ‘relevant market(s)’ as used in the Act (see the Guidelines). In this section, we discuss the appropriate market definition for this investigation.

Competition from other credit products

5.5 We begin by assessing the extent to which providers of other types of credit product are likely to impose a competitive constraint on payday lenders. We discuss:

(a) how the main characteristics of payday loans compare to the characteristics of other credit products;

(b) evidence on the extent to which payday loan customers have access to other credit products and, if they have some access, the extent to which credit is available via these alternatives when they take out a payday loan;

(c) evidence from payday loan customers on their perception of payday loans and alternatives and whether they had considered (or would consider) using other credit products instead of taking out a payday loan; and

(d) evidence of payday lenders and other credit providers competing with each other for customers.

5.6 We recognise that the consumer credit sector, like many we consider, is dynamic with new products being regularly introduced, each with its own particular characteristics. At the edges, this may lead to a degree of blurring between product definitions. However, in the light of the evidence that we have seen, we are content that the broad distinctions that we have drawn between different classes of credit product allow us to capture the spectrum of credit alternatives that are on offer to customers, and to understand the competitive constraint that different classes of credit products impose upon each other.

Product characteristics

5.7 We took the view that, as a general proposition, if there were significant differences between the characteristics of a payday loan and another credit product, customers would be less likely to consider that other product to be a suitable alternative to a payday loan, in turn making it less likely that the other product would impose a competitive constraint on payday lenders. For example, our survey showed that speed of access is an important aspect in customers' decisions to use payday loans.[2] Given this, other credit products

[2] Research into the payday lending market report – results of quantitative and qualitative research undertaken by TNS BMRB, p90.

which do not offer similarly rapid access to funds are unlikely to be seen by many customers as an attractive alternative to payday loans.

5.8 Based on our review of the products on offer, we identified the following as being some key observable characteristics of payday loans:[3]

(a) Amount of loan – this is typically less than £1,000.

(b) Loan duration – this is typically a month or less, but can be up to a year for some products, particularly instalment products.[4]

(c) No need to provide security – payday loans are unsecured loans.

(d) Payment and repayment method – when customers take out a payday loan online the loan amount is deposited in their bank account, making the money available for paying bills and withdrawing as cash. With high street payday loans customers can receive the funds in cash or as a credit to their bank account. Loans are often repaid through the use of CPAs and customers of some high street lenders (eg the Money Shop) can repay loans in cash in-store.[5]

(e) Speed of application, approval and transfer – successful applicants generally receive the funds on the same day, often within an hour (or less) of their application. Customers using high street payday lenders can receive the cash immediately after approval.

(f) Ability to roll over loans – many payday loan products allow customers to roll over their loan. The exact terms on which these facilities are offered, and the terms used to describe them, vary, but the common effect is to allow the customer to extend the duration of their loan beyond the originally agreed repayment date.

(g) Top-up facilities – some payday loan products allow the borrower to increase or top up their loan before the end of the loan term.

5.9 We then investigated the extent to which other credit products shared these characteristics, looking at credit cards, overdrafts (authorised and unauthorised), credit union loans, home credit, logbook loans, pawnbroking,

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[3] This list is not exhaustive, and will not reflect every characteristic of payday loans that customers might find important. Nevertheless, we consider that it serves as a useful basis on which to compare the key attributes of payday loans to other credit products.
[4] Rollovers and refinancing may also result in the extension of the effective loan period of shorter-term loans.
[5] www.moneyshop.tv/short-term-loan-FAQ/.

peer-to-peer lending, personal loans and retailer credit. Full details of this analysis are presented in Appendix 5.1.

5.10 Our review showed that credit cards and overdrafts shared a number of characteristics with payday loans. Credit cards and overdrafts could be used to borrow similar amounts, had similar payment and repayment methods and were also unsecured. They could also provide facilities similar to rollovers and top-ups, so long as the customer was able to borrow more within agreed credit limits. Customers with an existing credit card or overdraft facility could also access funds immediately (eg by making a purchase by card, or by withdrawing cash from an ATM).

5.11 Credit cards and overdrafts differed from payday loans in terms of the period over which credit is paid back to the lender. With credit cards, customers are only required to pay back a minimum amount every month, rather than the whole outstanding debt. Authorised overdrafts typically run over an extended period and can extend indefinitely. Unauthorised overdrafts typically cover a significantly shorter period – for example, Santander told us that the average time a customer spent in unauthorised overdraft was three days.

5.12 Other credit alternatives shared fewer characteristics with payday loans. Of the other products we considered, credit union loans and retailer credit appeared to share the most similarities. Credit union loans involved similar small, unsecured loans which are paid and repaid through bank accounts, offered top-up facilities and are available for shorter terms (including in some cases one-month loans). However, they sometimes could not be obtained quickly and did not offer the ability to roll over/refinance the credit. In addition, a customer would need to meet the membership criteria of a particular credit union in order to be able to borrow from them. Retailer credit could involve borrowing similar unsecured small amounts and the funds could be made available quickly. However, the credit had to be spent with a specific retailer and the payback period could be longer than for payday lending, as repayment generally operates in a broadly similar way to a credit card.

5.13 We also considered the characteristics of guarantor loans, such as those offered by Amigo Loans and UK Credit Limited. We found that these products differed from payday loans in some key respects – the amount of a guarantor loan is typically much higher (an average of £[✄] for Amigo Loans), the duration is longer (a minimum of 12 months, although it could be possible to repay early), they are not paid as quickly (typically the application process can last a few days) and the loan is paid to the guarantor, rather than the borrower.

5.14 We also looked at the relative cost of borrowing using a payday loan compared with borrowing using other credit products. We considered that the larger were any price differences between payday loans and other types of credit, the more likely there were to be significant differences in the characteristics of those products.

5.15 Our analysis, set out in Appendix 5.2, compared the prices of payday loans with other credit products in the following four scenarios:[6]

(a) A customer takes out a £100 loan for 28 days and pays back the loan on time.

(b) A customer takes out a £100 loan for 14 days and pays back the loan on time.

(c) A customer takes out a £100 loan for 28 days and then rolls over the loan for 28 days.

(d) A customer takes out a £100 loan for 28 days and pays back the loan 11 days late.

5.16 We found that borrowing using a payday loan was typically significantly cheaper than using an unauthorised overdraft (for example, a median cost of £29.25 per £100 for a 14 day payday loan compared with £72.50 for an unauthorised overdraft of similar duration and amount).[7] Payday loans were, however, generally substantially more expensive than the other forms of credit considered under all scenarios, apart from home credit. Borrowing using a payday loan was typically cheaper than using home credit in Scenarios 1 and 2 (the shorter-term scenarios), but more expensive than using home credit in Scenarios 3 and 4 (the longer-term scenarios). This was influenced by the minimum loan term for Provident's home credit products, which was significantly longer than 28 days.[8]

5.17 Finally, we considered other, non-commercial alternatives that were potentially open to some borrowers, including borrowing from friends and family. Wonga submitted that friends and family should be considered a competitive constraint, and that the non-financial costs associated with this

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[6] These scenarios were also used in our comparative pricing analysis of payday loans in Section 4.
[7] The full results are set out in Appendix 5.2, Table 1.
[8] Although we noted that, in principle, a customer might borrow from Provident on a longer, cheaper term and then get a rebate within 28 days, which would cause the relative price of using home credit to decline somewhat relative to the price of a payday loan.

type of borrowing would be a relevant consideration to customers when considering the price of a payday loan.[9]

5.18 These informal credit options, where available, may have some characteristics similar to a commercial payday loan, such as the speed of access to funds (assuming family or friends have ready access to the funds), but may differ in other characteristics such as customers' ability to borrow more or extend the loan. Moreover, since borrowing from friends or family is based on a personal rather than a commercial relationship, this form of borrowing is inherently different, as a much wider set of social and emotional factors are likely to be involved in any request to borrow money. Its availability as an alternative and the range of factors that would be involved in practice are likely to differ considerably between potential borrowers. Further, friends and family will not normally be driven by the profit-seeking incentives of commercial credit providers when lending. We have not seen any evidence to suggest that lenders take into account funds sourced from friends or family when setting their prices. Taken together, this suggests that the risk that customers might otherwise borrow from friends or family is unlikely to impose an effective competitive constraint on payday lenders' pricing.

Access to, and availability of, other types of credit

5.19 Alternative sources of credit will only provide a viable alternative to a payday loan if payday loan customers have access to other credit products, and are able to use those alternatives to borrow the required amount given their credit histories. To assess the extent to which payday loan customers are able to use other forms of credit to borrow, we reviewed:

(a) customer research, including our survey of payday loan customers, and the work carried out as part of the Bristol Report;

(b) CRA data on payday loan customers' use of other credit products; and

(c) evidence on the acceptance criteria of non-payday lenders.

Customer research

5.20 Our survey showed that use of other forms of credit was relatively common among payday loan customers, although not universal. Specifically, when asked about their use of other credit products, we found that 49% of payday loan customers had used an alternative form of credit (excluding an overdraft) in the last 12 months. Credit cards were the most commonly used credit

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[9] Wonga response to annotated issues statement, 28 February 2014.

product (31% of payday loan customers). The others were retail credit (13%), bank/building society loans (8%), home credit (6%), pawnbroker (4%), Department for Work and Pensions (DWP) Crisis Loan (5%) and credit union (2%).[10] Moreover, of customers with a bank account, 56% had been overdrawn in the previous 12 months,[11] around half of whom had entered an unauthorised overdraft.[12]

5.21 While many payday loan customers use other credit products, there was also evidence to suggest that a significant proportion had experienced credit repayment problems in the past (see paragraphs 2.23). We considered evidence on the extent to which payday loan customers have credit available to them from alternative credit sources at the point in time at which they take out their payday loan. Respondents to our survey were asked whether – instead of taking out a payday loan – they could have borrowed using another credit product.[13] We found that a significant proportion of customers – 39% – reported that they could not have used any alternative credit product to borrow the money. However, some customers did have credit alternatives available to them: 18% of all customers said that they could have used a credit card to borrow the money instead of a payday loan, 20% said that they could have used an overdraft and 30% said that they could have used at least one of these two alternatives.

5.22 The customer research produced for the Bristol Report[14] derived a measure of credit access from survey data, based on whether customers reported having unused balances on their overdraft or credit card or said that they were most likely to have used mainstream credit if they could not have borrowed from a short-term lender. On this measure, the report estimated that mainstream credit was a feasible alternative to short-term credit for 14% of high street payday loan customers and 24% of online payday loan customers. In most cases this would have meant using a credit card or overdraft.

5.23 The Bristol Report also investigated customers' perceptions of the alternative credit products that were available to them. For online payday loan customers, 50% agreed that they used payday loans because they did not

[10] Research into the payday lending market report – results of quantitative and qualitative research undertaken by TNS BMRB, response to QFCA1.
[11] ibid, response to QFC2. 96% of respondents said they had a bank, building society or credit union account.
[12] ibid, response to QFC3.
[13] ibid, response to QPDSB3. TNS expressed concerns regarding the possible limitations of this question, noting that some people may have answered in terms of what they would have done, rather than what they could have done, and that it may be difficult to judge whether one could use some of the alternatives, eg unlicensed lenders. This may result in the responses underestimating the availability of other sources of credit.
[14] The impact on business and consumers of a cap on the total cost of credit, Personal Finance Research Centre, University of Bristol, 2013.

have access to anything else. For high street payday loan customers the figure was 57%.

5.24 Other customer research that we reviewed provided additional evidence of the extent to which payday loan customers could have used other forms of credit to borrow instead of a payday loan.[15] In all cases these surveys showed a significant proportion of payday loan customers reporting not having access to any credit alternatives, although estimates of the proportion of customers this applied to varied significantly (from around a quarter, up to more than half), depending on the sample used and the precise question asked.

Credit reference agency data

5.25 To explore further the degree to which payday loan customers are able to access other credit products – and the amount of credit available to payday customers using those products – we analysed information relating to a sample of payday borrowers' credit records. The detailed analysis is in Appendix 5.3.

5.26 We began by selecting a sample of payday loan customers from the transaction databases of 11 major payday lenders, as discussed in 2.48. CRAs were then asked to provide information on the payday loans and any other credit products used by each customer in the sample in the period 1 January 2012 to 31 August 2013. Our sampling methodology was based on randomly selecting loans, rather than customers, so will tend to give extra prominence to heavier borrowers who account for a greater share of payday loans.

5.27 Using this sample, we estimated that 52% of payday loan customers in our sample had an active credit card during 2012 and 55% had an overdraft balance greater than £20. A smaller proportion of customers used other credit products, such as personal loans. Around 25% of customers were not recorded in our data set as having used any other credit product.

5.28 Our results suggest that a significant proportion of payday loan customers use (or have used) credit cards. We considered the extent to which customers actually had credit available on their credit card accounts when taking out a payday loan. We did this by taking each payday loan in the sample that was issued in the period from 1 April 2012 to 31 March 2013, and for those

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[15] This included research by the Consumer Finance Association; Which?; Dollar; [✂]; YouGov; Friend Provident/JMU/Policis. In addition, Think Finance submitted survey results of 1,016 short-term borrowers, which asked why they had not considered products other than payday loans. 70% said that it was because they had a bad credit score or were rejected by mainstream lenders.

customers with credit cards, seeking to estimate the total amount of available credit on all of their credit cards at the point at which the loan was taken.[16]

5.29 We estimated that in 82% of cases customers either did not have a credit card, or had less credit available than the amount that was ultimately borrowed using the payday loan. This finding, which is broadly in line with the results of our customer survey, suggests that although use of credit cards is relatively high, many payday loan customers with credit cards would not be able to use these cards to borrow further amounts as an alternative to a payday loan.

Evidence from non-payday lenders

5.30 Some non-payday lenders provided information on the likely availability of their credit products to payday loan customers.

5.31 A number of banks[17] told us that payday loan customers tended to represent higher credit risk than their typical customers, for example:

(a) Lloyds Banking Group (LBG) told us that it monitored the proportion of lending to customers with payday loans as these customers tended to have worse repayment behaviour overall than customers who did not use payday loans. LBG internal research from April 2012 suggested that of the Lloyds Bank customers who used payday loans, [✂]% would be rejected if they applied for a personal loan. For HBOS customers using payday loans, the figure was [✂]%. Follow-up research in July 2012 gave rejection figures of [✂]% for Lloyds Bank and [✂]% for Halifax.

(b) Another large bank ([✂]) told us that 4.4% of its retail customers had evidence of an active payday loan facility or had taken or applied for a payday loan facility in the last 12 months. Of those customers, 80% were currently in arrears on other credit facilities, with 73% having a registered default, county court judgment or insolvency marker. It told us that customers with recent payday loan activity had default rates up to ten times higher than those customers without payday loan activity.

5.32 In addition, a number of other credit providers[18] said that they were using or considering using information on payday lending as part of their credit checking process.

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[16] It was not possible to carry out a similar assessment for overdrafts, because of limitations in the data available for these products.
[17] [✂]
[18] [✂]

Summary of findings on access to and availability of alternative credit products

5.33 We found that use of other forms of credit was relatively common among payday loan customers, although not universal. We estimated that up to a half of all payday loan customers had used a credit card in the previous 12 months, and around a half had used an overdraft facility.

5.34 However, a significant proportion of payday loan customers have experienced repayment problems with credit in the past, and the evidence suggested that many customers would be constrained in terms of the alternative credit products available to them at the point of taking out a payday loan. In particular, we found that a significant proportion of borrowers would be unlikely to have *any* credit alternatives available to them when taking out a payday loan (our survey suggested that this applied to around 40% of all customers). In addition, despite relatively high usage of credit cards and overdrafts among payday customers, our survey suggests that only around 30% of customers could have used a credit card or overdraft to borrow the money instead of a payday loan. Our analysis of data provided by a CRA similarly indicates that many customers are likely to have only limited credit available on their credit cards at the point at which they take out a payday loan.

Payday loan customers' perceptions of other credit products

5.35 We next reviewed evidence on payday lending customers' perceptions of other credit products, and their willingness to use these products instead of payday loans.

5.36 In our survey we found that only a very small proportion of all customers reported that they would have used another type of credit product, had a payday loan not been available. In particular, respondents to our customer survey were asked: 'If you had not been able to get a payday loan on this occasion, what do you think you would have done instead?'[19] 6% of respondents said that they would have borrowed from a different type of credit provider.[20] These responses suggest that in general customers taking out a payday loan do not consider other credit products to be a close substitute. A

[19] In its response to the annotated issues statement, Wonga argued that answers to this question could not be relied upon because the question was unprompted and respondents could only choose one answer. However, if payday loans and other forms of credit were close substitutes, we would expect this to be reflected in the responses of customers irrespective of whether the question was prompted and despite the fact that customers could only report their most favoured alternative.
[20] Research into the payday lending market report – results of quantitative and qualitative research undertaken by TNS BMRB, response to QPDSB1.

similarly small proportion of those customers that might be considered more 'marginal' – ie more likely to have alternatives available to them if the price of payday loans were to increase – reported that they would have used a different type of credit had their payday loan not been available.[21]

5.37 Instead, most individuals stated that they would either have gone without the loan[22] or borrowed from friends or family. Of the minority of customers who said that they would have used an alternative product, and consistent with our review of product characteristics, a credit card was the most common option (21% of alternatives mentioned). Other options mentioned included overdrafts (15% of alternatives mentioned), bank/building society loan (12% of alternatives mentioned), pawnbroker loan (3% of alternatives mentioned) and home credit (1% of alternatives mentioned).[23] In total, around 2% of customers reported that they would have used a credit card or overdraft to borrow the money had their payday loan not been available. The proportion of customers who said that they would have used other credit products was lower still.[24]

5.38 Other survey evidence supported this finding. In particular, in the Bristol Report's customer survey payday loan customers were asked: 'What would you have done if you had been unable to obtain a payday loan?' 8% of respondents reported that they would have borrowed in some other way, which is close to our own figure of 6% (see paragraph 5.36).[25] In addition, we found that in total, only 14% of all payday loan customers reported having got as far as finding out information to compare the pros and cons of alternative credit products with the pros and cons of a payday loan.[26]

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[21] Specifically, we looked at respondents to our customer survey who said that they had not experienced any debt problems in the last 12 months, and so may be expected to be more likely to have other credit products available. Among this group, 5% of customers reported that they would have borrowed using another credit product had their payday loan not been available.
[22] In its response to the annotated issues statement and working papers, Dollar said that this result was inconsistent with the fact that 59% of payday loan customers said that the loan was for something that 'they definitely could not have gone without'. However, as discussed in paragraph 2.27, the qualitative research suggested that customers' mindsets at the time of taking out a loan tended to push their perception towards apparent need, exaggerating their need for a loan, while in retrospect customers thought that the expenditure could have been forgone or delayed.
[23] Research into the payday lending market report – results of quantitative and qualitative research undertaken by TNS BMRB, response to QPDSB2.
[24] Since we did not ask consumers specifically about guarantor loans, we reviewed the quantitative and qualitative research to understand if there were any cases where consumers had used or considered a guarantor loan. None of those interviewed as part of the quantitative and qualitative survey work mentioned guarantor loans. Source: Review carried out by TNS at CC request.
[25] The impact on business and consumers of a cap on the total cost of credit, Personal Finance Research Centre, University of Bristol, 2013
[26] Consistent with this finding, Think Finance provided the results of a survey in which 1,016 short-term borrowers were asked 'Thinking about the last time you used a payday loan, which, if any, of the following options did you also consider?' 58% said that they did not consider any other options or payday loans were the only option available to them. 15% said they considered borrowing from friends and family. 13% said they had considered using a credit card and 10% considered using their authorised overdraft.

5.39 As discussed in paragraphs 5.19 to 5.34, one reason why many payday customers may not consider other types of credit to be a close substitute is that they are *unable* to borrow using these other types of credit. For those individuals who are able to borrow using alternative types of credit, our customer research highlighted a number of other reasons why customers may prefer to use payday loans, either related to:

(a) the perceived attractions of payday loans; or

(b) the perceived disadvantages associated with the alternatives.

5.40 In terms of the perceived attractions of payday loans, discussions with customers as part of our qualitative research suggested that some customers were attracted to the practical benefits of payday loans, and in particular the speed, convenience and control. This was supported by the findings of the quantitative survey, in which we asked those payday customers who could have used an alternative source of credit why they did not do so. The main reasons given for favouring payday loans were that the alternatives were not as convenient (45%) and that they could not get the money as quickly (31%).[27]

5.41 The importance to customers of convenience were also highlighted in the customer survey of the Bristol Report, in response to which over 60% of online customers gave 'convenience' as the reason for using a payday loan rather than borrowing in some other way.

5.42 In addition to these practical advantages of payday loans, some customers also referred to the perceived disadvantages associated with alternative credit products. In particular, our survey found that some customers wanted to distance themselves from the type of customer that uses home credit or pawnbroking. In contrast, online payday loans were seen to be a relatively discreet way of borrowing by many respondents. In addition, some customers reported disliking or distrusting mainstream credit providers. A third of respondents to our customer survey agreed with the statement 'I try to avoid banks as much as possible'.[28]

5.43 Responses to the Bristol Report's customer survey also highlighted negative perceptions among some payday loan customers about characteristics of other forms of credit, particularly credit cards or overdrafts, that are revolving rather than having a fixed end date, and/or can be used continuously. Around 63% of high street payday loan customers and 54% of online payday loan

[27] Research into the payday lending market report – results of quantitative and qualitative research undertaken by TNS BMRB, response to QPDSB6.
[28] ibid, p84.

customers responding to the Bristol Report's customer survey agreed with the statement: 'I use this type of loan because I am less likely to get into difficulty using it compared with a credit card or overdraft.' Policis' payday loan customer survey[29] similarly found that 56% of payday loan users agreed that 'credit cards could trap you in long-term debt' while 43% believed that 'you are less likely to get into trouble with payday loans'.

Competitive interactions between payday lenders and other credit providers

5.44 We sought evidence of payday and non-payday lenders taking actions to compete with each other for customers, as well as lenders' views on the extent of competition between payday lenders and other credit providers. Further detail of respondents' views are set out in Appendix 5.4.

5.45 We began by noting that the market outcomes in payday lending, as set out in Section 4, suggest that lenders are not effectively constrained in setting their prices, although there is more evidence of lenders taking actions to improve the non-price dimensions of their loan offering.

5.46 A small number of payday lenders, including CFO Lending, Global Analytics and The Cash Store, told us that they did not see themselves as competing with other credit products. However, most payday lenders that we spoke to took the view that they did compete with providers of other forms of credit, including CashEuroNet, Cheque Centres, Dollar, MYJAR, Microlend, SRC, Think Finance and Wonga.

5.47 When asked for examples of how they competed with providers of other credit providers, most payday lenders highlighted the role of competition between payday lenders and providers of other forms of credit in driving product innovation. For example, Wonga told us that there was evidence that other financial providers were responding to the innovation brought to the sector by companies like Wonga: for instance, banks were improving their online and mobile platforms; Provident, a home credit provider, was now providing an online short-term credit product; and some credit unions were increasing their efforts to offer an alternative to payday loans.[30] We saw no substantive evidence that suggested that the prices chosen by payday lenders were influenced by the prices of non-payday products.[31]

[29] Credit and low-income consumers, Policis.
[30] Wonga response to annotated issues statement.
[31] Dollar told us that it had taken the price of authorised overdrafts into account when it had increased the price of the Money Shop payday product in 2013. Wonga referred to a draft website page comparing unauthorised overdraft charges with payday loan prices that it was intending to use, and internal analysis of unauthorised

5.48 Many of the non-payday lenders that we contacted believed they did not compete directly with payday lenders and/or told us that they had not taken actions to respond to competition from payday lenders. These included: banks (Barclays, HSBC, LBG, RBS/NatWest and Santander); credit card providers (MBNA and SAV); home credit providers (Shopacheck); Logbook loan providers (CarcashPoint); pawnbrokers (Fish Brothers and Mays Pawnbrokers); peer-to-peer lenders (Ratesetter); retail credit providers (SDFC, Next and Arcadia Group); and guarantor loan providers (Amigo Loans and UKCredit).

5.49 However, some respondents provided details of some actions that they had taken as a result of the actions of payday lenders:

(a) Capital One told us that it had tested two credit card products as potential alternatives to, and partly in response to, the growth of payday lending.

(b) Leeds City Credit Union said that its business volumes had remained steady and therefore there was no evidence that it was losing customers to payday lenders. However, it was trying to win customers from payday lenders, working with local partners and media to raise its profile.

(c) Mobilemoney said that the growth of payday lending was adversely affecting its business for logbook loans of £200 to £1,000.

(d) Provident Financial, a home credit provider, told us that its home credit offer did compete at the margins with payday lenders. Provident Financial told us that it had sought to update and modernise its home credit offer in response to the general trend in customer behaviour and preferences for greater convenience, speed and online interaction.

(e) S&U, a home credit provider, told us that it was competing for customer loan business, but did not compete directly online with payday loan companies.

5.50 To summarise, as set out in Section 4, we have observed some innovation in the payday lending sector, and it is possible that some of this innovation may be targeted at customers who had previously used other types of credit product. We observed a small number examples of other credit providers – particularly non-mainstream lenders – taking steps to increase the flexibility of their products, although most providers told us that they did not compete with

overdraft fees showing that Wonga is cheaper than the average bank charge. However, in neither case was any evidence provided showing how overdraft charges had actually affected the level of prices chosen by the lender, and there was no indication that the price of overdrafts (or indeed any other forms of credit) had driven either lender to keep their prices low for fear of losing customers.

payday lenders. We saw no substantive evidence of payday lenders taking developments in the pricing of any non-payday products into account when setting the prices of their products.

Provisional conclusions on competition from other credit products

5.51 Based on the evidence set out in paragraphs 5.5 to 5.49, and given the market outcomes that we observe as discussed in Section 4, we provisionally concluded that competition from other credit products was likely to impose only a weak competitive constraint on payday lenders, and in particular on their pricing. This was for the following reasons:

(a) The characteristics of payday loans differentiate them from many other credit products, which often do not allow customers to borrow such small amounts for short periods, access funds as quickly, or require some security. With the exception of unauthorised overdrafts, borrowing using other credit products is generally significantly cheaper than using a payday loan.

(b) It is relatively common for payday loan customers to use other forms of credit. However, a significant proportion of payday loan customers have experienced credit repayment problems in the past, and the evidence that we saw suggested that many customers would be constrained in the extent to which credit would be available using alternative products at the point at which they take out a payday loan. For example, only around 30% of respondents to our customer survey reported that, when taking out their most recent payday loan, they could have used a credit card or overdraft to borrow the money instead.

(c) Customer research suggests that in general customers taking out a payday loan do not consider other credit products to be a close substitute – only 6% of respondents to our survey reported that they would have used another type of credit had they been unable to take out a payday loan. Partly this is likely to be due to the fact that many payday customers do not have credit alternatives available to them. In addition, some customers may prefer payday loans because of the convenience, speed or discretion associated with these products, or because of a negative perception of alternatives such as a perceived lack of control.

(d) In addition to this evidence of a lack of substitutability, we saw no substantive evidence of payday lenders taking developments in the pricing of any non-payday products into account when setting the prices of their products, although it is possible that some of the innovation that

we have observed in the payday lending sector may be targeted at customers who had previously used other types of credit product.

Competition between online and high street lenders

5.52 We considered next the extent to which payday loans offered online and on the high street were perceived by borrowers to be substitutable, and whether online and high street lenders competed with each other for customers. First, we assessed the similarities and differences in product characteristics, prices and customer demographics between online and high street payday loans. Then we considered the extent to which customers had used both channels, and the reasons given for this. Finally, we considered lenders' submissions on whether online and high street lenders competed for customers.

Product characteristics and customer demographics

5.53 The clearest way in which high street and online payday loans differ is in the way in which customers apply for their loan – and whether this application takes place online or at a physical location. High street loans also differ in that borrowers are generally offered the ability to receive and repay credit in cash.

5.54 Putting these differences aside, however, we found that high street and online payday loans share many characteristics. For example, both online and high street payday lenders allow customers to take out loans for similar amounts and for similar short periods. Online and high street lenders both offer similar extension policies, generally allowing customers to roll loans over so long as they repay outstanding fees. For most lenders, whether online or high street, repayment dates are tied to a borrower's payday.

5.55 We also compared the prices (as of October 2013) of high street and online lenders. Table 5.1 provides the prices of the largest high street lenders under the different borrowing scenarios discussed in Section 4. It shows that the largest high street lenders (Cheque Centres and The Money Shop) charged prices close to the typical price of £30 per £100 for a one-month loan. The products of two other high street lenders, H&T and Speedy Cash, were relatively cheap, comparable to the cheapest online products available on the market.

TABLE 5.1 **Total cost of credit for a £100 loan for the largest high street lenders, under different borrowing scenarios**

£

Lender	*Product*	*Scenario 1*	*Scenario 2*	*Scenario 3*	*Scenario 4*
		Borrow for 28 days	*Borrow for 14 days*	*Borrow for 28 days, roll over for 28 days*	*Borrow for 28 days, repay 11 days late*
Cheque Centres	Payday loan	29.99	29.99	59.98	59.99
The Money Shop	Cheque-based loan	29.85	29.85	59.70	58.85
The Money Shop	Chequeless loan	29.99	29.99	59.98	58.99
H&T	Payday loan (cheque)	17.64	17.64	35.28	48.80
H&T	Payday loan (debit)	20.00	20.00	40.00	52.37
Speedy Cash	Payday loan	25.00	25.00	50.00	37.50
Speedy Cash	Flex Loan	23.01	11.51	46.03	32.05
Speedy Cash	Flex Account	23.01	11.51	45.92	32.05
The Cash Store	Payday loan	38.24	34.05	76.48	66.74

Source: CMA analysis.

5.56 We also considered the characteristics of high street and online payday loan customers. As discussed in paragraph 2.22, high street customers typically had lower incomes than online customers, and tended to be older. Nevertheless, there was considerable overlap in the demographic profile of online and high street borrowers.

Customer views of substituting between high street and online payday loans

5.57 We analysed survey evidence on the extent to which customers considered online and high street loans to be substitutes.

5.58 We found that in most cases, high street customers had heard of at least one online lender, and that similarly most online customers had heard of at least one high street lender.

5.59 Of the high street customers who had taken out more than one loan, half had only ever used high street lenders and half had borrowed both on the high street and online.[32] 26% of those who had never used an online lender (ie 13% of all high street customers who had taken out more than one loan) said that they had considered doing so.[33] Taken together, this suggests that 63% of high street customers who had taken out more than one loan had either used or considered using an online lender. These findings were broadly consistent with our analysis of data provided by the CRAs, as discussed in Appendix 6.2.

[32] ibid, p42.
[33] ibid, p61.

5.60 For those high street customers who had not considered using an online lender, the most common reasons given for not doing so were that they preferred to speak to someone face to face; they did not have Internet access; and they did not like providing personal information online.[34]

5.61 Of the online customers who had taken out more than one loan, 82% had only used online lenders.[35] Only 11% of those who had only borrowed online (ie 9% of all online customers who had taken out more than one loan) said that they had considered using a high street lender. Taken together, this suggests that 27% of online customers who had taken out more than one loan had either used or considered using a high street lender. These findings were also broadly consistent with our analysis of data provided by the CRAs, as discussed in Appendix 6.2.

5.62 Of those online customers who had not considered using a high street lender, the most common reasons given for not doing so were that online customers preferred the convenience of online, and because borrowing online was considered quicker/easier.[36]

5.63 Our qualitative research provided further insight into the reasons why some customers may prefer high street lenders over online and vice versa. Reasons given for preferring high street lenders were: *(a)* it was perceived as safer; *(b)* customers preferred the face-to-face interaction and building relationships with the staff; *(c)* the convenience and visibility of the store; *(d)* customers' use of other services in the same store, like pawnbroking; and *(e)* a lack of knowledge and experience of the online market. Reasons given for preferring online lenders were: *(a)* a perception that the high street was less regulated; *(b)* the anonymity of online borrowing, especially if their credit application was rejected; *(c)* a lack of high street stores nearby, allied to the convenience of online; *(d)* convenience, as customers' finances were already dealt with online; *(e)* a feeling that high street lending was for the poor and dis-possessed; and *(f)* an expectation that high street lenders did not offer the same products as online lenders.[37]

5.64 The qualitative interviews also suggested that some of the movement from online to high street lenders was the result of serial borrowers being rejected by online lenders, with convenience also being a factor.[38] Recommendations from a friend could also play a part in the decision. Movement from high street

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[34] ibid, p61.
[35] ibid, p42.
[36] ibid, p61.
[37] Research into the payday lending market, p63.
[38] ibid, p64.

to online was linked to marketing emails and texts after the initial loan, which could make borrowers aware of the online market.[39]

Lenders' views on competition between online and high street lenders

5.65 We also reviewed the submissions of lenders on the extent to which high street and online lenders competed with each other. CashEuroNet (an online lender) said that it competed with all payday lenders and SRC told us that the online sector was affecting the profitability of its high street stores. Other lenders' responses suggested that there was limited competitive interaction between high street and online lenders. For example, [✂] said that when setting prices it had peripheral awareness of the wider high street market and was not aware of how other providers affected its business, and The Cash Store said that the actions of other lenders did not affect its volumes or sales.

Provisional conclusions on competition between online and high street payday lenders

5.66 The evidence we reviewed indicates that:

(a) There were some differences in the age and income profile of the customer groups served by online and high street lenders. Except for the channel through which they were sold, the products offered by the two types of lender were very similar.

(b) A significant proportion (63%) of high street customers had used or considered using an online lender. By contrast, fewer online customers had used or considered using a high street lender, though some had done so.

(c) Lenders' views on whether online and high street lenders competed for customers were mixed.

5.67 We provisionally concluded that while some high street customers may have a strong preference for borrowing face to face from a high street lender, the majority of customers were likely to consider online to be a viable alternative, such that online lenders were likely to compete with high street lenders. Any competitive constraint imposed on online lenders by high street lenders was likely to be weaker, given the relatively small proportion of online customers who had also used or considered taking out loans on the high street.

[39] ibid, p64.

Competition in different local areas

5.68 We also reviewed the evidence on whether competition between high street lenders differed between different local areas. In particular, we considered:

(a) how far customers were willing to travel to their store, and the overlap between high street lenders' operations;

(b) the extent of local variation in lenders' payday loan offering and lenders' reactions to local competitive conditions; and

(c) the ease with which lenders are able to launch stores in new localities.

5.69 The evidence we collected showed that payday loan customers taking out loans on the high street generally travelled only a short distance to their store: 80% were located within 3.2 miles. There was considerable overlap between the operations of high street lenders—largely as a result of the significant networks of stores operated by the two largest high street lenders, The Money Shop and Cheque Centres. Our detailed analysis of local overlap and concentration is set out in Appendix 5.5.

5.70 The evidence provided by high street payday lenders showed that there was very little local variation in their payday loan offering. Most of the larger high street lenders (including Cheque Centres, H&T, Oakam, SRC and The Cash Store) said that they did not vary their offer locally. Dollar (The Money Shop) said that it varied some aspects such as opening hours and marketing materials in response to competition, but not its price: when it had purchased existing operations it had gradually moved the prices in the acquired store to the uniform level. Most smaller high street lenders also reported not varying their offer locally – only three respondents to our smaller lender questionnaire said that there was any local variation in their offer.

5.71 We also asked high street lenders for examples of occasions where they had reacted to actions taken by other high street payday loan providers. In general, the commentary provided by lenders in their responses to our questionnaire yielded very little in the way of examples of lenders reacting to local competitive conditions.

5.72 We considered whether any localised barriers existed which would made it difficult for lenders to open stores in new local areas. To enter a new area, a high street payday lender would need to rent premises in a location with retail units available with the appropriate use class (A2 Financial and professional services).[40] In addition to this, high street lenders would need to fit out the locations for payday lending and hire staff.

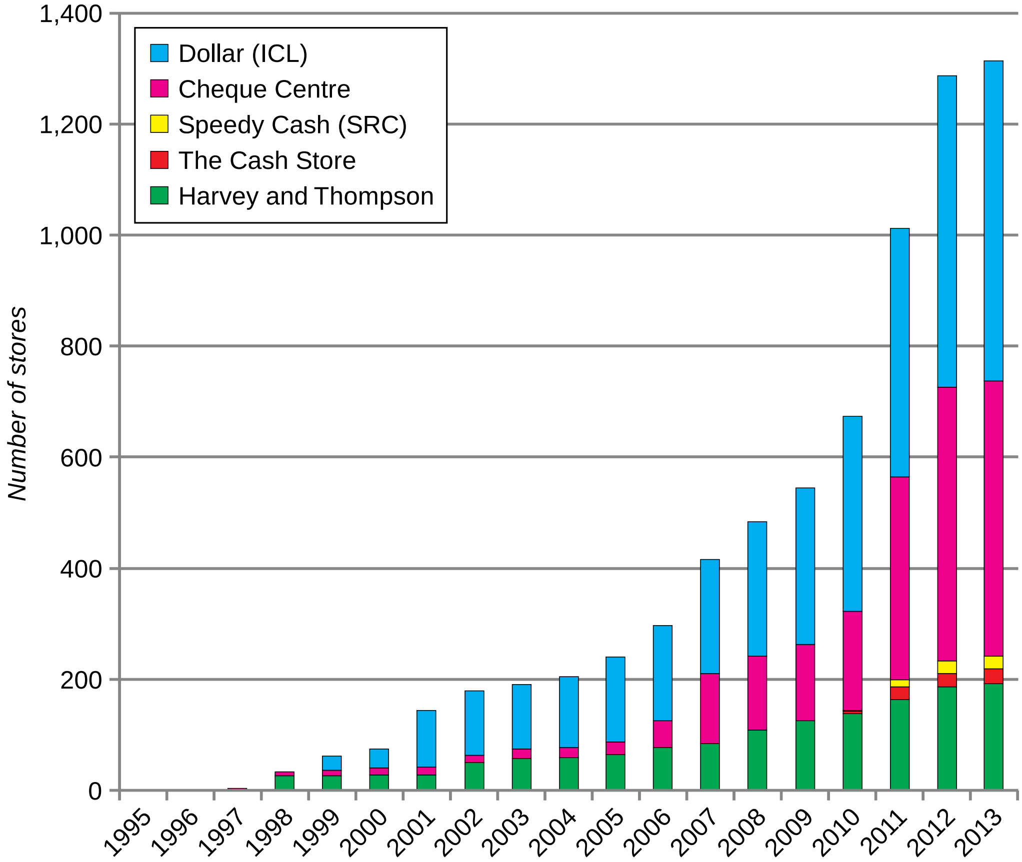
5.73 Dollar (The Money Shop) told us that costs of opening a store ranged from £[✄] to £[✄] per store. It said that a provider of only payday loans would incur much lower costs when opening a store because they would not need much of the safety/security equipment that Dollar required. SRC (Speedy Cash) said that its investment per store included £250,000 for construction and approximately £150,000 to fund receivables. SRC also invested in significant advertising, promotion and recruiting efforts. It took approximately 12 months from deciding to enter the market to starting to trade.

5.74 Figure 5.1 shows the evolution of the number of high street stores operated by the major lenders over time. It shows that these high street lenders have opened large numbers of stores in recent years, particularly between 2010 and 2012, although the rate of growth in store openings has decreased in 2013.

[40] As set out in the Town and Country Planning (Use Classes) Order 1987 (as amended).

FIGURE 5.1

Number of high street payday lending stores over time



Source: CC analysis.

5.75 This evidence suggests that existing high street lenders appear able to open stores in new localities with relative ease should there be sufficient demand for payday loans.

Provisional conclusions on local competition

5.76 We provisionally concluded that while high street lending had a local dimension (since most customers would be unwilling to travel more than a relatively short distance to their store), competitive conditions were unlikely to vary significantly by location. This is because:

(a) online lenders (who account for the majority of loans issued) are likely to constrain high street lenders in a similar way across the UK;

(b) there is a high degree of overlap between different high street lenders' stores; and

(c) existing high street lenders appear able to open stores in new localities with relative ease.

5.77 In line with this conclusion, we noted that lenders' prices and product offerings are generally set at a national rather than a local level.

Provisional conclusions on the relevant market

5.78 On the basis of the analysis set out in this section, we considered the relevant market definition for the purposes of our investigation.

5.79 We decided not to include products other than payday loans within our definition, due to the weak competitive constraint that other products impose on payday lenders. There are a combination of factors that have informed our provisional conclusion on the relevant product market, including the differences that exist between payday loans and other types of credit (which serve to limit customers' willingness to substitute between them), the limited extent to which many payday customers are able to borrow using other credit products, and the limited evidence of competitive interaction between payday and other lenders.

5.80 Regarding competition between online and high street lenders, we found that the products are similar and there is considerable overlap in the customer groups served by online and high street lenders. However, there is evidence to suggest that some customers may have a preference for particular channels, and we also noted an asymmetry, in that a higher proportion of high street customers used online lenders than vice versa. We did not, however, consider that the segmentation that we observed was sufficiently great that it was necessary to define separate markets for online and high street payday loans.

5.81 Finally, given the constraint that online lenders are likely to impose on high street lenders, the lack of local variation in high street lenders' offering and the relative ease with which lenders are able to open new stores in different local areas, we did not consider that competitive conditions differed across local areas such that it was necessary for our competition analysis to define separate local geographic markets.

5.82 Given the above, we therefore provisionally concluded that the market relevant to our assessment of competition is the provision of payday loans in the UK.

6. Competition for payday loan customers

Introduction

6.1 In this section, we assess the extent and nature of rivalry between payday lenders, with a particular focus on the role played by payday loan customers in driving competition. In a market in which competition is working effectively, firms are incentivised to keep their prices down and the quality of their products high because if they do not do so, customers will choose an alternative supplier. If barriers exist that prevent customers from effectively shopping around for loans and/or switching supplier, then firms may be able to exploit these barriers and enjoy market power.[1]

6.2 Our assessment of competition between payday lenders, and the role of customers within this, is structured as follows.

6.3 We begin by reviewing evidence on the overall effectiveness of the constraint imposed on lenders by the threat that customers will choose an alternative supplier. We summarise the evidence regarding payday lending customers' sensitivity to variation in prices, and the impact this has on the effectiveness of price competition between lenders.

6.4 We then present evidence we have gathered related to how customers choose their provider:

- *(a)* First, we provide a description of the extent to which payday lending customers compare the different products on offer prior to taking out a loan (ie shop around).
- *(b)* Second, we discuss the frequency with which customers switch lenders when returning for additional credit, and the reasons given for doing so.

6.5 Next, we discuss five characteristics of the payday lending market which may impede customers from effectively shopping around for a loan or switching lender to get a better deal, reducing their responsiveness to variation across lenders and so weakening the pressure for lenders to compete on prices. These are:

- *(a)* aspects of the context in which the decision to take out a payday loan is made;
- *(b)* the potential difficulties associated with identifying the best-value loan;

[1] See *CC3*, paragraph 295.

(c) additional factors limiting customers’ awareness of and sensitivity to late payment fees and other fees and charges incurred if customers do not repay their loan in full and on time;

(d) the reliance of many customers on lead generators; and

(e) the perceived risk and loss of convenience associated with changing lender.

6.6 We finish by presenting our provisional conclusions on the constraint imposed on payday lenders by the need to price at a level to attract customers from other payday lenders and on whether there are any features of the UK payday lending market which restrict the effectiveness of this constraint.

The effectiveness of the competitive constraint imposed by the need to attract and retain payday lending customers

6.7 As set out in (paragraphs 4.214 to 4.216), the outcomes that we have observed in the payday lending market suggest that while there is competition on certain non-price dimensions of payday loans, competition between lenders on prices is weak. This is consistent with our profitability assessment, which shows that the largest lenders have earned profits significantly above the cost of capital over much of the past five years, although we have observed significant variation in the level of profitability both between lenders and over time.

6.8 The evidence that we have reviewed suggests that customer demand is generally unresponsive to differences in prices between providers. In particular, while price reductions are uncommon, where we do observe examples of lenders offering significantly lower rates, these lenders have generally not been particularly successful in attracting new business. For example, [✂] told us that it increased its [✂] interest charge from [✂]% to [✂]%, in order ‘to increase revenue as [it was] getting no appreciable marketing benefit by undercutting competitors on price’ (see paragraph 4.73(a)). Similarly, despite the size of the discount that was offered, Speedy Cash told us that its interest-free loan offer had only led to a marginal pick-up in volume (see paragraph 4.73(d)).

6.9 In many cases, we have observed cheaper products being withdrawn, or the prices of these products eventually being increased (see paragraphs 4.43 to 4.51). Nevertheless, despite this trend we continue to observe some significant differences between the price of the cheapest and most expensive products available on the market for a loan of a given value and duration (see paragraphs 4.28 to 4.34). For example, comparing the products in our review, we found that a borrower seeking to take out a payday loan for £100 for 28 days could pay interest and fees of under £20, or more than £50, depending on which lender they chose. The extent of the variation in prices was even greater in the event that a customer repaid their loan late (see paragraph 4.31).

6.10 Moreover, lenders whose payday lending products are relatively expensive in different borrowing scenarios continue to capture a significant share of customers (see paragraphs 4.78 to 4.98). Although our data does not allow us to rule out the possibility entirely, the evidence does not suggest that this pattern can be explained by customers preferring certain lenders for reasons other than price, such as non-price aspects of their product offering, or by their relative willingness to grant credit to particular customers.

6.11 Despite this observed lack of price sensitivity, there is evidence to suggest that – as we would expect – customers care how much they pay for their payday loan. For example, in response to our survey, 55% said that the total cost of the loan was 'very' or 'extremely' important, and a further 30% said that this was 'fairly' important. This is especially likely to be the case given the tight financial constraints that payday lending customers often face when they take out a loan. This suggests that some impediments exist which are preventing or deterring customers from responding to variations in the prices of payday lending products, as they would do in a well-functioning market. By reducing the responsiveness of customers to prices, these impediments are likely to be a primary reason why lenders are not driven to compete for customers by lowering their prices.

The extent and nature of shopping around

6.12 In order to be able to make effective comparisons between the value for money represented by different products – and so for lenders to face an effective competitive constraint – payday loan customers need to be aware of and willing to use other lenders' products that are available to them. In this subsection, we describe evidence of the extent to which customers carry out comparisons prior to taking out a loan and the nature of the comparisons that are carried out.

The extent to which customers shop around at all before taking out a loan

6.13 First, we considered the extent to which payday lending customers compare alternatives before taking out a loan.

6.14 The findings of our customer survey indicated that the majority of payday loan customers do not compare the pros and cons of different payday lenders at all prior to taking out a loan.[2] Seven out of ten customers reported that they had not done so for the most recent loan, and six out of ten customers reported never having done so.[3]

6.15 Other customer research also suggested that a significant proportion (ie at least a third) of payday lending customers do not carry out any comparisons before choosing a payday loan, although the proportion of customers found not to have carried out any comparisons before taking out their loan were generally lower than found in our own customer survey:

(a) Research carried out as part of the Bristol Report found that 54% of online customers reported not having compared the cost before taking out their loan.[4]

(b) Wonga provided details of its own customer research which indicated that [✂]% of its first-time customers did not look at or consider an alternative lender's website before choosing Wonga.[5]

(c) An online survey conducted by CashEuroNet of approximately 2,000 of its own customers[6] found that [✂]% of respondents had neither shopped around for the most recent loan, nor for a previous payday loan.

6.16 We noted the variation between these results. One likely reason for this is the differences in methodology between the surveys. In terms of sampling approach, Wonga's and CashEuroNet's research included only their own customers, while our survey was able to draw on a market-wide sample using lenders' customer lists. While the Bristol Report research was based on interviews of the customers of more than one lender, its coverage was more limited than that of our own survey, and – because of its focus on the broader high-cost credit sector – its sample of payday customers was smaller than our own. A second possible explanation is the variation in the precise questions that customers were asked. For example, while the question in our survey

[2] The survey asked customers the question 'Did you shop around between payday lenders—for example, compare some of the pros and cons of different payday lenders—before you applied for your loan?'.
[3] CashEuroNet argued that the extent of shopping around was not low when compared with other financial products (and in particular the current CMA market investigation into private motor insurance (PMI) which found that two-fifths of PMI customers said that they last compared insurers or insurance policies less than a year ago). We note that there are substantial differences in the extent to which between PMI and payday loan customers compare products. Nearly all PMI customers (95%) had at some point compared insurers/policies. The majority of customers who had ever shopped around online used a price comparison website and of these, around 30% used more than one price comparison website to compare policies.
[4] University of Bristol (2013): 'The impact on business and consumers of a cap on the total cost of credit'. Customers were asked the following question 'Before you took this loan out from [name of lender], did you find out what it would cost to borrow the money you needed from any other payday lenders?'.
[5] According to customer research conducted in March 2013, [✂]% of Wonga's customers considered one or two other lenders before choosing Wonga, [✂]% considered 'lots', and [✂]% could not remember.
[6] CashEuroNet asked similar questions as in our customer survey.

addressed the extent to which customers compared the pros and cons of different payday lenders before taking out their loan, Wonga's question asked about whether customers 'looked and considered' alternative lenders' websites before choosing Wonga (an act which may not necessarily involve a comparison of products).[7]

6.17 While having regard to the different estimates of the proportion of customers who have shopped around, we placed greater reliance on the estimate from our own survey, because it was representative of the overall population of payday lending customers and because the question put to customers was the relevant one for the purpose of our assessment.

6.18 We also considered how the extent to which customers reported having shopped around varies between the different customer groups represented in our customer survey. Our assessment included using an econometric analysis to estimate the relationship between different customers' characteristics and their likelihood of reporting having shopped around (see Appendix 6.1 for further details). We found that:

(a) There was little variation in the extent to which new and repeat customers reported having shopped around for their most recent loan.

(b) Online customers were significantly more likely to report having shopped around for their most recent loan (32%) compared with high street customers (13%).

(c) The financial literacy of a customer (as indicated by their ability to calculate simple interest) and whether they had a higher education degree had a positive effect on the likelihood that they reported shopping around for their most recent loan.

(d) Customers who considered speed as the most important factor when taking out a loan were less likely to report having shopped around.

The nature of the comparisons carried out

6.19 We considered the nature of the comparisons that were carried out by the minority of customers who reported having shopped around.

6.20 Of the customers who reported having ever shopped around for a payday loan in our customer survey,[8] visiting lenders' websites was by far the most

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[7] Wonga asked the following question 'Before deciding to apply for your first Wonga loan, can you remember if you looked at and considered other cash advance websites too?' (see Populus Customer Survey, March 2013 – Annex 3 of Wonga's initial submission).
[8] 40% of the total sample. See TNS BMRB survey report, p96.

common source of information that customers reported having used (89% of these customers mentioned this source) followed by advertising (57%) and comparison websites (42%). Significantly less common were talking to friends and family (18%), speaking to lenders over the phone (16%) and visiting high-street shops (14%).[9]

6.21 Of those customers who reported using lenders' websites to shop around,[10] around half reported visiting the websites of four or more lenders. Of those customers who reported visiting lenders' stores to shop around,[11] most reported having visited the shops of two or fewer lenders.

6.22 Nearly all (91%) of the customers who said that they had shopped around for any loan[12] reported having found out how much it would cost to borrow the amount needed from another lender. Most also reported having found out how quickly the other loan would be granted (84%) and the amount that they could take out (80%). Around two-thirds of customers who had shopped around reported having found out the cost of borrowing with another lender if they did not pay back on time.

6.23 Dollar told us that it was beginning to observe a change in the factors that customers shopped around on, as the market started to mature. Whereas in the past shopping around had focused mainly on speed, ease and convenience, Dollar considered that price and some of the other product features were becoming more important.

6.24 The results of our qualitative research indicated that in some cases customer search activities relating to different lenders' prices may not be particularly thorough, and that, in general, shopping around appeared to be a 'very cursory experience'.[13]

6.25 For example, for some customers shopping around consisted of typing payday-loan-related terms (eg 'short-term loan' or 'fastest way to get a loan') into a search engine and clicking on the first two or three results, picking a site of which they liked the look or where the loan application appeared very clear, and applying (and if rejected, trying the next site in the list). If during the application process there were some aspects that the customer did not like, such as having to provide evidence of income, they would search again.

[9] For those customers who shopped around and took out a payday loan on the high street (a small minority of the survey sample of the high-street customers, ie 13%, reported having shopped around for the most recent loan), visiting a shop was, however, a relatively important source of information (see TNS BMRB survey report, p101).
[10] 35% of all respondents.
[11] 17% of all respondents.
[12] 40% of the total sample.
[13] See TNS BMRB survey report, p95.

6.26 The qualitative research also suggested that even when they tried to shop around, customers encountered various difficulties: eg they were unaware of price comparison websites that could assist in searching, the borrowing terms on such comparison sites were for different amounts and/or time periods and so they could not be easily compared, they found it difficult to compare financial concepts such as APRs, they intentionally limited the number of lenders to which they sent their details due to privacy concerns, and they had a perception that lenders' charges were very similar.[14] Due to these difficulties, some customers were unable to identify the best deal for them.[15] We discuss in paragraphs 6.65 to 6.87 characteristics of the payday market which are likely to impede customers' ability effectively to identify and choose the best-value loan.

Conclusions on the extent of shopping around

6.27 The evidence that we have reviewed on patterns of shopping around shows that:

(a) The majority of payday loan customers do not shop around at all prior to taking out a loan. High-street customers are particularly unlikely to compare different lenders' products before taking out a loan.

(b) Those comparisons that do take place are typically carried out using lenders' websites, and most customers who have shopped around report finding out how much it would cost to borrow the amount needed from another lender. There is some evidence from our qualitative survey to suggest that comparisons may often be a 'very cursory experience', and that customers may face difficulties when trying to compare loans. Factors affecting customers' ability effectively to shop around for their loan are discussed in greater detail below.

The extent to which customers change lenders, and their reasons for doing so

6.28 As discussed in Section 2, repeat lending to the same customer – whether in the form of taking out completely new loans, rolling over existing loans, or

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[14] See TNS BMRB survey report, p104.

[15] TNS BMRB told us that respondents to the qualitative research revealed their inability actually to identify the best deal in two ways:

- Respondents explained that since taking out loans with a certain lender, they had taken out subsequent loans with different lenders, with lower interest rates, fees and/or better terms. Respondents reported that they had been unable to identify these loans as a 'better deal' until they had experience of both lenders, for example due to unexpected charges.
- During the interview, respondents showed the interviewer the lenders that they had compared, and explained their decision-making process. Based on a comparison of the headline price, fees and administration charges, between two and three loans with similar repayment, the interviewer noticed when customers made an incorrect judgement. This, however, occurred in a very limited number of interviews.

topping up – is pervasive, and accounts for a substantial proportion of the loans issued by payday lenders.

6.29 We also found that it is relatively common for customers to borrow from more than one lender. Using information on a sample of customers selected from our transaction data, we estimated that around four in ten payday lending customers borrowed from at least two different lenders during 2012, and that on average a customer borrowed from 1.9 lenders in a year. These findings were broadly consistent with the results of our customer survey.

6.30 This suggests that a substantial proportion of payday lending customers will have had some direct experience of the loan terms offered by more than one provider. In this section, we consider the factors underlying these patterns, and what drives payday loan customers to either change supplier or remain with the same lender.

Reasons for changing loan provider

6.31 Our analysis of borrowing patterns and our customer survey suggested that the use of multiple lenders by payday lending customers often takes place as a result of customers being constrained in their ability to borrow further amounts from an existing lender (see Appendix 6.2 for further details). We reached this view for the following reasons:

(a) First, we found that customers often use multiple lenders concurrently, ie taking out a new loan while an existing loan was outstanding with a different lender. Nearly all customers who used more than one lender 'multisourced' in this way on at least one occasion, and for many customers a large proportion of their loans were taken out concurrently. Typically, where a customer has a loan outstanding with a lender, we would expect their ability to borrow further amounts from that lender to be constrained. In particular, most lenders will not issue a customer a new loan if they already have a loan outstanding. Although in some cases customers who multisource their loan may have been able to meet their credit requirements via an existing lender by topping up a previous loan, this was unlikely to be the case for most occasions of multisourcing that we observed (see Appendix 6.2, paragraph 35, for further details).

(b) Secondly, we noted that customers may be constrained in their ability to return to a lender that they had previously used if they had experienced repayment problems with the previous loan. We found that the last loan a customer takes out with a lender is around ten times as likely never to be

repaid compared with other loans.[16] In addition, responses to our customer survey suggested that about 70% of customers who had used multiple lenders had also experienced some form of financial problem[17] in the previous 12 months (compared with 42% of customers who had used only one lender).

6.32 Given this evidence, we took the view that the credit constraints facing borrowers are likely to be responsible for a significant part of the use of multiple lenders that we observe. We found that more than 95% of those occasions where customers changed lender took place either *(a)* while a loan to an existing lender was being repaid and no further credit was available with the existing lender(s) or *(b)* following a repayment problem on a previous loan.[18] We estimated that less than 10% of customers in our sample had used different lenders for consecutive loans at least once during the course of a year where neither of these conditions applied and so where the customer was unlikely to be credit constrained.

6.33 The importance of credit constraints in driving borrowers to change lenders was also highlighted by our customer survey, although responses suggested that issues with credit availability accounted for a smaller proportion of the switching that we observed than was suggested by our analysis of borrowing patterns. In particular, when we asked those customers who had taken out loans from more than one lender in the past[19] what had caused them to go to another payday lender rather than borrow more from the same lender, a third of customers reported that they had not been able to go back to the same lender either because they already had an outstanding loan or because they would not be granted a higher/further loan by that lender.

6.34 At the same time, our customer survey also suggested that some customers had changed lender because they had a preference for a loan or service offered by another lender (30%). Other reasons, such as having had a bad

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[16] Around two-thirds of 'last loans' are never repaid in full, compared with around 6% of loans that are not a customer's last loans.
[17] Financial problems were defined as either *(a)* having been overdrawn on any of the customer's bank accounts, *(b)* having gone over the agreed limit on any of the customer's accounts, or *(c)* having been turned down for any types of credit.
[18] Wonga submitted that customers who did not repay loans were likely to encounter difficulties in taking out subsequent loans from any lender because their CRA credit record would include information indicating the unpaid loan. We note, however, that: *(a)* different lenders may have different strategies in relation to the customer risk profiles that they are willing to accept, and *(b)* the information available via CRAs suffers from a number of limitations (see paragraphs 7.108 to 7.110), which means that an alternative lender will generally not have as good visibility of a customer's repayment history as their previous lender.
[19] We did not ask whether the loans from different lenders were taken out simultaneously (ie multisourced), or one after another.

experience with the previous lender, convenience or a personal recommendation, were cited less frequently.[20]

Reasons given for not changing lender

6.35 A significant proportion of customers in both our analysis of borrowing behaviour and our customer survey had taken out multiple loans, but had only ever used the same lender. We considered the reasons given by customers for remaining with the same provider.

6.36 Customers interviewed as part of our qualitative research indicated six key reasons for not switching lenders:

(a) they were generally pleased with the service they had received from the lender;

(b) a perception that lenders offered essentially the same deals;

(c) a reluctance to provide more information about themselves or proof of income;

(d) a concern that another lender might not accept their application and this might affect future loan applications;

(e) a concern that by being accepted by another lender they might be tempted to take out more loans than they could afford; and

(f) inertia brought on by having an account with a lender that made it easy to apply for further loans from it.

6.37 We explored the frequency with which these reasons were put forward by payday loan customers in our quantitative survey. Of those customers who had taken out more than one loan but used only a single lender (34% of the sample), only 15% had at some point considered going to a different lender, whilst a clear majority (85%) said that they had not considered using alternative providers.

6.38 When asked about the reason why they had not considered switching supplier, the majority (61%) of respondents asked this question[21] said that this was because they were happy with the service provided by the existing lender. Of the remainder, respondents cited the general ease/convenience of

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[20] Although not captured in the quantitative survey, the qualitative research suggests that sometimes customers use a new lender to repay other loans and avoid late payment fees.
[21] Approximately 18% of the survey sample.

sticking with the same lender (11%), avoiding the need to go through a new application process (6%), concerns about the likelihood of approval with another lender (4%) and that the current lender offered better terms (4%).[22]

6.39 For those customers who had used only one lender but had considered using an alternative provider,[23] again the most common reason given for deciding not to switch (36%) was because the customer was happy with the service provided by the current lender. However, in general these customers were more likely to cite other factors, such as the need to go through a new application process (13%), the general convenience of sticking with the current lender (12%), a preference for the terms offered by their current lender (12%) and concerns about the likelihood of approval with another lender (9%) as reasons for not switching, compared with customers who did not consider using an alternative lender.

6.40 Our qualitative research explored what customers meant when they said that they were 'happy with the service provided by the current lender'. In-depth conversations with customers indicated that customer satisfaction appeared to be related to the perception that the sector was potentially unsafe or that there were 'dodgy' lenders in the market. Therefore, using a lender with which a customer had previously had a good experience could reduce the perceived risk of having a negative experience in the future. A number of factors were cited as contributing to customers having a positive experience with a lender, including: an easy and quick application and approval process; having an account that could be logged into and did not require a customer to provide basic information again; being offered increased loan amounts; not being charged for paying late by a few days; and 'thank you' texts after repayment that make a customer feel valued.[24]

6.41 Where customers reported not having considered switching because they were happy with the service provided, there was some evidence to suggest that these borrowers were often not aware of the alternative products available in the market:

(a) The proportion of customers who had ever shopped around is significantly lower among those who had never considered changing the lender (29%)

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[22] A smaller proportion of respondents who did not consider changing supplier said that they saw no incentive to switch as they considered lenders to be all the same (3%), they never thought about other lenders (4%) and they were not aware of other lenders (1%).
[23] Approximately 5% of the survey sample.
[24] For high-street customers a good experience means: the customer can build up a relationship with the outlet staff; where staff make the customer feel valued by being friendly, helpful, engaging and establishing a report; and by being a 'friend offering a helping hand'.

compared with the equivalent figure for customers who had either used multiple lenders (53%) or considered changing supplier but did not (61%).

(b) Of the customers who did not consider changing supplier as they said that they were happy with the service provided by an existing lender, one in three (32%) had ever shopped around, whereas the equivalent figure is twice as large for customers who considered changing lender but did not.

Conclusions on customers' use of multiple lenders

6.42 A substantial proportion of payday lending customers have used multiple lenders, and so will have had some direct experience of the loan terms offered by more than one provider. To summarise the evidence that we reviewed on the factors driving customers' use of multiple lenders:

(a) The borrowing patterns that we observe suggest that where borrowers change lenders, this will often take place where customers are constrained in their ability to borrow further amounts from an existing lender (eg where customers already have a loan outstanding with a lender, or have experienced a repayment problem with the previous loan taken from a lender). However, our customer survey suggested that some switching also takes place where customers change lender because they prefer the product offered by another lender.

(b) For those customers responding to our survey who had taken more than one loan but had only ever used a single lender, the most common reason given for not changing or not considering changing lender is that they are happy with the service provided by their current provider. Our qualitative research suggested that satisfaction with levels of service provided by existing lenders generally stemmed from having had a positive experience in the past: customers were unwilling to switch away from a lender with which they had had a good experience previously, in part because of concerns about unsafe lending practices that may be used by other providers in the market. This is consistent with evidence that lenders have taken actions to improve their customer service in order to retain customers (see paragraph 4.210). Where customers reported not having considered switching because they were happy with the service provided, there was some evidence to suggest that these borrowers were often not aware of the alternative products available in the market. Other reasons given for not switching include the convenience of sticking with the same lender, avoiding the need to go through a new application process, concerns about the likelihood of approval with another lender and a preference for the terms of the existing lender.

6.43 Despite the frequent use of multiple lenders that we have observed, neither the threat of customers switching lender (to the extent that it exists), nor the fact that many customers have direct experience of different lenders' loan terms, appears to have resulted in lenders facing an effective competitive constraint when setting their prices. Evidence on borrowing patterns suggests that in part this is likely to be because the use of multiple lenders is often driven by concerns about credit availability rather than customers seeking out a better deal. In the next section, we consider how this and other characteristics of the payday market may act to impede customers from effectively comparing different loans and responding to variation in prices.

Potential factors limiting customer responsiveness to the price of payday loans

6.44 The discussion above indicates that although some shopping around does take place in the payday lending sector, and many customers have experience of more than one lender's products as a result of having used other lenders in the past, this is not sufficient (or sufficiently effective) to incentivise lenders to compete on price. We considered whether there were aspects of the payday lending market which might lead to this outcome, either by deterring customers from shopping around; impeding their ability to do so effectively; or deterring repeat customers from choosing an alternative lender for their next loan on the basis of its loan offering (rather than simply as a result of them being unable to return to a lender for further credit).

6.45 We began by noting that there are certain aspects of the payday lending market which – other things being equal – we might expect to help make borrowers responsive to the differences in the terms on which products are offered by different lenders:

(a) First, compared with some other financial products (such as, for instance, mortgages), payday loans are relatively simple and the total cost of credit – universally provided by lenders – is a relatively easy way of comparing prices for a given borrowing scenario.

(b) Second, most customers borrow online, where information is generally relatively easy to access.

(c) Third, customers often take out large numbers of payday loans, which are by their nature generally short-term products. This suggests that customers have regular opportunities for learning about payday loan products and to change supplier if they could identify a better alternative (see paragraphs 6.28 to 6.30).

(d) Finally, as many payday lending customers are operating under tight financial constraints, they might be expected to place a relatively high value on any savings on the cost of borrowing that could be achieved by shopping around.

6.46 Notwithstanding the above factors, we identified a number of barriers to shopping around or switching which might explain why customers are unresponsive to variation in payday lenders' prices. These can be categorised as follows:

(a) the context in which the decision to take out a payday loan is generally made;

(b) difficulties that customers face in identifying the best-value offer;

(c) additional factors limiting customers' awareness of and sensitivity to late fees and other extra charges;

(d) the role played by lead generators; and

(e) the risk and loss of convenience perceived to be associated with switching lender.

6.47 With the exception of the issues related to the role of lead generators, which is specific to the online market, these barriers are likely to affect both online and high-street customers. We discuss each of these potential barriers in turn.

The context in which many customers decide to take out a payday loan

6.48 The first potential barrier that we identified stems from two common aspects of the context in which borrowers' decisions to take out a payday loan are often made. The first aspect is the perceived urgency of taking out a payday loan and the weight that customers place on being able to access credit quickly. The second aspect is the extent to which payday loan customers are uncertain about whether they will be granted credit to meet their borrowing requirements, and from which lenders credit is likely to be forthcoming. These factors, which we discuss in turn below, will tend to frame the way in which customers make decisions about the payday loan that they take out, and their attitude to shopping around and changing lender.

Perceived urgency of the loan

6.49 Payday loans are by their nature a short-term credit option, with most products allowing funds to be accessed quickly (often within a matter of minutes or hours). Payday loans are most commonly used for essential living expenses, often following an unexpected, temporary decrease in income and/or increase in expenditure.[25] Taken together, these factors suggest that the need for payday loans will often be perceived as urgent.

6.50 Related to this, there is evidence to suggest that being able to access funds quickly, once a need for credit has been identified, is important to both new and repeat customers:

(a) As part of our customer survey we asked respondents to indicate the importance of various product characteristics in the choice of payday loan. ‘Speed of getting the money’ was the factor most commonly emphasised, cited as very or extremely important by 74% of the respondents. When respondents were asked to choose a single factor as being the most important, speed was the most common single factor indicated by both online and high-street customers, with (on average) 31% of respondents highlighting speed compared with around one in ten for most of the other factors.[26]

(b) The importance of speed to customers is also supported by consumer research carried out by lenders. For example, a survey commissioned by Wonga found that [✂]% of its customers indicated that the most appealing feature of Wonga’s products is ‘that it is faster than other lenders’. A survey commissioned by CashEuroNet in 2012 found that [✂] indicated speed of process as the most important driver of the provider choice (although CashEuroNet submitted that more recent evidence suggested that other factors were now more important drivers of product choice than speed because rapid availability of money was provided by all of the main lenders).[27]

(c) Our qualitative research suggested that the importance attributed to speed reflects the psychological state in which customers seek a payday loan[28] and in some cases the speed of application and accessing the money ‘trumps’ the value of the deal, with customers in some cases

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[25] See paragraphs 2.26 to 2.30.
[26] Both new (26%) and repeat customers (35%) cited speed as the single most important factor.
[27] Specifically, CashEuroNet referred to a survey from August 2013 which it said suggested that factors such as interest rates [✂] were now more important drivers of product choice than speed within the UK payday loan market. In CashEuroNet’s view, this indicated that speed was a less important factor overall because rapid availability of money was provided by all the main payday lenders and therefore ‘is not a driver of choice between different online payday loan options’ (CashEuroNet’s response to the issues statement, p5.)
[28] The research identified a number of reasons explaining why customers attribute primary importance to the speed of the process and the speed of accessing the money: *(a)* customers feel they need the money now, in order to deal with their impending financial issue, with some describing themselves as ‘panicky’ at the time of applying; *(b)* they want to know that they have the money as soon as possible and that the financial issue they have been dealing with is sorted out; and *(c)* they want to get the process of application over as soon as possible so that they can ‘return to normal’.

saying that they paid more for a speedy 'peace of mind'.[29] Similarly, qualitative research conducted for BIS by Ipsos MORI found that customers tended to 'need money very quickly, or wished to get the uncomfortable act of taking a payday loan out over with as soon as possible' and this dissuaded them from researching lenders in detail.[30]

(d) Our qualitative research also suggested that the speed of the process may remain important even when the need for the money is more discretionary.[31]

6.51 Lenders appear to be aware of the importance that customers attribute to speed as many of them highlight on their website and/or in the advertising campaigns the speed of the arrangement as a major feature of their offer (see Appendix 6.3 for further details).[32,33] The importance attached by customers to speed has led to the widespread introduction of faster payment services (FPS), which are currently offered by most lenders (see paragraph 4.199).

6.52 Irrespective of the actual time necessary to search for various offers available in the market, one consequence of the perceived urgency that customers attach to getting a payday loan is that borrowers may be unwilling to spend much, if any, time collecting information on different lenders' products and comparing them prior to taking out the loan.[34]

6.53 This is corroborated by the findings of our customer survey, which indicate that the time pressure perceived by payday loan customers can restrict the extent to which they shop around. 'Not enough time to search' was the most common explanation given by respondents (both new and repeat customers) for not shopping around for their most recent loan (cited by 21% of these

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[29] See TNS BMRB survey report, p93.
[30] See Payday lending advertising research conducted for BIS by Ipsos MORI Social Research Institute (October 2013).
[31] Customers can see payday loans as 'impulse purchases' and they are concerned that if they have time to rationalise their decision they may end up changing their mind about getting a loan ('the longer it takes the longer I doubt things, it was like an impulse thing', 'It's not something you've thought about, it's one of the quick things that you do'). See TNS BMRB survey report , p93.
[32] Cash Converters submitted that it believed it was at a disadvantage to competitors who relied on credit searches to assess affordability whilst it required customers to complete a detailed income and expenditure form which it then matched with bank statements to verify income and ensure that all expenditures had been declared. It told us that this approach was time-consuming and customers often commented that they went to competitors who could provide them with funds more quickly.
[33] Wonga submitted that it did not consider that it emphasised the easy availability of loans and speed of arrangement but this was not given precedence over the total cost of borrowing (see Wonga's initial submission).
[34] Which? pointed to the results of the survey carried out as part of the Bristol Report which found that payday loan users chose a lender primarily on the basis of convenience and speed of application and payment. It submitted that the behavioural economics suggested that consumers might tend to discount heavily the future cost of credit and as a consequence choose lenders that promise to pay out rapidly at the expense of offers with significantly lower interest rates.

customers).[35] Among those customers who reported that they had shopped around, the lack of time was cited as the most common barrier to not comparing a larger number of lenders or spending more time comparing offers (cited by 34% of these customers). We also note that customers who regarded speed as being the most important factor when taking out a payday loan were less likely to report having shopped around prior to taking out the loan (see paragraph 6.18*(d)*).

Credit constraints and uncertainty about obtaining credit

6.54 Another key aspect of the context in which the decision to take out a payday loan is often made is that many customers are credit constrained, and as a result will face some uncertainty about whether or not a lender will approve them for a loan.

6.55 The evidence we have reviewed suggests that uncertainty regarding credit availability may affect a significant proportion of payday lending customers.

6.56 First, while the overall income profile of payday loan customers – and online customers in particular – is not dissimilar to the UK population as a whole, many payday loan customers nonetheless display characteristics indicative of relatively high levels of credit risk.[36] According to our survey, over half of payday loan customers were overdrawn in the last year (with around a quarter going over their agreed overdraft limit), and around 30% were turned down for another type of credit. Half of respondents said that they had experienced debt problems such as a bad credit rating or making arrangements to pay off arrears in the last five years.

6.57 Second, the rate of refused loans is often well above 50% for many of the major lenders (see Table 6.1 below) – and likely to be much higher for first-time customers – illustrating that a significant number of prospective customers see their application refused.

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[35] Both online customers (21%) and high-street customers (22%) cited 'Not enough time to search' as the most common explanation for not shopping around for their most recent loan. We note that the customers who said that they could easily have gone without the loan (12% of those who did not shop around) cited 'happy with the first loan I looked at' as the most common reason cited (20%), whilst lack of time was cited less frequently (12%). Among those who said that they definitely could not have gone without the loan (62% of those who did not shop around), lack of time was the most common reason cited (21%).This suggests that the more customers consider the loan as indispensable the more they feel under time pressure to obtain a loan. Similar proportions of new customers (24%) and repeat customers (21%) cited 'Not enough time to search' as a reason for not shopping around for their most recent loan, suggesting that this aspect of the context in which customers take out payday loan is common to both customer groups.
[36] See paragraphs 2.23 & 2.24.

TABLE 6.1 **Rate of refused loans* for the major lenders†**

Lender	*Brand (if data was provided separately by brand)*	*Rate of refused loans %‡*
CashEuroNet		[✂]
CFO Lending		[✂]
Dollar	PaydayUK	[✂]
	PaydayExpress	[✂]
	TMS	[✂]
Global Analytics		[✂]
H&T		[✂]
SRC	Speedy Cash	[✂]
The Cash Store		[✂]
TxtLoan		[✂]§
Wonga		[✂]

Source: CMA analysis.

*The rate was calculated as the proportion of refused loans over the completed applications.
†Some lenders did not provide this information, namely: Ariste and Wage Day Advance (SRC).
‡The rate of refused loans varies significantly by lender, in particular high-street lenders ([✂], Speedy Cash (SRC) and The Cash Store) have on average a significantly lower rate of refusal than online lenders. This may be because high-street customers are rejected even before submitting an application as they do not satisfy the minimum requirements. These customers may not be accounted for in the calculation of the rate of refusal.
§[✂]

6.58 Third, our analysis of borrowing patterns (see paragraphs 6.31 to 6.33) suggested that a key reason for the high levels of use of multiple lenders that we observe is likely to be the credit constraints facing many customers. In particular, we found that a large proportion of those customers changing lenders already have a loan outstanding with a previous lender, or do so following repayment problems with a previous loan.

6.59 Payday loan customers facing uncertainty and expecting that some lenders are likely to refuse to grant them a loan would need to go through an application process in order to establish whether any given lender would be willing to lend to them. When coupled with the perceived urgency surrounding the decision to take out a payday loan (as well as the possibility that customers may be discouraged from applying to multiple lenders by the perceived impact on their credit record),[37] this may result in customers primarily choosing their loan on the basis of which lender they think will approve their application, rather than the merits of a particular lender's product.

6.60 One consequence of the importance of credit availability to payday loan customers is the widespread use of credit brokers – and in particular lead generators – which seek to attract customers on the basis of high acceptance rates and the offer that they will find customers a lender willing to grant them

[37] Lenders typically use data from CRAs to assist in making their lending decision, which requires some form of credit check. There are two types of credit check: *(a)* 'enquiry' or 'quotation' searches which do not leave a visible 'footprint' on a customer's credit file (ie that a third party lender can see that a search has been performed by another lender), and *(b)* 'application' or 'credit' search which do.

credit. The implications of the role of lead generators for competition to attract customers on price are considered further in paragraphs 6.96 to 6.106.

6.61 Uncertainty may also affect the behaviour of repeat customers, who – having been approved for a loan by a lender in the past – are likely to expect to be approved if they seek to borrow a further amount from that same lender in the future (assuming they had not defaulted on the previous loan). In contrast, a customer is likely to face greater uncertainty about whether or not they will be approved for a loan if they apply to an alternative lender, which may take different factors into account in its credit assessments, and will generally not have access to detailed information on that customer's repayment history.

6.62 In this context, looking at those repeat customers in our customer survey who had only used one lender but did not report being happy with the service provided, it was not uncommon for respondents to attribute their ultimate decision not to change lender (or not to consider doing so) to the higher likelihood of being approved by the current lender (see paragraphs 6.38 and 6.39). Cash Converters told us that payday loan customers typically had been turned down for other financial products (eg credit card, store card, etc) and when they eventually found a lender willing to lend, 'they do not want to move out of that comfort zone, for want of a better term, because they have been turned down so many times before'.

Conclusions on the impact of urgency and uncertainty

6.63 To summarise, the evidence we reviewed suggests that:

(a) When taking out a payday loan, customers often perceive the need for their loan to be urgent, and attach considerable importance to the speed with which they are able to access the credit.

(b) Many payday loan customers are also uncertain, often with good reason, about whether they will be granted credit to meet their borrowing requirements and from which sources credit is likely to be forthcoming (and they may be concerned that applying to multiple lenders would have an impact on their credit record).

6.64 These factors will tend to make customers reluctant to spend time shopping around for the best deal available, and will cause customers to focus on which lender is more likely to lend to them (or, for a repeat borrower, to stay with a lender that they previously used) rather than which lender offers the best value product. This is likely to reduce the responsiveness of borrowers to variation in lenders' prices.

Difficulties associated with identifying the best value payday loan

6.65 The second barrier that we identified related to impediments to customers' ability to identify the best-value loan for their requirements. As set out in the Guidelines, access to information about the products available in the market and customers' ability to identify which offer provides the best value are key elements in driving effective competition.[38] Where customers perceive their need for a loan to be urgent, are concerned about their willingness to obtain credit and need to take a decision rapidly (see paragraph 6.63), any factor that makes it more difficult to compare loans is likely to magnify the search costs that they face.

6.66 We carried out a review of the websites of online payday lenders, the results of which are set out in detail in Appendix 6.4. We found that in general the key information about different lenders' products is available and presented on their websites (with some exceptions related to information about late payment and default fees, which are discussed in further detail in paragraph 6.93). In addition, our customer survey suggests that of those customers who have ever shopped around for a payday loan, more than eight in ten said that it was easy to find information to compare lenders' offer and that the information they looked at was very or fairly clear.[39]

6.67 Despite information generally being available, we found that customers' ability to identify easily the best-value loan for their needs may be impaired by a number of factors:

(a) While the basic payday lending product is generally relatively straightforward, there are also significant elements of complexity involved in comparing the cost of different payday loans in different scenarios. This can make it difficult for customers to make effective comparisons.

(b) Identifying the different lenders available on the market and their relative prices can be difficult, given that the provision of comparison websites listing different suppliers and cataloguing their prices is undeveloped in the payday lending sector, and those sites that do exist often suffer from important limitations.

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[38] *CC3*, paragraph 296.
[39] See TNS BMRB survey report, p108.

Complexities associated with making comparisons of the prices of payday loans

6.68 As set out in paragraphs 4.6 to 4.13, as criteria such as loan amount, loan duration and customer repayment behaviour change, the price that a customer pays for a payday loan may also change substantially. This can make it difficult for customers to make effective comparisons between payday loans.

6.69 Specifically, despite the relative simplicity of payday lending products (see paragraph 6.45*(a)*), such complexities can arise because different lenders often:

(a) offer products with different rules and levels of flexibility regarding loan duration;

(b) have different approaches to finance charges (eg daily versus monthly interest rates);

(c) use different pricing structures when a borrower does not repay on time (eg different combinations of fixed charges and interest rates); and

(d) are subject to other differentiating factors with implications for the cost of borrowing, such as the ability to repay in instalments, roll over a loan or top up during the term of the loan.[40]

6.70 Comparing the price of payday loans is likely to be particularly difficult if borrowers seek to compare traditional payday loans with 'non-standard' products (eg instalment loans) or if they seek to take into account the risk that they repay late.

6.71 In Section 4 we found that the ranking (according to the total cost of credit paid by the customer) of a sample of the payday loan products offered by the major lenders varied significantly depending on the specific borrowing scenarios considered (see paragraphs 4.32 and 4.33). This indicates that, when comparing different products, the process of identifying the cheapest or best-value payday loan can be complicated for borrowers that have some flexibility around the length of time over which they wish to borrow, or who seek to take into account the risk of repaying late.

6.72 In some other credit markets (eg mortgages, credit cards), the APR is often used as a common metric by which the relative price of products may be

[40] See Section 4 – Pricing of payday loans.

assessed, thereby reducing the difficulties customers face in making comparisons between products with different pricing structures. The regulatory framework for consumer credit generally seeks to enhance the role of the APR by setting common rules for its calculation and for its use in financial promotions (see Appendix 3.1 for further details). For example, where an advertisement includes an amount relating to the cost of a credit product, the advertisement must also show the representative APR and must give more prominence to the APR than to any of the other financial information presented (including any other rate of charge, comparative indication, the total amount payable, etc). Lenders must also ensure that the advertised APR reflects the price at or below which the lender reasonably expects credit will be provided pursuant to at least 51% of agreements entered into as a result of the advertisement.

6.73 We considered the role of APRs in aiding comparisons in the payday lending market. Evidence from our customer survey suggested that customers generally looked at the total cost of the loan, rather than making comparisons on the basis of APRs. For example, nine in ten respondents to our customer survey (89%) looked at the total amount repayable before taking out a loan, compared with around two-thirds (68%) that considered the APR.[41] Qualitative research conducted by Ipsos Mori for BIS found that many borrowers view the APR as irrelevant, 'as they intended the loan to be short-term, and were more interested to know the "fee" – or the amount they would pay if the loan was paid back in a month'.

6.74 One likely reason for customers' perceptions of the limited usefulness of APRs is that the APR for short-term loans is very sensitive to the duration of the loan. This can make comparisons using APRs based on representative examples difficult, as these interest rates will vary considerably depending on the representative loan duration chosen by each lender. The usefulness of APRs for comparisons will be particularly limited if the customer's borrowing requirements do not closely match the representative example – for example, if the borrower wants to take out a loan for a shorter duration, or wants to compare the cost of different loans in the event that they are repaid late.

6.75 A number of lenders also highlighted problems arising from the application of the APR rules to payday loans. For example:

(a) Wonga noted that the APR may mislead customers and make them 'think that the company with the highest APR is actually the highest priced'

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[41] See TNS BRMB survey report, p109.

while, for example, a shorter loan, even if it had a higher APR, may have a lower cost of credit.[42]

(b) Wonga also told us that because of the nature of payday loans the resulting APRs are significantly higher than 'what people think of as a normal kind of interest rate'. This may have repercussions on the brand image of the lenders.

(c) Think Finance told us that it faced difficulties in marketing its risk-based pricing, which offered lower monthly interest rates of 15% to low-risk customers. Currently fewer than [✄]% of its customers received rates of 15% on their first loan while the majority still received an interest rate of 29%, so the 15% interest rate could not be reflected in the advertised APR. Think Finance said that while it could have two representative APRs on the main page, this would confuse customers who would not know which interest rate was applicable and this might ultimately lead to disappointment when customers were not granted the lowest rate.

(d) CashEuroNet told us that in relation to risk-based tariffs, it would face difficulties to target low-risk customers with advertisements specifically promoting the cheapest price charged to this group of customers, as it expected that the ASA would require it to specify the exact rates it had (ie. not conditional to the relative risk of a customer).[43]

6.76 In light of the above evidence from customers and lenders, we concluded that the regulatory obligations on lenders to disclose representative APRs were unlikely to be of much, if any, assistance to customers in making comparisons between payday loans. Instead, the most useful basis for customers to make comparisons between payday loans is likely to be on the basis of the total cost of credit in relation to specific scenarios of relevance to the customer (consistent with the analysis set out in Section 4). We also recognised the challenges that could be posed for lenders seeking to advertise risk-based prices, given the regulatory requirement to include a representative APR in the advertisement or promotion, though we also appreciated the need to ensure that advertising about payday loans does not mislead customers as to the price that they are likely to pay.

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[42] It added that:

> in many of the press articles where they will show a table where they have a list for £100 loan what the total cost of credit is but also what the APR is and on many of those tables we actually will be lower on the total cost of credit but we are the highest on annual percentage rate and it is because we are fully abiding by the laws of how to calculate that and so it is more looking at tables like that that are out there in the press and recognising that unfortunately people will see the higher APR and get scared off.

[43] CashEuroNet said that it '[✄]'.

6.77 Nevertheless, we did not consider that the disclosure of the APR was without value for payday lending customers. In particular, given the large number of loans taken out by many customers in a 12-month period (see paragraph 2.49) and the historically high use of rollovers to extend the effective term of a loan, we took the view that the disclosure of an APR can provide an indication of the cumulative cost of taking out multiple payday loans over the course of a year, or of repeatedly extending a short-term loan over a longer period.

Availability and functionality of comparison websites

6.78 In many markets for financial products, comparison websites play a key role in helping customers who are shopping online to compare the offering of different suppliers.

6.79 The evidence we have collected indicates, however, that payday loan customers make only limited use of online comparison services:[44]

(a) Information submitted by the major lenders suggests that only a very small proportion of customers apply through comparison websites. Based on data submitted by a number of the largest online lenders,[45] only 1.4% of customers[46] taking out their first loan with a lender in 2013 came through comparison websites (although there is some variation between lenders, the proportion of customers acquired via comparison websites is never above 4%).

(b) Our customer survey indicates that 42%[47] of customers who shopped around for their most recent loan or had previously done so reported having visited a comparison website.[48] This is significantly less than the

[44] While comparison websites are more likely to be used by online customers, high-street customers may also be expected to benefit from a wider availability of online comparison websites. In its report, TNS noted that 'those taking out high street loans still often used online methods to compare' (see TNS BMRB survey report, p101). Of those high-street customers who shopped around, visiting the websites of payday lenders was the most common source of information (61%) and visiting comparison websites was mentioned by 22% of those customers.
[45] We asked the 11 major lenders to provide information on the number of new customers coming through various channels. The figures in paragraph 6.79*(a)* are based on the responses provided by Wonga, CashEuroNet, H&T, Ariste, SRC, Lending Stream and MYJAR.
[46] For comparison, in another current investigation, the CMA has provisionally found that price comparison websites have become an important sales channel for car insurance and they now account for [55–65]% of all new business sales. See Private motor insurance market investigation provisional findings (p9-2).
[47] 45% of the online customers and 22% of the high-street customers.
[48] Approximately 17% of the entire sample.

proportion of customers who used lenders' websites (89%) and advertising (57%) as sources of information.[49,50]

6.80 An important reason for this finding is the fact that the availability of online comparison services for payday loan products is limited. None of the four largest UK comparison websites for financial services[51] – www.moneysupermarket.com, www.gocompare.com, www.comparethemarket.com and www.confused.com – currently covers payday loans (although www.moneysupermaket.com operated a payday loan comparison site until spring 2013).

6.81 www.money.co.uk is currently the largest comparison website for payday loans,[52] [✂]. www.money.co.uk told us that most visitors clicked on one or two lenders' products when using the comparison tables, although a small number of visitors will follow the links to a large number of lender websites. It also told us that pay-per-click was the only advertising channel that it used for payday loans [✂].[53]

6.82 Other than www.money.co.uk (which appears prominently in search results for payday-related terms), other comparison websites tend to rank relatively low in payday-related search results, and generate significantly lower volumes of traffic. For instance, www.allthelenders.co.uk told us that the total number of clicks to payday loan products on its page was approximately 500,000 in 2013 and that it made no investment in advertising.[54]

6.83 Where online borrowers do use comparison websites, these individuals are often offered promotional rates, suggesting that these websites may increase price competition between lenders for those customers. For example, Wonga used to waive its transmission fee to customers coming through the moneysupermarket.com comparison website. In 2012/13,[55] Dollar's PaydayUK and Payday Express offered a discounted monthly interest rate of 25% to customers referred from moneysupermarket.com.[56] [✂]

[49] Both new and repeat customers use comparison websites as a source of information less often than visiting lenders' websites and seeing advertising, though new customers appear to rely on comparison websites slightly more (50%) than repeat customers (40%).
[50] Our qualitative research suggests that some customers were unaware of price comparison websites and because of this, they were not able to compare lenders' offer like with like.
[51] See Mintel report *Web Aggregators in Financial Service*', UK, July 2011.
[52] [✂]
[53] SRC stressed the importance of advertising ('whether it is conventional media or through pay-per-click and SEO strategies') as a key factor to attract visitors to the comparison website. With the exception of money.co.uk, we have seen little evidence of other comparison websites investing to enhance their visibility.
[54] It said that all the traffic was generated from search engines, primarily Google.
[55] Until spring 2013 when www.moneysupermaket.com withdrew the payday loan page from its website (see paragraph 6.80).
[56] See Price over time presentation, slide 24.

6.84 We note that the payday comparison websites that currently exist suffer from some important limitations:

(a) These websites typically do not allow customers to adapt the search criteria in order to compare loan terms for a given set of borrowing criteria. Instead, products can generally only be ranked on the basis of one or two standardised measures of price (eg APR or TCC for a scenario that may not be consistent across all products), which may not reflect a borrower's requirements, or the range of possible outcomes. Related to this, our qualitative research found that where comparison sites were used, consumers did not find them particularly helpful. This was because comparison sites did not compare 'like-for-like' loans and as a consequence comparison was very difficult. This limitation was also raised by a number of lenders. For example, Wonga told us that comparison websites [✂] tended to compare a standard product but did not allow flexing the search criteria. Think Finance said that currently there was no comparison website which enabled customers to evaluate loans on 'easily measurable factors' and compare loans 'based on what happens if things do not progress as the consumer may hope'.[57]

(b) The comparison websites that do exist include only a limited subset of payday lenders. For example, as of 22 April 2014, www.whichwaytopay.com listed 25 providers. www.allthelenders.co.uk offered somewhat better coverage with 38 lenders. www.money.co.uk listed 20 products.

(c) Some comparison websites, such as whichwaytopay.com and money.co.uk, include lead generators among the providers listed in their comparison tables. The prices listed for these lead generators will not necessarily reflect the actual price that customers would pay if they applied through a lead generator (see paragraphs 2.122 to 2.127 for further details on lead generators). [✂] noted that price comparison websites may be listing the lowest possible price for a lender that the lead generator may source despite sourcing only a small proportion of the leads to this lender.[58]

(d) The order in which various products are presented by comparison websites (and even which products are displayed to customers at all) may not solely depend on the relative prices of the products or other factors of importance to customers. For example, [✂]. WizzCash told us that one major concern with comparison websites was that they did not necessarily

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[57] See Think Finance response to issues statement, p3.
[58] [✂]

rank lenders according to the APR but rather according to what they were prepared to pay per click. Along the same line, MYJAR said that some comparison websites worked not too dissimilarly from lead generators as 'the more you pay, the higher you end up in the list'.

6.85 We considered the reasons why comparison websites are relatively undeveloped in payday lending. These reasons appear to be primarily related to the reputation of the payday lending market:

(a) moneysupermarket.com told us that it withdrew its payday loan page as a result of the increasing level of media and political scrutiny into payday lender practices, and the perception of non-compliance in the sector (see paragraph 2.131).

(b) Dollar emphasised the role played by search engines, in particular Google, in regulating and controlling the amount of traffic that a website received. In its view, the risk of experiencing repercussions on the total traffic generated by the website influenced the decision by moneysupermarket.com to drop its payday loan page. Similarly, Think Finance told us that the reason why many comparison sites did not feature payday was because they were being penalised by Google for having payday sites.

(c) Some lenders reported having considered developing a comparison website, but had eventually abandoned the idea. CashEuroNet said that [✂]. Think Finance pointed at the risk that a comparison site built by an individual lender would lack credibility.

6.86 Comparative advertising may act – to some extent – as a substitute for comparison websites. However, we saw very little evidence of comparative advertising being used by payday lenders.[59]

Conclusions on customers' ability to identify the best-value payday loan

6.87 To summarise, the key information about lenders' products is generally available on their websites, or in the shops of high-street lenders. However,

[59] The only two examples that were submitted to us were: *(a)* a leaflet provided by The Money Shop which advertised a cash-back promotion under which customers were offered £5 cash back per £100 borrowed for loans paid back in full and on time, and which included a comparison of the cost of £100 loan for 28 days repaid on time with Cheque Centres, Cash Converters and Wonga; and *(b)* a campaign used by CashEuroNet which presented side-by-side comparison between its own products and Wonga's Little Loan product. One campaign compared QuickQuid's Payday product with Wonga's Little Loans and mainly stressed the differences in relation to: the APR and the total amount repayable for a £250 loan for 30 days, the fee for fast funding, the maximum amount of loan that new (and repeat) customers can borrow and the offering of a loyalty programme. A second campaign compared Pounds to Pocket product with Wonga's Little Loans where mainly non-price factors were emphasised: loan duration, maximum amount of loan, the speed of funding, and the fee for faster funding.

customers' ability to use this information to identify the best-value payday loan is likely to be impeded by:

(a) the complexity associated with making effective price comparisons between payday loans, given variation in product specifications and pricing structures, and the limited usefulness of the APR in facilitating such comparisons; and

(b) the limited availability of online comparison services for payday loans and the limitations of those comparisons sites that currently exist.

6.88 The consequence of this is that customers who do seek to carry out comparisons on the basis of price may struggle to identify the best-value loan on offer; moreover that difficulty, in combination with the perceived urgency affecting many customers and the overriding importance of finding a supplier that is willing to lend, may deter some customers from shopping around at all. This will in turn reduce the responsiveness of customers to the prices offered by different lenders.

Additional factors reducing customers' sensitivity to late fees and other charges incurred if they do not repay a loan in full on time

6.89 The third potential barrier that we identified relates to additional characteristics of payday lending customers and the information that is available to them, which may reduce the extent to which customers take into account costs resulting from late fees and other charges incurred if they do not repay a loan in full on time when choosing their loan.

6.90 Late repayment and default are relatively common among payday loan customers. Of the loans issued by the 11 major lenders in 2012, 14% were never repaid in full, and 22% were repaid in full after the originally agreed repayment date (although some loans in this latter category may have been subject to an agreed extension). We estimate that fees specifically related to late payment/default account together for approximately 5% of lenders' revenues in 2012. Late payment/default fees, however, represent only part of the revenue generated in cases of late payment as they do not include the interest that continues to accrue beyond the repayment date.[60] Late fees and other charges incurred by customers when they repay a loan after the due

[60] The data provided by lenders does not allow separating accurately the revenues generated by headline interests and those generated by late payment interests.

date are therefore a common additional cost for customers and a source of revenue for lenders.[61]

6.91 The evidence we collected suggests that customers are in general less well informed about fees and charges incurred if they do not repay a loan in full on time than other aspects of the cost of the loan, and are less likely to factor them into their choice of lender:

(a) Two-thirds of all respondents said that when taking out the loan they looked at the cost they would incur if they did not repay on time. This is significantly less than the proportion of the respondents who reported having looked at information on the total cost of the loan (89%).[62] We also note that around half of those customers who were not very or not at all confident in their ability to repay the loan (and therefore might expect to end up paying late payment fees) looked at the late payment fees prior to taking out their loan; less than the proportion of customers who were more confident in their ability to repay.

(b) Of those customers who reported having shopped around for a payday loan,[63] 63% collected information on the late payment fees. This is significantly less than the proportion of customers who reported having gathered information on the total cost of the loan (92%), the speed of the process (83%) or the amount that they could take out (80%) when shopping around.[64]

(c) Similarly, the Bristol Report[65] found that while 80% of high-street payday lending customers considered the total amount they had to repay (including the original amount borrowed) when they took out the loan, fewer than one in two customers (42%) looked at 'other fees or charges, such as early resettlement or penalty charges'.

(d) The results of our qualitative research suggested that some customers became aware of late payment fees only if they ended up paying them.

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[61] Some lenders told us that they did not always charge late payment/default fees. For example, SRC submitted that of the late fees chargeable in the last 12 months, 17% were waived. [✂] Nonetheless, as noted in this paragraph, the amounts actually charged to customers through late fees and interest are clearly substantial.
[62] This holds true for new and repeat customers as well as for online and high-street customers (though the proportion of high-street customers who reported having looked at information on the total cost of the loan is lower (76%) than the average across the sample).
[63] 40% of all respondents (see paragraph 6.14).
[64] These figures are similar for both repeat and new customers. 69% of the new customers and 62% of the repeat customers compared the late payment charges of various lenders. For both types of customers this figure is significantly lower than the proportion of the respondents who reported having gathered information on the total cost of the loan, the speed of the process or the amount that they could take out.
[65] The Bristol Report, Table 5.3.

(e) Of the customers in the contemporaneous sample[66] who failed to repay on time and who are therefore most likely to have incurred late payment fees, 36% considered that they had not spent enough time looking at costs and charges when taking out the loan; significantly higher than the equivalent figure for the customers who repaid on time (10%).

6.92 One characteristic which could prevent payday loan customers from taking the fees charged in case of late payment/default into account when choosing their loan is if they are overconfident about their likelihood of repaying the loan on time. There was some evidence from our customer survey to suggest that customers underestimate their likelihood of repaying late:

(a) Although around 20% of respondents[67] reported having failed to repay in full by the repayment date,[68] almost all customers (95% of respondents) recollected[69] having been very or fairly confident of being able to repay on time[70] at the time they took out the most recent loan.

(b) Among customers who had failed to repay in full by the repayment date, more than 80% reported having been very or fairly confident of being able to repay on time at the point at which they took out the loan.

(c) Given their greater experience, we might expect repeat customers to be better at anticipating the risk of not being able to repay on time. However, our survey shows that, although 14% of repeat customers failed to repay in full by the repayment date, 94% of these borrowers reported that they had been very or fairly confident of being able to repay on time when they took out the most recent loan.

(d) Around half of customers who failed to repay on time said that the total repayment amount was more than they expected when the loan was taken out, whereas only 13% among those who repaid in full by the repayment date said that they paid more than they expected. Commenting on this finding, TNS noted that this might be due to

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[66] The contemporaneous sample was made up of customers who had taken out loans on four specific dates in October and November 2013. The objective of the contemporaneous sample was to speak to customers very soon after their loan repayment dates so as to 'get closer to the mindset of customers at the point the loan was taken out' (see TNS BMRB survey report, p8).
[67] This figure is based on those customers whose repayment date had passed at the time of the interview. These customers represent almost 80% of all respondents.
[68] Which? submitted the results of a survey conducted in August 2012 according to which almost half (48%) of the payday loan users had taken out credit in the past that it turned out they were not able to repay. (See Which? Response to issues statement, p2.)
[69] Question QPDSI3 of the CC survey: 'Thinking back to when you first took the loan out, how confident were you that you would be able to repay the loan in full on the date originally agreed with [name of the lender]?'
[70] Of those who said that their need for a loan was due to a change in financial circumstances (80% of the respondents), nine in ten expected this change to be temporary.

customers either misunderstanding the repayment amount (which might in turn have been a factor in their failure to repay) or not including the late payment charges in their original understanding of what they would need to repay.[71]

6.93 Further, there was evidence to suggest that customers' ability to take late fees into account when choosing their loan may be affected by limitations in the information provided by lenders regarding these charges. In particular, although the key information about loan terms, including default and late charges, is typically available on each lender's website, in our review of lenders' websites (discussed in Appendix 6.4) we found that:

(a) Late payment/default fees are not typically presented on the same page that shows the TCC.[72] This implies that customers have to make an additional effort in order to find out information on these fees.

(b) There were some examples (Short Term Loan (CFO Lending) and PaydayUK (Dollar)) where late payment fee information on lenders' websites is unclear or not complete.[73]

(c) There are also some instances where these fees are presented in a smaller or less prominent font than other information shown on the website. This is the case for Payday UK (Dollar) and Cash Genie (Ariste).[74]

6.94 Moreover, we noted in Section 4 (see paragraph 4.13) that the pricing structure of late interest charges varies significantly across lenders. This is likely to make it difficult for any customers who do seek to take late fees into account to compare different offers, particularly given the limited availability of effective online comparison tools.[75]

Conclusions on customers' sensitivity to fees and charges incurred if a customer does not repay a loan in full on time

6.95 To summarise, we found that a combination of the limitations in the information provided by lenders regarding late fees, the difficulty in making comparisons given lenders' different charging structures and a tendency among some customers to be overconfident about their ability to repay mean that customers generally do not take these charges into account when

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[71] TNS BMRB report, p120.
[72] See Appendix 6.4, paragraph 14.
[73] See Appendix 6.4, paragraph 15.
[74] See Appendix 6.4, paragraph 16.
[75] See paragraphs 6.78–6.84.

choosing their loan. Customer demand is therefore particularly unresponsive to variations in the charges incurred if a customer does not repay a loan in full on time. This is consistent with the evidence on market outcomes (discussed in paragraph 6.9), which indicates that there is a particularly high degree of variation in prices in scenarios where a borrower repays their loan late, and that lenders are not particularly concerned about the impact on demand for their product when setting their late fees.

The role of lead generators

6.96 The fourth potential barrier that we identified was the impact on online suppliers' incentive to compete on prices of the large proportion of payday lending customers that use lead generators to find their lender.

6.97 As described in Section 2 (see paragraph 2.122), many online payday loan customers take out a loan via a lead generator, rather than going directly to a lender. Around 40% of customers taking out their first loan with a major online lender in the 12 months to August 2013 came via a lead generator.[76] As shown in Figure 6.1, the proportion of new customers sourced from lead generators varies significantly across the major online lenders – for many lenders, nearly all new customers are acquired via a lead generator.

FIGURE 6.1

Proportion of new customers sourced from brokers/lead generators by lender, year to 31 August 2013

[✄]

Source: CMA analysis of transaction data.
Notes:
1. Online customers only.
2. The figures for CashEuroNet have been derived using its response to the Market Questionnaire (as transaction-level data on whether customers were sourced via lead generator or broker was not available).

6.98 Lead generators auction customer application details to a panel of lenders, selling the lead to the lender which is willing to pay the highest amount for that applicant (this process is discussed in greater detail in Section 2). This auction process increases the probability of a customer being able to find a loan compared with a situation in which they applied to a single lender – essentially allowing customers to apply to multiple payday lenders simultaneously.

[76] Among these first-time customers there will be borrowers who have taken out payday loans with another lender previously (see Appendix 6.2, paragraph 29).

6.99 In line with this and the importance of credit availability to many payday loan customers (see paragraphs 6.54 to 6.62), our review of lead generators' websites found that it was common for lead generators to emphasise high acceptance rates or target individuals with bad credit ratings on their websites or in their advertisements. For example, Google Adword text used by those lead generators that appears most often in the first pages of results generated by Google for payday-loan-related search terms (see Appendix 6.3) contained messages such as 'Very high approval', 'Bad credit loans', 'No credit check', 'High acceptance rate'. Money Gap Group Limited (formerly PDB UK Limited), one of the major lead generators in the UK, told us that 'for many customers price was less important and customers were looking for a lender that would accept their application and lend them the money'. T3, another major lead generator, told us that 'given that customers face uncertainty about whether or not they will be approved by a lender they use lead generators as a means to increase the chances of finding a lender willing to accept their application'.

6.100 To the extent that a borrower goes on to take a loan from the lender to whom his or her application is sold, a customer using a lead generator is essentially forgoing any comparison of lenders on the basis of the merits of their loan offering. This is because the relative attributes of different products do not enter the auction process. Given that borrowers have already gone through an application process and their details sold to a lender before they are able to observe any details of the loan that they are being offered, the threat of these customers switching to another lender is unlikely to impose any material competitive constraint on lenders.

6.101 Lenders seeking to win customers with an attractive product offering may even be at a disadvantage if, as a consequence of offering customers a better deal, they are less able to bid higher amounts in lead auctions. For example, H&T told us that other lenders were able to pay for high-quality leads because they charged the customer more. This drove up the cost of leads and/or forced it to acquire riskier customers, with an associated increase in bad debt. Along a similar line, MYJAR told us that because it did not offer rollover loans, leads were less valuable to it than to other lenders that did offer rollovers, and as a consequence it could not bid competitively in the auctions run by lead generators.[77]

6.102 We also saw evidence suggesting that a substantial proportion of customers that use lead generators do not understand the nature of the service that they are being provided, or the difference between lenders and lead generators. In

[77] Figure 7.3 sets out evidence about the proportion of customer acquisition expenditure of MYJAR and other large online lenders allocated to lead generators.

particular, of those respondents to our customer survey who had applied through lead generators/brokers, two-thirds mistakenly told us that they applied directly to a lender.

6.103 A review of the information made available to customers by lead generators highlighted the potential for such a misunderstanding to arise (see Appendix 6.4):

(a) Distinguishing between lenders and lead generators is far from straight-forward. A web search for ‘payday lending’ or related terms will often generate a mixture of direct lenders and lead generators among both organic and pay-per-click results (see paragraphs 2.134 to 2.138), and the text accompanying these results, the product or company name, or the website title will very rarely identify the target website as belonging to a credit broker rather than a lender. Although most of those lead generator websites that we looked at informed visitors somewhere on the site that they offer a brokerage service rather than directly lending funds (in differing degrees of prominence and clarity), we found that visually these websites were very similar to those of the lenders themselves.[78]

(b) There is often a lack of transparency in how the service that lead generators provide is described on their websites, particularly in relation to the basis on which applications are matched with lenders. Very few lead generators make clear that they are remunerated by lenders who buy the lead, and we are not aware of any examples of lead generators explaining exactly what happens to customer applications after these are submitted (ie that leads are auctioned and sold to the lender that pays the highest amount). Some lead generators describe the service they provide by referring to saving customers the need to search or shop around, which some customers might reasonably interpret as meaning that they were being matched with the ‘best-value’ loans for them (whereas in practice the customer is matched with whichever lender pays the highest amount for the lead).

6.104 This lack of transparency was also noted in the submissions of some lenders. [✄] told us that there was a general lack of transparency in lead generators’ websites because disclosure was made at the bottom of the website using small characters or ‘buried in secondary text’. It also told us that ‘customers may perceive that the lead generator has acted to sort available lenders to provide the cheapest or most suitable alternative. In reality, the lead generator is selling the lead to the highest bidder’. Similarly, allthelenders.co.uk told us

[78] See Appendix 6.4, paragraphs 29 & 30.

that 'it is extremely hard to tell if some of these brokers are lenders or not and many do not display this information clearly enough, some might have it at the foot of their page but many you have to look very hard to find this information, if it's even there at all'.

6.105 [✂] also pointed to what it considered to be misleading price information presented by some lead generators, which it found often presented the cheapest terms among the lenders to which they can sell the lead, although the lead is not necessarily bought by that lender.[79] [✂] added that lead generators typically used APRs of 1,700% and charges of £25 for a £100 loan which in its view understated the actual charges paid by the borrowers. It told us that lead generators' lack of transparency might frustrate online customers' attempts to shop around, as when they applied through lead generators the actual offer they received could be higher than the advertised terms. This might prompt other searches and protract the searching process which ultimately resulted in a poor searching experience and therefore 'low likelihood of switching'.

6.106 If customers are unaware of what is happening to their loan application when they use a lead generator, then we would expect any incentive for lenders to compete for these customers by improving their offering to be very weak. This is because customers making their initial decision of which loan to take out on the basis of the example loan terms provided on the lead generator's website, or thinking that by using a lead generator they are being matched with the best-value provider, are unlikely to be responsive to the terms offered by the lender to whom their details are sold.

Conclusions on the role of lead generators

6.107 To summarise, we found that a substantial proportion of online payday lending customers used lead generators to apply for a payday loan. The auction process used by lead generators to allocate customers to lenders willing to offer them credit is based entirely on which lender bids the highest amount, implying that any incentive for lenders to compete for these customers by lowering their prices was likely to be very weak. The lead generator model may also create an incentive for lenders to increase prices to customers, as lenders offering cheaper loans would find it harder to bid high prices in lead auctions and hence acquire valuable leads. There is often a lack of transparency in how the service that lead generators provide is described in their websites – particularly the basis on which applications are matched with lenders – and many customers are unaware of the nature of the

[79] For example, [✂].

service that they are being provided by lead generators. This further reduces the likelihood that the risk of customers using another provider would impose a material competitive constraint on lenders.

The perceived risk and loss of convenience associated with changing lender

6.108 We considered whether – additional to those barriers set out above, which would apply equally to new or repeat customers – customers who have taken out a previous loan with a lender would face any further barriers which would inhibit them from changing lender on the basis of price or other aspects of another lender's product offering. We identified two additional aspects of the payday market which might dissuade customers from switching to an alternative lender unless required to do so: the perceived risk associated with an unknown lender, and the loss of convenience associated with switching.

6.109 Customers who have the option of staying with their current lender may be discouraged from switching if they perceive there to be risks associated with changing lender. This is likely to be particularly relevant for payday loan customers, given the importance that borrowers attach to aspects of lending relationships that are likely to be difficult to observe prior to taking out a loan with a lender (see the findings of our qualitative research discussed in paragraph 6.40). In particular, these include the quality of a lender's customer service and their approach to loan collections.[80]

6.110 The impact of this effect will be heightened by the current negative reputation of the payday lending sector and the poor lending practices of certain payday lenders (see paragraphs 3.2 to 3.5 and 6.40). Given the reputation of the sector, customers may be particularly unwilling to take the risk of using a lender that they have not used before unless they are required to do so – even if the other lender's product is of significantly better value.

6.111 In this context, Think Finance told us that when switching occurred, it was driven mainly by negative experiences rather than the promise of a better loan and that it was difficult to disrupt the relationship between customers and lenders, especially with repeat customers, as customers valued the familiarity with the lender and traded this off against the uncertainty related to the conduct of another lender. This is consistent with the focus of many lenders on customer retention (see paragraphs 4.209 to 4.211), and the emphasis placed by respondents to our customer survey on satisfaction with existing suppliers as a reason for using only one lender.

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[80] For example, the research conducted by Ipsos MORI for BIS found that payday loan customers are particularly concerned with the actions taken by lenders if borrowers are unable to repay the loan (p35).

6.112 As well as the perceived risk associated with switching, some borrowers may perceive it to be simply more convenient and straightforward to stay with an existing lender, rather than spend time filling in application forms or researching alternatives. While this is a factor in many markets, it has an additional relevance in the payday lending market given the short-term nature of the demand for the product, and the perceived urgency of the loan.

6.113 The relative convenience of staying with an existing lender is likely to be particularly high for a borrower who is considering topping up or rolling over an existing loan, as these processes are likely to require very little effort to arrange with an existing lender. Furthermore, for customers who are considering rolling over a loan, the perceived loss of convenience associated with changing lender may be exacerbated by a concern that funds from any new lender may not be received in sufficient time to pay off the existing loan and make all of the relevant transfers.

6.114 As discussed in paragraphs 6.38 and 6.39, most customers who had remained with the same lender reported having done so because they were happy with the service provided and therefore perceived no reason to give any consideration to changing lender. However, if we look at the remainder – ie those customers who may have had a less positive experience and so would be more likely to be looking to switch lenders – the results of our customer survey suggest that a significant proportion of these individuals identified the ease/convenience of remaining with the current provider and avoiding the need to go through a new application process as a factor contributing to their decision not to switch.[81] We also noted that less than 10% of the customers who had rolled over their most recent loan said that they would consider taking out a loan with a lender in order to pay off a debt to another lender. This indicated a clear difference in customers' perceptions of the attractiveness in refinancing a loan with an existing lender versus taking out a new loan with an alternative supplier.

Conclusions on the risk and loss of convenience associated with changing lender

6.115 In summary, where their choice of lender is not dictated by concerns about credit availability, borrowers may be dissuaded from looking at alternative suppliers by the perceived risks associated with using a new lender (ie a lender not used previously by the customer), particularly in light of the

[81] Of 39% of the customers who did not consider changing lender and who did not report staying with the same lender because they were happy with the service provided, 17% indicated either the ease/convenience of remaining with the current provider or the burden of going through a new application process as reasons contributing to their decision not to change lender.

negative reputation of the payday lending sector as a whole. In addition, customers may perceive a loss of convenience associated with applying to a new lender, particularly if the alternatives are rolling over or topping up an existing loan or taking out a new loan shortly after repaying the previous one. These factors, in combination with the other barriers identified in this section, are likely to reduce further the constraint placed on lenders by the threat that existing customers will switch to an alternative lender offering a better-value product.

Provisional conclusions

6.116 We have identified a combination of market features which give rise to the limited responsiveness of customer demand to prices that we have observed in the UK payday lending market, and which reduce the pressure for lenders to compete to attract customers by lowering their prices. These features act in combination to deter customers from comparing the different loans available, to impede their ability to do so effectively, and to discourage repeat customers from considering and/or selecting a new lender that offers a better-value loan for their needs.

6.117 These market features are:

(a) The context in which customers take out payday loans is often not conducive to customers shopping around to find a good-value loan and may amplify the adverse effects of other barriers to shopping around and switching lender. Customers often perceive the need for their loan to be urgent, and attach considerable importance to the speed with which they are able to access credit. Many payday loan customers are also uncertain, often with good reason, about whether, and from whom, they will be granted credit to meet their borrowing requirements. These aspects of the decision-making environment can tend to make customers reluctant to spend time shopping around for the best deal available, and can cause customers to focus on which lender is willing to lend to them (or, for a repeat borrower, to stay with a lender that they previously used) rather than which lender offers the best-value product.

(b) It can often be difficult for customers to identify the best-value loan product on offer for them. Despite information on headline rates generally being available on lenders’ websites or in the shops of high-street lenders, customers’ ability to use this information to identify the best-value payday loan is impeded by the complexity associated with making effective price comparisons given variation in product specifications and pricing structures, and the limited usefulness of the APR in facilitating comparisons between payday loans. Existing comparison websites, which might help

customers compare loans, suffer from a number of limitations and are infrequently used. Consequently, customers who do seek to carry out comparisons on the basis of price may struggle to identify the best-value loan on offer, and – in combination with the perceived urgency affecting many customers and the overriding importance of finding a supplier that is willing to lend – some customers may be put off shopping around for their loan entirely.

(c) Customer demand is particularly insensitive to fees and charges incurred if they do not repay their loan in full on time. Customers tend to be less aware of these potential costs of borrowing than they are of the headline interest rate when choosing a payday loan provider. This is in part because overconfidence about their ability to repay the loan on time can cause some customers to pay only limited attention to these costs when taking out their loan. Even where customers seek to anticipate the costs associated with late repayment, the information generally provided about such costs is significantly less complete, less easy to understand and/or less prominent than information on headline rates. It can therefore be difficult for customers to estimate, and so make effective comparisons about, the likely cost of borrowing if they do not repay their loan in full on time.

(d) Many online customers take out their first loan with a lender via a lead generator's website. Lead generators typically promote their ability to find customers a lender willing to offer them a loan within a short period of time. The value for money represented by different lenders' loan offerings is not taken into account in the auction process operated by lead generators, who instead sell customer applications to the highest bidder. Furthermore, there is often a lack of transparency in how the service that lead generators provide is described in their websites – particularly the basis on which applications are matched with lenders – and many customers do not understand the nature of the service offered by lead generators. An implication of the operation of this distribution channel is that lenders acquiring customers through lead generators are unlikely to have a strong incentive to lower their prices. The lead generator model may also create an incentive for lenders to increase prices to customers, as lenders offering cheaper loans would find it harder to bid high prices in lead auctions and hence acquire valuable leads.

(e) Where their choice of lender is not dictated by concerns about credit availability, customers can be dissuaded from looking at alternative suppliers by the perceived risks associated with using a new lender (ie one they had not used previously), particularly in light of the negative reputation of the payday lending sector. Customers may perceive a loss

of convenience associated with applying to a new lender, particularly if the alternatives are rolling over or topping up an existing loan. These factors further reduce the constraint placed on lenders by the threat that existing customers will switch to another lender offering a better-value product.

7. Entry and expansion

Introduction

7.1 The threat of entry by new rivals or expansion by incumbent firms is often an important source of competitive discipline in a market. Entry or expansion can make it difficult for an incumbent firm to exercise market power, promote efficient firms at the expense of inefficient ones, introduce innovation to an industry and lead to more competitive prices as well as greater choice and quality.[1]

7.2 As set out in the previous section, price competition between payday lenders is ineffective as a result of the interaction of a number of barriers to shopping around and switching, which means that customers are unresponsive to the price of payday loans. In this section we consider whether – if customers were more responsive to prices – the prospect of new entry or expansion by existing providers would impose a further competitive constraint on the prices of payday lenders.

7.3 To do this, we begin by documenting the history of entry and expansion in payday lending. We find that a large number of lenders have entered the payday lending sector in the past five to ten years, that the market as a whole expanded substantially over the period, and that within this broader trend of market expansion a small number of lenders have been able to grow their shares of supply significantly.

7.4 While informative about the historical ease of entry for certain types of supplier, evidence of historical patterns of entry and expansion do not allow us to understand the extent to which significant entry should be expected in the future given market developments, nor how effective new entry will be in constraining incumbent lenders. For this reason, we also considered the key requirements for a firm to be an effective payday lender, and whether the market conditions facing a new entrant today would be likely to restrict its ability to expand sufficiently to become an effective competitor, or to discourage entry by particular types of supplier.

7.5 We discuss three characteristics of the market which may reduce the strength of the competitive constraint imposed by new entry or expansion. First, we set out how the negative perception of payday lending – and the associated political and regulatory uncertainty – may deter or prevent some types of firms from entering payday lending. Second, we discuss whether new entrants and smaller lenders may find it difficult to raise awareness of their product and

[1] See *CC3*, paragraphs 205 & 206.

attract new customers, thus impeding their ability to establish themselves in the market. Third, we present evidence of disadvantages faced by new entrants and smaller lenders when assessing credit risk, which may also impede their ability to establish themselves as effective competitors.

7.6 In the final part of this section, we draw some provisional conclusions on the effectiveness of the constraint imposed on payday lenders by the prospect of entry and expansion, and any factors inhibiting the effectiveness of this constraint.

History of entry and expansion

7.7 Table 7.1 sets out the date on which the 11 major payday lenders entered the payday lending sector. It shows that the earliest entrants (The Money Shop, Cheque Centres, Payday Express) first began offering payday loans ten years ago or more. The most recent high-street entrant among these 11 larger lenders was Speedy Cash, which entered in November 2010. The most recent entrant among the major online lenders was Ariste, which entered in October 2009 (although H&T and Cheque Centres both launched online products alongside their existing high-street operations after this date, in June 2011 and July 2011 respectively).

TABLE 7.1 **Entry dates of the 11 major lenders**

Lender	*Date lending started*	*Date of acquisition by current parent (if applicable)*
Cheque Centres (CNG Financial)	1996 (online Jul 2011)	Jan 2006
The Money Shop (DFC)	1998	Feb 1999
Payday Express (DFC)	Jan 1999	Apr 2009
H&T	Jan 2003 (online Jun 2011)	N/A
PaydayUK (DFC)	Aug 2003	Apr 2011
WageDayAdvance (Speedy Group)	Dec 2006	Feb 2013
Wonga	Jan 2007	N/A
CashEuroNet (Cash America)	Jun 2007	N/A
CFO Lending	Jan 2008	N/A
Global Analytics	Nov 2008	N/A
MYJAR	Mar 2009	N/A
Ariste (EZCORP)	Oct 2009	Apr 2012
The Cash Store	Apr 2010	N/A
Speedy Cash (Speedy Group)	Nov 2010	N/A

Source: Parties' responses to financial and market questionnaires.

Note: N/A = not applicable.

7.8 We have observed firms entering the payday lending sector using a variety of different strategies, including:

(a) *Privately funded start-ups.* CFO Lending, Global Analytics, MYJAR and Wonga entered as start-ups and developed online payday lending businesses from scratch funded by private equity investors.

(b) *Acquisition of an existing business.* CNG Financial, DFC, EZCORP and Speedy Group each acquired one or more UK-based payday lending companies that had been founded as start-ups in the UK. Following these acquisitions, the respective parent companies (two of which are listed on North American stock exchanges) have provided the majority of funding for expansion.

(c) *Expansion from payday lending in North America.* Cash America adapted technology systems originally developed in the USA to launch CashEuronet, which is operated mainly from its existing premises in the USA. The Cash Store Financial Services (based in Canada) and Speedy Group (based in the USA) opened their first UK stores in April 2010 and November 2010 respectively.

(d) *Product diversification strategy.* H&T entered payday lending via a product diversification strategy, adding payday lending products to its existing pawnbroking business.

7.9 In Appendix 7.1 we discuss two examples of recent entry into payday lending by well-resourced lenders, Provident Financial and Think Finance. Provident's Satsuma product provides an example of a diversification strategy, representing a move by the largest UK home credit provider to launch an online product that falls within our payday loan definition. Think Finance's product, Sunny, provides a recent example of a large US payday lender seeking to enter the UK market, and is also interesting in that the product includes an element of risk-based pricing.

7.10 The period since 2008 has seen significant expansion in the payday lending market, both online and on the high street. Payday lending revenue growth for the major lenders ranged from 40 to over 100% a year in the period from 2009 to 2012. The number of stores operated by high-street lenders also grew very rapidly in this period (see paragraph 5.75). After very strong growth in the early part of this period, the recent trend has slowed: revenue growth in 2013 was significantly lower, at around 5%. Looking across the period, the total number of payday loans issued by the major lenders increased from fewer than 2 million in 2008, to over 8 million in 2013.

7.11 Figure 7.1 shows how, within the broader pattern of expansion, the relative size of the 11 major lenders has evolved over the period. It shows that since entering in 2007, Wonga's share of loans relative to the other major lenders increased by a significant amount [✂], reaching [✂]% of all loans issued by these lenders in 2012. CashEuroNet and MYJAR have also made gains since entry, although the relative scale of their expansion is much smaller, and their shares remain [✂]%. At the same time, the share of loans accounted for by Dollar and H&T has contracted markedly.

FIGURE 7.1

The relative number of loans issued by the major payday lenders, financial years 2008 to 2012*

[✂]

Source: CMA analysis of financial data provided by the major lenders.
*See Appendix 2.5 for a description of how different lenders' financial years have been treated.
Notes: [✂].

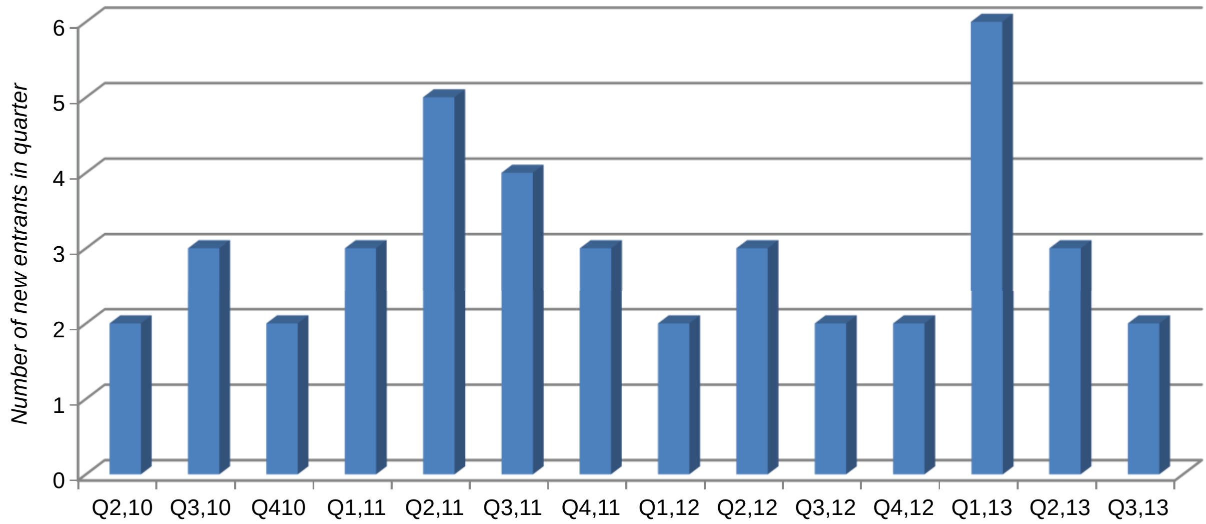
7.12 Some recent entrants that we spoke to were optimistic about their ability to expand successfully to the next stage of their development. SRC told us that although it would probably take another two to three years to get there, it expected that it would eventually be able to establish a good business. Think Finance projected significant growth for its new Sunny product, and told us that although it was incurring significant losses, it was making progress, and was comfortable that it would eventually turn profitable.

7.13 Looking beyond the 11 larger lenders, we have also seen large numbers of smaller providers entering the payday lending sector in the period since 2008. As set out in Section 2, there are currently at least 90 lenders active in the market.

7.14 We asked smaller lenders about the date on which they began payday lending. Figure 7.2 illustrates the reported entry dates of these lenders, split by quarter. It shows that companies have continued to enter the sector throughout the period since 2010, at a rate of around two to five new entrants per quarter.

FIGURE 7.2

Entry by smaller lenders, first quarter 2010 to third quarter 2013



Source: Response to small company questionnaire.
Notes:
1. The information presented in the chart may underestimate the true number of lenders entering the market in each quarter, to the extent that certain lenders did not respond to our questionnaire (for example, the chart will exclude firms which entered in the period but had exited before 2013).
2. A previous version of this chart showed an apparently large number of smaller lenders entering the market in quarter 1 2010 (see Figure 1 of the working paper on entry and expansion). This anomaly appears likely to have been driven by the design of the questionnaire – many of the lenders recorded as entering in this quarter are likely to have entered the market prior to that date. As a consequence, we restrict our analysis above to the period quarter 2 2010 to quarter 3 2013.

7.15 To summarise:

(a) The first payday lenders began offering loans ten years ago or more. We have observed firms employing a variety of different entry strategies, including start-ups, firms entering by acquisition, entry by North American-based lenders, and diversification by lenders originally offering non-payday credit products.

(b) The payday lending sector as a whole (both high street and online) has expanded rapidly in recent years, with growth particularly strong between 2010 and 2012. Wonga has expanded particularly rapidly since its entry in 2008, becoming the largest payday lender by some distance. CashEuroNet has also increased its share of supply significantly.

(c) Entry by companies into the payday lending sector has been observed regularly since 2008, at a rate of at least two to five new entrants per quarter. Today there are more than 90 active payday lenders.

7.16 These patterns indicate that large numbers of lenders have managed to enter the payday sector in recent years, and that a small number of lenders have succeeded in significantly increasing their market shares.

7.17 While informative about the historical ease of entry for certain types of supplier, the observation that entry into payday lending has taken place relatively frequently in recent years does not allow us to understand the extent to which significant entry should be expected in the future given the various developments in the market that have taken place. Nor does it allow us to understand how effective new entrants will be at establishing themselves as effective competitors to incumbent providers. For these reasons, we next consider the key requirements for a firm to be an effective payday lender, and whether the market conditions facing a new entrant today would be likely to restrict their ability to expand sufficiently to become an effective competitor, or to discourage entry by particular types of supplier.

Overview of requirements to be an effective payday lender

7.18 We considered the components necessary to operate a successful payday lending business. We identified the following key requirements:

(a) Regulation and compliance – as discussed in Section 3, payday lenders must be authorised by the FCA to offer loans; must comply with the requirements of the Consumer Credit Act; and must comply with the rules in the FCA's Handbook.

(b) Customer acquisition – in order to be successful, a lender must be able to promote its product and acquire new customers. Online lenders typically use a variety of different strategies in order to acquire new customers, including television, radio and other types of offline advertising, pay-per-click and other forms of online advertising, and purchasing applications directly from lead generators. High-street lenders may also advertise their products, but unlike online lenders will also rely on the visibility of their stores to attract new business.

(c) Credit risk assessments – a core capability for a payday lender is the ability to assess the credit risk of new and returning customers. As discussed in 2.71, in order to perform credit risk assessments, lenders typically analyse various different types of information relating to an applicant. Most lenders have developed automated risk models, of varying degrees of sophistication, to carry out these assessments. Some lenders' risk assessments – and in particular high-street lenders – also have a manual (ie non-automated) element.

(d) Loan management systems – lenders require certain technology capabilities, including the software and know-how to develop and maintain payday loan management systems. These systems are used to process

applications, record loans and repayments, and link to other businesses (eg banks and CRAs).

(e) Payment processing services – payday lenders need a commercial banking relationship in order to make bank transfers of new loans to their customers' bank accounts and recover amounts due. Online products are debit card based and lenders use CPAs to some degree in order to debit borrowers' bank accounts. Payday lenders also need a banking relationship for their day-to-day activities (eg payments for employees, goods and services, and management of working capital).

(f) Customer services and call centres – the extent to which payday lenders use call centres to interact with customers depends on their individual business strategy (eg Internet-based lenders generally require a call centre to service customer accounts). The use of call centres to manage inbound customer calls and loan applications can be scaled up or down according to the business requirements. An entrant may also be able to outsource the operation of its call centre to a third party instead of investing in its own operations.

(g) Financing and access to capital – this financing for payday lending includes the capital required to fund start-up costs or business expansion, including the costs of meeting the business requirements set out above. The sources of finance may include private equity investment and retained earnings.

7.19 High-street lenders will also have additional requirements. In particular, a high-street payday lender would need to rent premises in suitable locations. This will be influenced by the need to operate in areas with high demand for payday lending and the availability of retail units with the appropriate planning use class (A2 Financial and professional services).[2] In addition to this, high-street lenders will need to fit out the locations for payday lending and hire staff. High-street lenders' ability to expand by opening new stores is discussed in paragraph 5.75, where we provisionally conclude that lenders are able to open new stores with relative ease.

7.20 Having reviewed these requirements, we identified three characteristics of the payday lending market which may weaken the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion. These related to the reputation of the payday lending sector, and the ability of new entrants and smaller lenders to acquire new

[2] As set out in the Town and Country Planning (Use Classes) Order 1987 (as amended).

customers and assess credit risk accurately. These issues are discussed in turn in the following subsections.

The reputation of payday lending and the political/regulatory environment

7.21 In recent years payday lending has been an issue which attracts a large amount of political and media attention. There is a widespread perception of the existence of bad lending practices among lenders, and the existence of such practices was highlighted in the findings of the OFT in its review of the sector, which found that non-compliance among payday lenders was ‘causing real harm, and the problem has grown’ (see paragraph 3.4).

7.22 We identified three different ways in which the reputation of the payday lending market might restrict the extent to which payday lenders’ prices and product offerings would be constrained by the threat of new lenders entering the market and competing for their customers. First, some mainstream lenders (or other established businesses) may be discouraged from entering entirely by the negative reputation of the sector. Second, recent changes in how the sector is regulated may increase the uncertainty and costs faced by lenders, discouraging new entrants from coming into payday lending or discouraging existing lenders from investing further. Finally, the reputation of the sector may affect payday lenders’ access to banking services. We discuss these three issues in turn below.

Deterrence of mainstream lenders

7.23 We saw some evidence to suggest that the reputation of the payday lending sector was likely to discourage mainstream lenders (or other businesses with established reputations in other markets) from entering the payday market.

7.24 Lloyds told us that it did not have any mainstream products on sale that had an APR above a given level (orders of magnitude lower than current payday loan APRs) because of the potential reputational and brand damage, as that was the level it judged at which people started to question the legitimacy of the product.[3] The APR was a difficult issue, particularly in relation to how it was communicated and interpreted. In Lloyds’ view, the APR was not appropriate for short-term lending products (and this was why it was not used for overdrafts) and presented a false impression of the cost of the product. This could lead to inappropriate comparisons being made using APRs between the cost of very short-term lending products and longer-term products such as a personal loan. However, if there was a way to overcome

[3] In particular, Lloyds told us that it did not have any mainstream products on the book that had an APR above [✂]% because that was the level it judged at which people started to question the legitimacy of the product.

this issue, then it might make it more likely that Lloyds Banking Group or other mainstream lenders would consider entering payday lending or developing products designed to meet the same need. However, at present the thought of doing so would be really difficult reputationally because the very high headline APR would be likely to lead to stronger criticism of the banks than that currently experienced by payday lenders.

7.25 Barclays told us that it would be concerned about entering the short-term month-end money-lending business primarily due to questions about the affordability of these products for customers, but it would also have reputational unease.

7.26 In addition to banks, the reputation of payday lending might serve to dissuade other established businesses that might otherwise consider entering the market. For instance, as discussed in paragraph 6.87 it may also affect the willingness of comparison websites to enter the sector (see, for example, the withdrawal of moneysupermarket.com as a result of the increasing level of media and political scrutiny into payday lending practices, and the perception of non-compliance in the sector).

7.27 CashEuroNet suggested that reputation may not be the only reason why banks would be unlikely to enter the payday lending sector. In particular, it said that sub-prime customers provided very limited scope for mainstream banks to cross-sell other products and thereby spread acquisition costs, meaning that such customers were unlikely to become a focus for mainstream lenders, even in the absence of negative political and media attention on the sector.

The impact of recent political and regulatory developments

7.28 Following the OFT’s compliance review in 2013, we have seen significant regulatory change affecting the payday lending sector, including the new CONC rules introduced by the FCA on 1 April 2014, and its ongoing work regarding a price cap, which must come into force by 2 January 2015. These developments are discussed further in Section 3 and Appendix 3.1.

7.29 Given the ongoing political and regulatory focus on payday loans, there is likely to be a degree of uncertainty affecting the payday sector at present, which may reduce suppliers’ willingness to enter, or the willingness of existing lenders to expand. A number of lenders expressed this view. For example, Dollar said that lenders were hesitant to enter the market at the moment because of the instability and the uncertainty created by regulatory changes. Think Finance said that the current uncertainty was stifling innovation, with lenders putting plans to launch new products on hold.

7.30 The most significant aspect of this uncertainty currently affecting the sector is likely to relate to the impending price cap and the impact on lenders of the recently introduced CONC rules. We considered that subsequent to the nature and level of the cap being determined, and the new FCA rules becoming established, the extent of uncertainty facing payday lenders about the UK regulatory regime is likely to decline significantly.

7.31 In addition to uncertainty, entry and expansion into payday lending may also be affected by the increased obligations placed upon payday lenders, and the corresponding implications for lenders' costs (see Appendix 3.1 for further details of the changes being made, including the limit placed on the number unsuccessful CPA attempts that lenders are able to make, lenders' ability to use CPAs to take partial payments, and the restriction on the number of times customers may roll over a loan). Lenders' costs may also be affected by the more general increase in compliance requirements as a result of the FCA's reforms to how payday lending is regulated.

7.32 We saw some evidence to suggest that the increase in costs may discourage entry (or encourage exit) by smaller or less profitable lenders. In particular, the FCA stated that it expected, based on work done by Europe Economics, that its proposals to change the regulation of payday lenders could lead to between 25 and 30% of lenders leaving the industry.[4] CashEuroNet said that [✂] would be lower under the new FCA regime, and that some less compliant firms would not be able to meet the new requirements. Wonga said that the new regulatory regime was going to be very expensive, and would require them to build a whole compliance and monitoring team.

7.33 The current levels of uncertainty and the increase in lenders' costs created by these changes may discourage entry or expansion in the near future. However, over the longer term we would expect the deterrent effect on entry created by the sector's negative reputation to decline, to the extent that ongoing reform is successful in improving conduct within the payday lending sector and thereby improving the market's reputation.

Access to banking services

7.34 As set out in paragraph 7.18, to operate effectively payday lenders need to have access to banking services. There is evidence to suggest that some payday lenders entering the sector today may find it difficult to establish the necessary banking relationship, and that this may be at least partly a result of the negative perception of the sector.

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[4] FCA, Detailed proposals for the FCA regime for consumer credit, paragraph 6.95, consulted 3 October 2013.

7.35 A number of lenders told us that either they had themselves experienced difficulties accessing banking services, or had observed other lenders having difficulties, and many reported only being able to find a single bank that was willing to offer them the necessary services. For example:

(a) MYJAR said that the largest barrier to entry was the difficulty of obtaining commercial relationships with the banking sector because the banks considered payday lenders as competitors and were reluctant to progress banking relationships. It said that [✂].

(b) H&T said that it had seen banks withdraw facilities from smaller businesses and that new businesses found it increasingly hard to obtain card-processing accounts.

(c) Loaf told us that its entry into payday lending had been frustrated by the UK banking industry. Numerous banks it approached to open a standard business account had cancelled its application upon learning that it planned to offer payday loans. Loaf said that 'anti-competitive behaviour by the UK mainstream banking oligopoly was a significant barrier to small and independent new entrants providing better value payday solutions to UK consumers'.[5]

(d) Cash Converters said that it had around 130 franchisees, but only one bank which was willing to offer it services.

(e) WageDayAdvance told us that while it was happy with its current bank, it had from time to time looked to see if any alternatives were available, but had found its options were limited.

(f) Mr Lender reported [✂].

(g) The Cash Shop reported having difficulties finding a bank when it had entered the sector, and ultimately having had to buy another business because it had a banking facility.

7.36 The submissions of the banks also indicated that they were often unwilling to deal with payday lenders. In particular:

(a) HSBC said that [✂].

(b) Lloyds said that it had limited commercial banking exposure to payday lenders, although there were reputable and well-managed payday companies that it was pleased to support. It said that it looked at each

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[5] Loaf submission, p1.

business on its own merits – taking into account a company's credit and regulatory risk.

(c) RBS said that [✄].

(d) Santander said that [✄].

7.37 One exception was Barclays, which told us that it provided corporate banking services to [✄] payday lenders, and merchant acquiring services to [✄] payday lenders. It was not aware of rejecting any applications by payday lenders to bank with Barclays, although it had rejected a number of applications for merchant acquiring services where [✄]. It told us that, with regard to merchant acquiring services, [✄].

7.38 Despite the limited options available to payday lenders, we were not aware of any lenders that had in the past either attempted to enter the market, but had ultimately been unable to because they were unable to access banking services, or lenders which had left the market as a result of their banking services being withdrawn. We were also told by one lender that possible alternatives to dealing directly with the major banks did exist.[6] Nevertheless, we considered there to be a significant risk that a firm entering the payday lending sector today could be impeded from doing so – and even prevented from entering altogether – by the difficulty involved in establishing the necessary banking relationships.

Conclusions on the impact of reputation and regulation

7.39 The history of non-compliance and irresponsible lending by some payday lenders and the resulting negative reputation of the sector are likely to reduce the constraint imposed on payday lenders by the prospect of new entry. In particular:

(a) The reputation of payday lending is likely to deter some businesses with established reputations in other sectors – such as mainstream credit suppliers –– from entering the market. This reduces the likelihood of entry by parties with the capability to transform the nature of competition in the market.

(b) Potential entrants may also be dissuaded from entering payday lending by the difficulty – which may itself be linked to the current reputation of the sector – in establishing banking relationships, and the very small number

[6] Specifically, [✄].

of suppliers currently willing to provide banking services to payday lenders.

7.40 The level of political and regulatory uncertainty currently affecting the sector may also reduce the current appetite for new entry and for investment by existing lenders. However, to the extent that ongoing reform is successful in improving lenders' conduct and thereby improving the market's reputation, we would expect the deterrent effect created by the sector's reputation to decline in the future.

Difficulties faced by new entrants and smaller online lenders in attracting new customers

7.41 A crucial determinant of the strength of the rivalry that established lenders will face from new entrants and smaller lenders is how effectively they are able to acquire new customers. The more difficult or expensive it is for these lenders to raise awareness about and market its products, the weaker the competitive constraint that it will exert on established providers.

7.42 New entrants and smaller lenders' ability to acquire new customers is likely to be significantly impeded by the characteristics of the payday market which restrict the extent to which customers can identify and choose better-value payday loan products which are on offer (see Section 6). In particular, we identified a number of barriers to shopping around or switching that may cause customers to be unresponsive to variation in payday lenders' prices, including aspects of the context in which the decision to take out a payday loan is generally made, difficulties that customers face in identifying the best-value offer (especially if they seek to take late fees into account), the role of lead generators in the online sector, and the perceived risk and loss of convenience associated with changing lender. One implication of these barriers is that it is likely to be difficult for a new lender to raise awareness of its product and win customers on the basis of a low-cost loan offering.

7.43 We considered whether there are additional characteristics of the payday lending market which may make it difficult for new entrants and smaller lenders to acquire new customers and expand.

7.44 We focused in particular on online lenders, as this is by some margin the largest distribution channel and the most likely source of future new entry. In addition, we noted that high-street payday lenders generally rely to a large extent on the physical presence of their stores to generate customer traffic. This option is not open to online lenders, who instead must use a range of marketing approaches – including online and offline advertising – to raise awareness of their products. Many online lenders also rely to a considerable degree on purchasing customer applications from lead generators in order to generate new business (see paragraph 6.97). On average, customer acquisition expenses (including advertising and promotions costs, and commissions paid to lead generators, brokers and affiliates) accounted for around one fifth of the 2012 total costs of the major payday lenders that offer loans online.

7.45 In our consideration of this issue, we begin by describing the different customer acquisition strategies used by online lenders. We then consider whether smaller online lenders are likely to face disadvantages which mean that they will struggle to establish an effective brand and generate new business organically. Finally, we consider the limitations associated with other marketing channels that may be more accessible to smaller online lenders.

Channels of customer acquisition

7.46 Online payday lenders use a variety of different methods to source new customers. There are examples of lenders advertising their products using traditional ‘offline’ methods such as television, radio, sports sponsorship and outdoor advertising. Online lenders may also seek to generate new business by buying customer applications directly from lead generators, using pay-per-click advertising (most commonly alongside search engine results, or via affiliates such as price comparison websites or voucher schemes) or devoting resources to search engine optimisation (ie taking steps to try and ensure that their website appears highly among the results presented by search engines when customers search for terms related to payday loans).

7.47 Table 7.2 summarises how total expenditure is split across the different channels for the largest online payday lenders in 2013.[7] It shows that expenditure on lead generators, offline advertising and online advertising each accounted for around a third of total expenditure on customer acquisition across the sector. Within traditional, ‘offline’ advertising, television accounted for over 80% of all expenditure. Within online advertising, pay-per-click fees accounted for around two-thirds of all expenditure.

[7] The lenders included in this analysis are Ariste, CashEuroNet, Dollar (Payday Express and PaydayUK), Global Analytics, MYJAR, WageDayAdvance and Wonga.

TABLE 7.2 **Total expenditure of the major online payday lenders on different customer acquisition channels, 2013**

Channel	*Proportion of all expenditure on customer acquisition, 2013* *%*
Lead generators	**34.3**
'Offline' advertising	**33.5**
– TV	27.7
– Other	5.8
Online advertising	**32.1**
– PPC	20.9
– Comparison Websites	3.1
– Affiliates	2.2
– Other	5.8

Source: CMA analysis of customer acquisition expenditure information provided by the major online lenders.

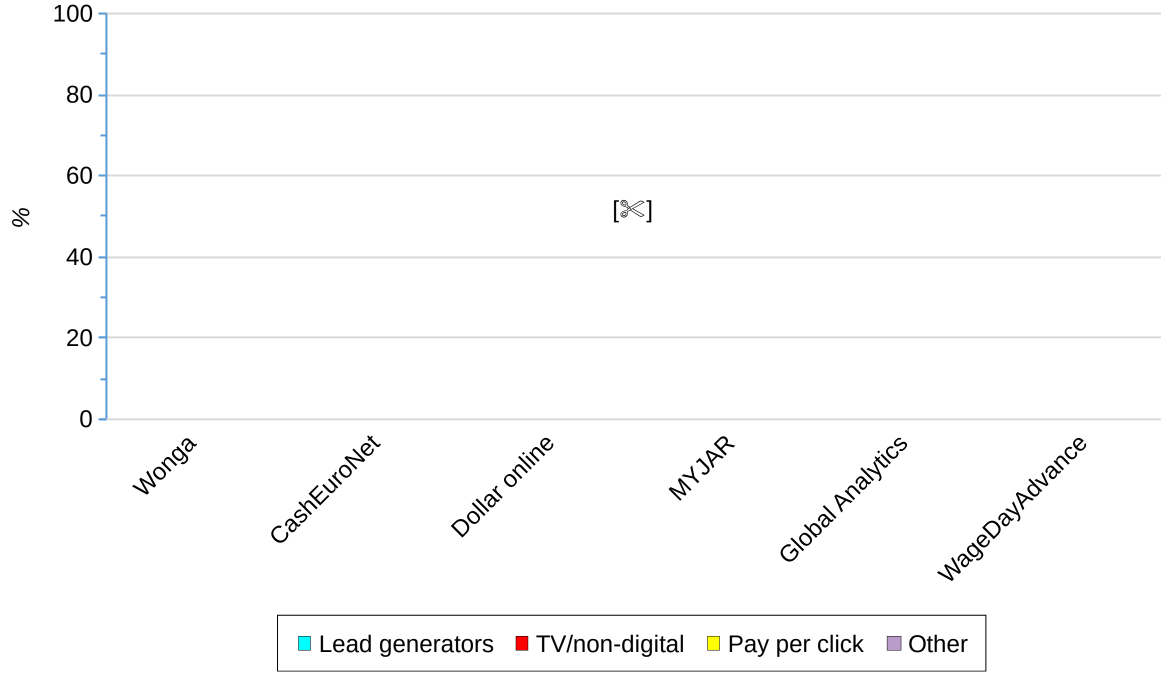
7.48 The amounts spent by payday lenders on advertising are relatively large compared with those of other credit providers. In its report 'Consumer Credit & Debt', Keynote estimates that the top three payday lenders represented approximately 80% of the £33 million spent on main media advertising by providers of *all* forms of unsecured personal loans in 2012.[8] Further, the amount paid to Google for pay-per-click advertisements associated with the most popular payday-specific terms are high compared with terms specific to other credit products (an average of £[✂] paid per click for the term 'payday loans' in 2013, compared to £[✂] for credit card specific terms, and £[✂] for personal-loan-specific terms).

7.49 Within this overall allocation of customer acquisition expenditure, we observe significant variation in different lenders' approaches. Figure 7.3 shows how the proportion of customer acquisition expenditure allocated to each channel varies by lender.

[8] Neilsen/KeyNote: *KeyNote Market Assessment 2012 – Consumer Credit & Debt report.*

FIGURE 7.3

Customer acquisition expenditure by channel, 2013



Source: CMA analysis of customer acquisition expenditure information provided by the major online lenders.

7.50 The figure shows that the largest online lenders ([✂]) allocate a [✂] greater proportion of their customer acquisition expenditure to television and other forms of traditional advertising than other online lenders. [✂] In contrast, the other online lenders tend to rely to a [✂] greater degree on lead generators.

7.51 For some lenders, relative expenditure on different customer acquisition channels has remained quite stable over time. For others, we have observed some significant shifts. For example, CashEuroNet has reduced the proportion of its expenditure allocated to [✂] over the period, while significantly increasing its relative expenditure on [✂]. Dollar told us that since [✂] it had increased its reliance on 'organic' customers, ie new business driven by advertising and branding.

7.52 Different lenders also use a variety of different approaches when sourcing customers from lead generators. For example, PDB UK (a large lead generator) told us that the largest lenders typically operated 'towards the top of the ping tree', ie bidding for the most sought-after customers. In contrast, [✂].

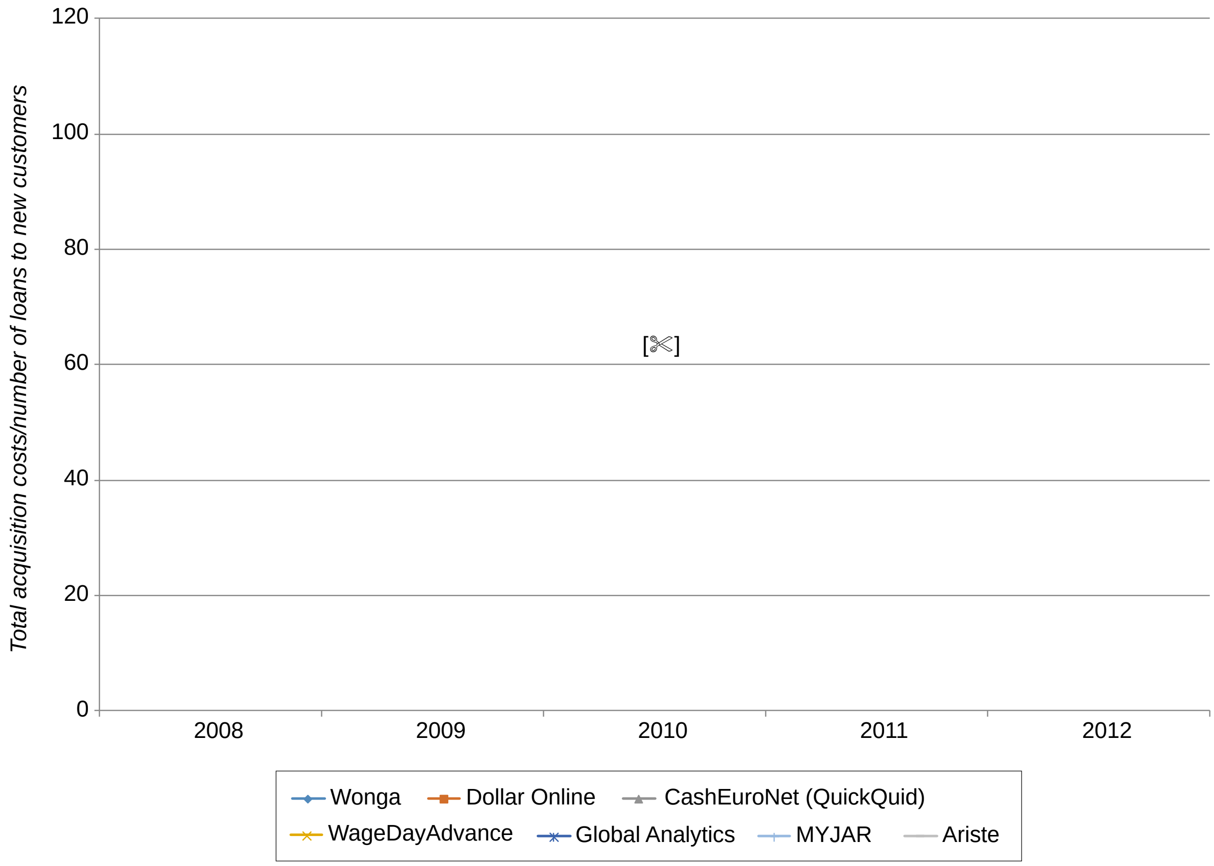
7.53 We saw some evidence to suggest that the cost of a customer acquired via a lead generator had increased over the period. PDB UK told us that in 2008, it received around £10 to £20 per accepted customer. For a customer of comparable quality, this [✂]. A number of lenders also referred to this trend.

For example, CashEuroNet said that the price of the most expensive leads had risen between 2010 and 2013, from £[✄] to close to £[✄].

7.54 Looking more generally, the evidence suggested that lenders' total expenditure on customer acquisition (ie across all channels) for each customer acquired had generally increased over the period. Figure 7.4 shows how each lender's expenditure on advertising, promotions and commissions paid to lead generators, brokers and affiliates – per loan issued to a new customer – has increased since financial year 2008.

FIGURE 7.4

Expenditure on advertising, promotions and commissions paid to lead generators, brokers and affiliates, financial years 2008 to 2012



Source: CMA analysis of customer acquisition expenditure information provided by the major online lenders.

New entrants and smaller lenders' ability to use advertising to build a brand

7.55 We considered whether a smaller online lender would face disadvantages affecting its ability to use advertising to build a brand and attract customers organically (ie by relying on customers seeking out its website after hearing about its product, rather than customers being redirected to its website by, for example, a lead generator).

7.56 As noted in paragraph 7.50 above, the largest online lenders allocated a [✂] greater proportion of their customer acquisition expenditure to offline advertising than smaller lenders. Offline advertising is likely to be a major driver of customers' awareness of a lender's brand. Table 7.3 sets out the findings of different customer surveys with respect to awareness among customers of different lenders' brands. The table shows that Wonga (and to a lesser extent CashEuroNet) have considerably greater brand awareness than other payday lenders.

TABLE 7.3 **Survey evidence of customer awareness of online payday lenders' brands**

%

Lender	*CC survey*	*YouGov*	*CashEuroNet*
Wonga	99	77	[✂]
QuickQuid	91	43	[✂]
PaydayUK	56	30	[✂]
Payday Express	28	14	[✂]
WageDayAdvance	-	5	[✂]
Lending Stream	-	-	[✂]
Base	927 'online only' payday customers	2,090 adults aged 18+	[✂]
Date	Oct/Nov 2013	Mar 2013	[✂]

Source: CMA survey.

Note: In all of the surveys reported above, brand awareness was 'prompted', ie customers were asked if they had heard of a particular brand. Where customers were not prompted about a particular lender in a survey, this is denoted with a hyphen.

7.57 One reason that it may be difficult for a new entrant or a smaller lender to build a brand and attract customers organically is if established brands control such a large share of voice that it would be difficult for a new entrant today to raise awareness of its product. The above findings on brand awareness indicate the current strength of the brand of Wonga in particular. A second disadvantage that may be faced by new entrants is the difficulty in recouping the cost of the advertising required to build a brand, and in particular television advertising. Wonga's total expenditure on television advertising in 2013 was £[✂] million, CashEuroNet's £[✂] million.

7.58 Commenting on the difficulties faced by lenders in raising awareness of their product, Think Finance told us that despite spending a large amount on advertising (its marketing budget for 2014 was £[✂] million, compared with projected revenues of around £[✂] million), it expected that it would take some time for it to establish significant brand awareness, given the established brands of larger lenders. SRC told us that while it had looked at ways that it could be more strategic about its advertising placement, it would be difficult to get through the messaging not only of competitors like Wonga, but television advertisers more generally.

7.59 In relation to the cost of raising brand awareness, SRC told us that unlike in Canada, where it was the second largest player and able to afford a sustained television campaign, it did not have the scale to test whether more advertising would work in the UK. It referred to the high market shares of the largest payday lenders, and said, 'Wonga spends £30 million a year on TV and soccer sponsorships, et cetera. We have tried some TV and it just does not [work] … We cannot get through their kind of onslaught. I would love to try it at some point but we just do not have the pocket book for that right now.' Matching Wonga's media spend would require [✂]. Think Finance told us that the cost of advertising on television was much higher today than it had been for previous entrants.

7.60 These difficulties were illustrated by an example of a television campaign run by a smaller lender that had not been particularly successful. Global Analytics, a lender that is primarily reliant on lead generators and pay-per-click advertising, ran a trial of television advertisements in 2011 and 2012, but with very limited success. It spent a total of £240,000 on television advertising in 2011, but estimated that this generated only around 1,000 new loans. It spent a substantially higher amount in 2012 – a total of £600,000 – but estimated that this resulted in only a very small uplift in booked loans (an increase of around 250).

7.61 However, we also noted that the cost of advertising had not discouraged Think Finance from investing heavily in television advertising. Similarly, MYJAR said that while it would not be possible to match the advertising spend of the largest lender (ie Wonga), it would be feasible for it to match the expenditure of other large lenders. It was testing television advertising, and was confident of its ability to get a share of voice and establish its brand (although this would take a matter of years rather than months). Dollar said that it did not think that a minimum investment would be required in order to advertise effectively, and referred to the fact that although Wonga's advertising expenditure was large today, it had begun at a relatively low level.

7.62 It was also put to us that a lender might not need to build a brand to be successful. In particular, while CashEuroNet said that it was hard to build a brand, it told us that [✂]. We discuss potential limitations associated with the other key channels of customer acquisition open to lenders in the following paragraphs.

The limitations of other customer acquisition channels

7.63 Smaller online lenders typically rely much more heavily than larger lenders on other customer acquisition channels in order to grow their business, and we considered the extent to which these channels could be relied upon as an alternative to building a brand.

- *Lead generators*

7.64 Lead generators have a number of advantages from the perspective of a new entrant or a smaller lender. In particular, they are accessible to all lenders, irrespective of size, and allow lenders to exercise close control over the volume and profile of customers that they want to attract. Lead generators allow a new entrant to build up a loan book quickly, in loan-by-loan increments, and to their own specification. In keeping with this, more recent lenders to enter payday lending have typically relied heavily on lead generators for new business.

7.65 Where a lender expands using lead generators, it is likely to impose little or no competitive constraint on the prices offered by established lenders. In particular, as set out in Section 6, an implication of the operation of this distribution channel – where customer application details are auctioned to the highest bidder – is that lenders acquiring customers through lead generators are unlikely to have a strong incentive to lower their prices and, in some cases, the opposite may be true (in so far as lenders offering cheaper loans to customers may not be able to bid as much for leads).

7.66 There are also some limitations associated with relying on the lead generator channel from the perspective of a new entrant. First, while a large number of payday loan customer applications are available to purchase from lead generators, this is only around 40% of all new online payday customers. Given this, a lender that expands only by taking customers from lead generators will not access over half of the pool of potential new customers.

7.67 In addition, a number of lenders told us that the quality of applicants coming via lead generators was lower than those coming from other channels and some lenders referred to what they saw as poor sales practices among some lead generators:

(a) [✂] said that it had sought to reduce its reliance on lead generators because of the ‘supply risk’ of using them to acquire new customers. It said that lead generators had the highest default rate of customer acquisition channels, and that this might be due to the fact that a lender would not have the opportunity to develop a relationship with a customer finding its website via a lead generator without any knowledge of the identity of the potential lender itself. This is in contrast to where a customer actively seeks out a lender’s website and completes an application form on that lender’s website, in which case there is an element of relationship creation.

(b) [✄] said that the quality of leads that it got from lead generators was poor, partially because of the practices of those suppliers, which tended to mislead customers. It referred to poor compliance among lead generators as a challenge associated with using this channel.

(c) SRC said that the credit performance of customers who came directly to its website was better than customers who came through its affiliate network.

7.68 We concluded that, given the ease with which they could be used to grow business, lead generators provided a simple and accessible way for a new entrant to establish an initial presence in the payday lending market. However, a lender would not impose an effective competitive constraint on existing lenders if it continued to rely on lead generators alone, and would not be able to access the larger pool of payday loan customers who did not take out their loan via a lead generator. In addition, there was some evidence to suggest that customers acquired via lead generators were generally of a higher credit risk than customers who approached a lender directly, which could put a smaller lender reliant on lead generators at a competitive disadvantage (although the extent of this disadvantage may decrease as a lender's ability to assess credit risk improves – see the discussion beginning in paragraph 7.81).

- *Customer acquisition via search engines*

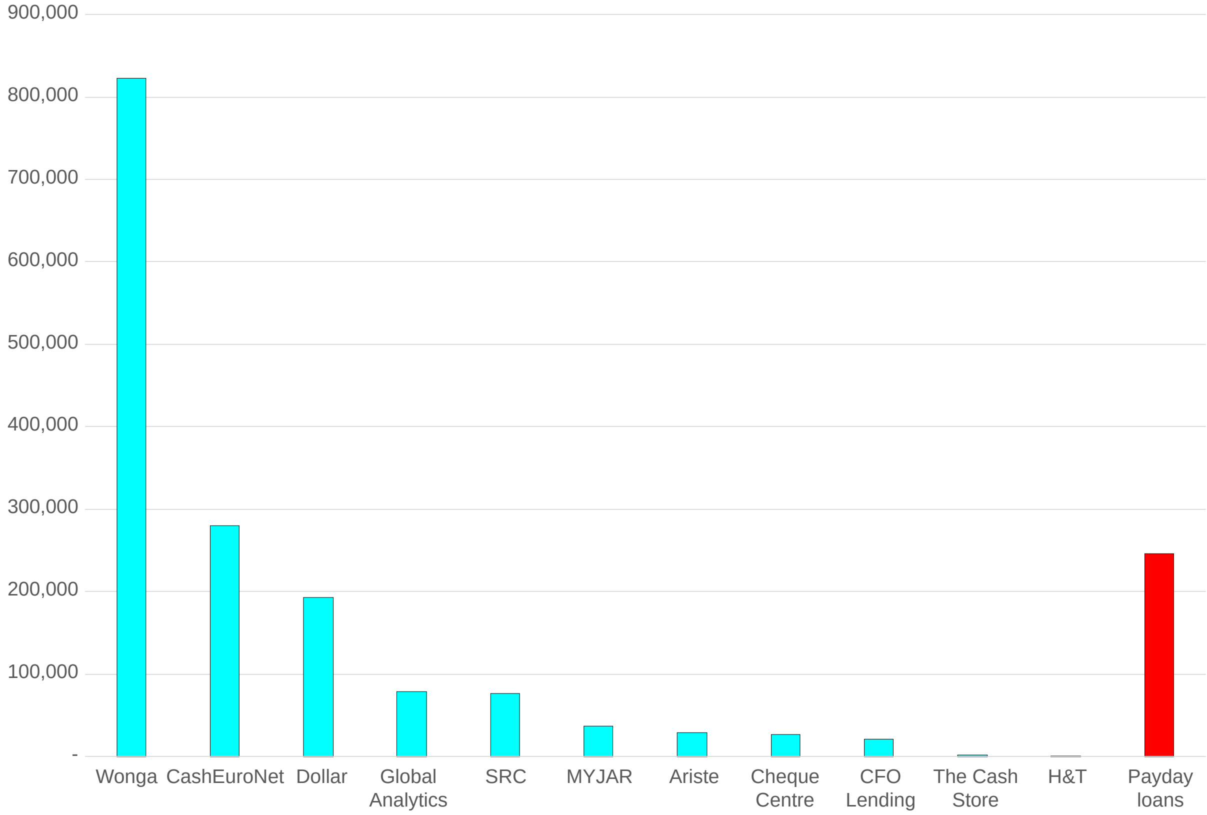
7.69 An alternative channel of customer acquisition available to new online entrants would be to rely on search engines: either by paying for pay-per-click advertisements to be displayed alongside search results, or by taking steps to increase their website's prominence within organic search results via Search Engine Optimisation (SEO). Most lenders from which we collected information devoted some resources to these forms of customer acquisition, although this typically accounted for a relatively modest proportion of all customer acquisition expenditure ([✄]).

7.70 One limitation of relying on search engines to acquire customers is that, as with lead generators, this is likely to give lenders access to only a limited pool of potential borrowers, because many customers will go directly to a lender's website, and others will have already chosen a payday lender prior to using a search engine.

7.71 We collected information from Google on the average number of monthly searches for different search terms in 2013. In total, the ten most popular payday-related terms which were not specific to a particular lender generated on average around [✂] searches per month.[9] The most popular term, accounting for the majority of these searches ([✂]), was 'payday loans', with between 200,000 and 300,000 searches per month in 2012.[10] Lender-specific terms often received a greater number of hits. Figure 7.5 shows the total number of searches for a number of lender specific payday-related terms, and the term 'payday loans' on Google in 2013.

FIGURE 7.5

The average number of monthly searches for different search terms using Google, 2013



Source: CMA analysis of data from Google keywords planner.
Note: The average monthly searches reported relate to the search terms specific to the products of each lender (eg 'wonga' for Wonga, but 'quickquid' for CashEuroNet). For some lenders we included a number of keywords relating to their products/brands.

7.72 These results illustrate the strength of the Wonga brand, as well as suggesting that many customers are likely to have already been influenced in their decision of which provider to use before using a search engine.

7.73 The evidence on the number of searches for non-lender specific terms related to payday loans also suggests that the volume of new customers available via

[9] These terms were [✂].
[10] Google Adwords Keyword planner.

pay-per-click advertising is unlikely to be sufficient on its own for a lender to expand to become a payday lender of a significant size. In particular, if we combine estimated click-through-rates[11] for the term ‘payday loans’ (up to 5% for a lender bidding a relatively large amount) with the total number of monthly searches for the ten most popular payday related terms, this suggests that a lender bidding a significant amount on pay-per-click advertising in a search engine might in a ‘best-case’ scenario be able to direct up to [✄] potential customers to its website a month. We expect that only a small proportion of these customers would then go on to take out loans; assuming that this conversion rate is [✄]% ([✄]), then this scenario would imply fewer than [✄] new loans being generated by pay-per-click advertising per month. By comparison, Wonga made approximately [✄] loans to new customers per month on average in 2013[12], and CashEuroNet approximately [✄] loans.

7.74 In addition to the limited pool of potential customers, we identified further limitations associated with acquiring customers via search engines.

7.75 First, pay-per-click advertising can be an expensive method of acquiring new customers, because lenders must compete with each other and with lead generators in auctions for advertising space. Lead generators will generally be able to pay relatively high amounts for these advertisements, as their business model enables them to maximise the revenue they can earn from any given customer application by selling that lead to the highest bidder.

7.76 Second, it may be difficult for a lender to rely on influencing its position in Google’s search results for payday-related terms as a source of new customers, given the lack of transparency regarding the precise factors which will determine the relative ranking of different websites. In relation to this, Dollar said that acquiring customers via organic search was challenging because it was so dynamic, which meant that nobody had a particular competitive advantage.

7.77 One factor that may serve to heighten this difficulty in the payday lending sector is the prevalence of ‘spam’ (where individuals try to manipulate search engine results, eg by filling their pages with irrelevant terms). Where it is successful, spam will push lenders’ own websites further down the rankings. Relating to this, a presentation prepared by Lending Stream referred to the existence of ‘bad actors that repeatedly use “black hat” SEO techniques to hijack sites and “steal” many leads out of the market’; and MYJAR said that it was at a disadvantage in terms of SEO because it upheld decent practices.

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[11] As indicated by Google Adwords Keyword Planner.
[12] Note that this estimate was not confirmed by Wonga prior to publication.

7.78 In addition, the prevalence of spam relating to payday lending had caused Google to take various steps in order to mitigate spam. We were told that changes to Google's algorithms had had an impact on different lenders' rankings, and we were aware that one outcome of these changes had been to push lenders' websites further down the rankings, in deference to news articles and other non-commercial pages relating to payday lending. One specific example brought to our attention was a penalty imposed by Google on [✂], which [✂] told us took place because a number of poor-quality sites were linking to its website. The penalty reduced the ranking of the [✂] website by 50 positions for all search terms.

7.79 The unpredictable nature of organic search was supported by our consideration of Google search results for a number of payday-related terms. We found that very small lenders appeared relatively prominently among search results, and that the prominence of different lenders varied substantially over time. For example, WizzCash – which issued [✂] loans a month on average in 2013 – regularly appeared as the most prominent payday lender. It told us that it had engaged an SEO marketing agency to manage its website content so as to boost its rankings (for example, by engaging in projects like running a blog). It had been surprised by its success, given its reliance on 'white hat' techniques.

Provisional conclusions on customer acquisition

7.80 We concluded that despite the historic success of some online lenders in establishing themselves in the payday lending market, the ability of new online entrants to expand and establish themselves as an effective competitor is likely to be obstructed by a number of characteristics of the market which make it difficult for them to raise customers' awareness of their products. In particular, the time and expense required for a lender to establish itself in the market today will be accentuated by difficulties associated with raising customers' awareness of their product in the face of the barriers to shopping around and switching summarised in paragraph 6.117, the strength of the well-established brands that already exist in the market and the costs associated with advertising on a sufficient scale to be effective in overcoming these obstacles. New entrants with established brands in other markets may be able to overcome this disadvantage more easily than other suppliers.

Disadvantages faced by new entrants and smaller lenders in assessing applicants' credit risk

7.81 A core capability for a payday lender is the ability to assess the credit risk of new and returning customers when deciding whether to grant them a loan.

One factor that may put smaller lenders at a cost disadvantage – and so potentially impede their expansion – is their more limited ability to assess applicants' credit risks, due to their greater reliance on new customers, and the lack of experience and data available to them to develop and calibrate their risk models.

7.82 While the ability to assess credit risk accurately will be important in all credit markets, it is likely to be particularly significant in the payday lending sector because of the relatively high credit risk profile of payday lending customers (see paragraph 6.56). In addition, certain characteristics of the payday lending sector (and especially the short-term nature of payday loans) means that there are significant limitations to the reliance that lenders can place on information from CRAs when assessing the risk of new applicants (this is discussed further in paragraph 7.108).

7.83 Our analysis of financial data indicates that a payday lender's ability to assess credit risk accurately will have a significant impact on their performance. Costs associated with doubtful debt represented around 45% of total costs for all lenders in 2012. For online lenders the proportion is around 50%, and for high-street lenders this is around 25% (as these lenders must also pay store and staff costs).

7.84 There is significant variation in the approaches taken by different lenders to credit risk assessment. Nevertheless, there are also certain commonalities. As discussed in paragraph 2.71, when performing credit risk assessments lenders will typically rely on some combination of information collected during the loan application process; any information already held about the applicant internally; and relevant third party information sources (eg information purchased from CRAs).

7.85 Most lenders also use automated credit models, which can be used to process the relevant information and generate an internal credit score for a customer in a matter of seconds. These models differ in the information that is relied upon as being predictive of the likelihood that a customer will repay their loan, the weight given to different pieces of information, and the way that information is processed.

7.86 Some lenders' risk assessments also have a manual (ie non-automated) element. All high-street lenders have a staff member reviewing the application process. [✂], did not rely on the member of staff to make the ultimate lending decision in all cases. By contrast, only one of the major online lenders, [✂], relies on a human underwriter to make the final lending decision.

7.87 Figure 7.6 shows how default risk – as measured by the principal loss rate[13] – varies across lenders. It shows that the extent of variation is significant, with the loss rate of some lenders as much as [✂] times greater than that of other lenders. This suggests that variation exists in the ability of different lenders to accurately assess different applicants' credit risk (although this pattern could in principle also be driven by other factors, such as variation in lenders' collection policies, their approach to customer acquisition, or differences in lenders' products driving differences in their customer profiles).

FIGURE 7.6

Variation in principal loss rate across lenders, financial year 2012

[✂]

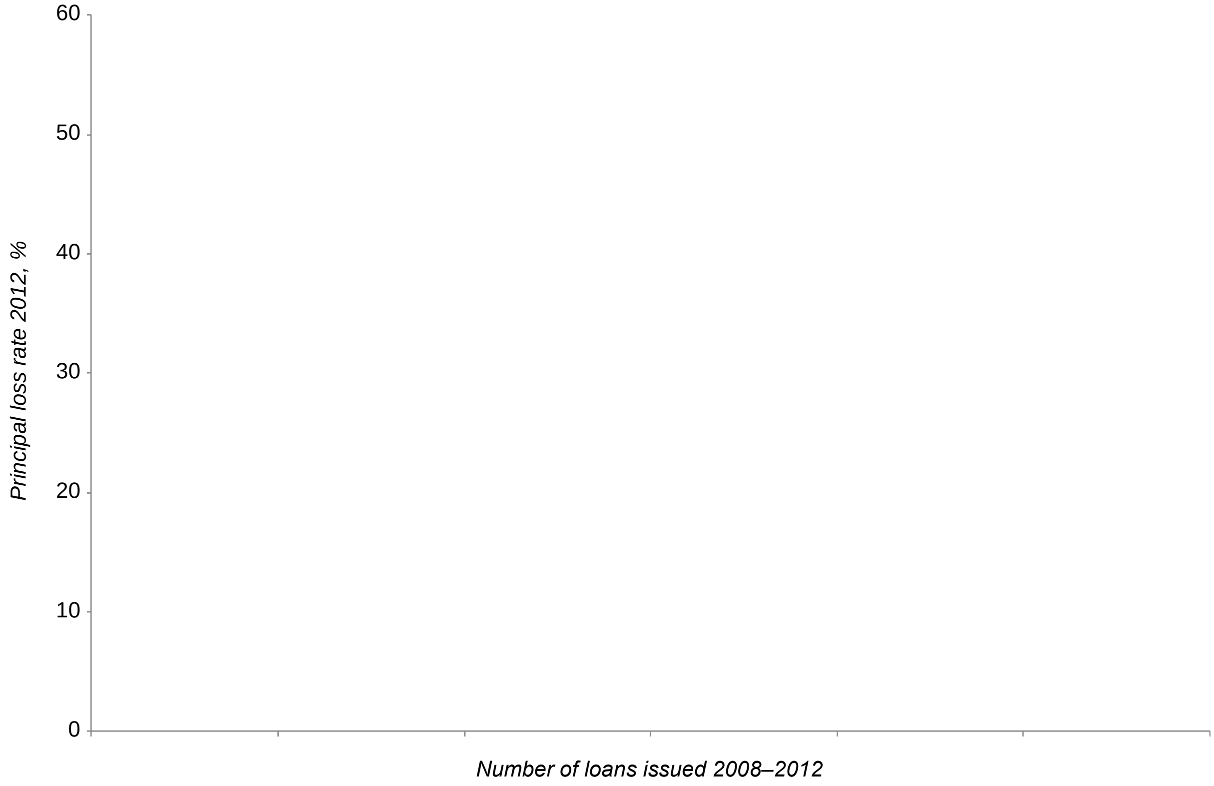
Source: CMA analysis of financial data provided by the major lenders.

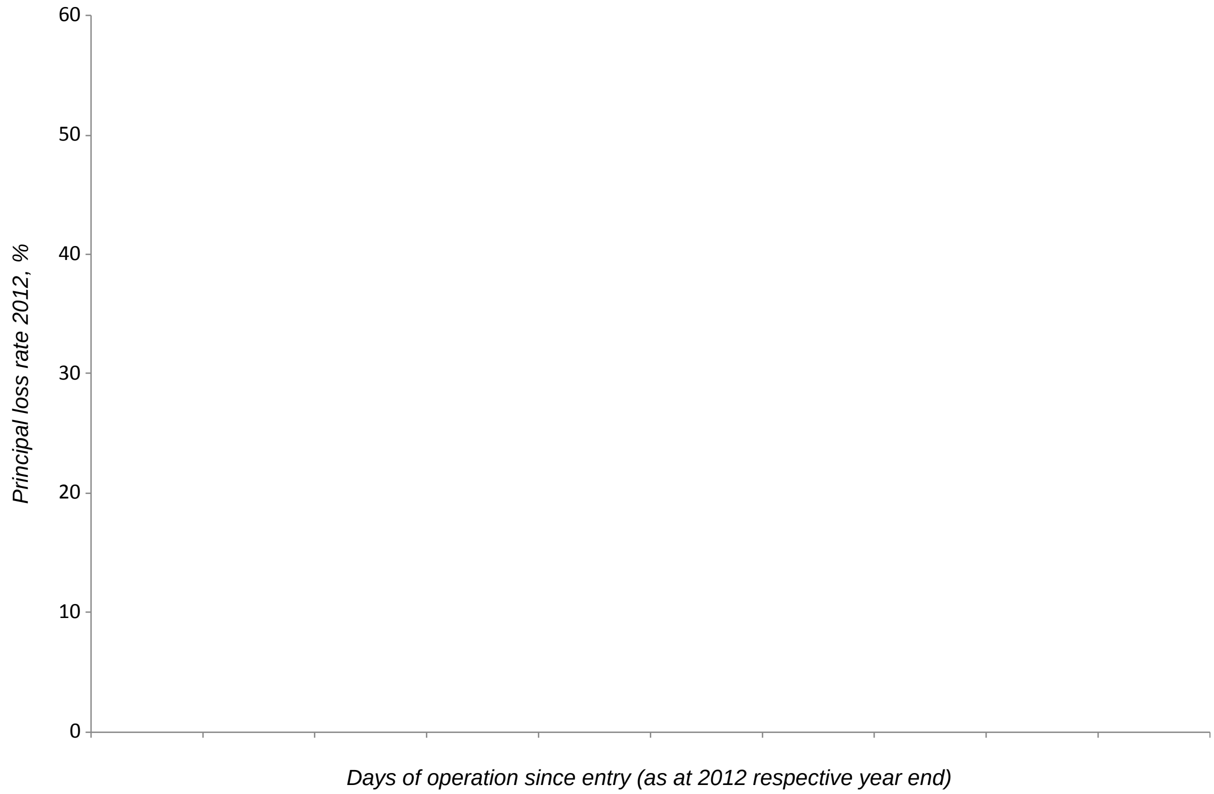
7.88 We considered whether a lender's ability to assess credit risk accurately was influenced by the cumulative number of loans they had issued and/or length of time that they have spent in the market. The top panel of Figure 7.7 shows how principal loss rates vary with the total number of loans issued by a lender since 2008. The lower panel shows how principal loss rates vary with the number of days passed since the lender began issuing payday loans.

[13] This measure of default risk is calculated as *1 – (loan principal collected / loan principal issued) for a given financial year*.

FIGURE 7.7

How principal loss rates vary with the cumulative number of loans issued, and the number of days since the lender entered payday lending





Source: CMA analysis of financial data provided by the major lenders.
Note: 2012 is based on the last reported financial years ended July to December 2012 and January to June 2013.

7.89 The charts suggest that although they are clearly not the only relevant factors at work, a lender's longevity in the market and the cumulative number of loans issued by that lender are positively correlated with its ability to assess credit risk. Interpreting the nature of these relationships is not straightforward, as various confounding factors could in principle exist.[14] To explore these relationships further, we considered in detail two potential reasons why a new entrant might be at a disadvantage in terms of their default costs when compared with a more established lender. First, new entrants are likely to be much more reliant on new customers. Second, new lenders will have had less time and information available to them to develop their risk models. We discuss these possibilities in the subsequent sections, before considering the potential role of information available from CRAs in removing any asymmetries between new and established lenders.

Reliance on new customers

7.90 One way in which new entrants may face a disadvantage in assessing credit risk is because of their heavier reliance on 'new' customers (ie customers to whom the lender has not lent previously).

7.91 As discussed in paragraph 2.49, demand for payday loans is typically recurring, with a payday lending customer taking out nearly six payday loans in 2012 on average, and around three-quarters of borrowers taking out more than one loan. One impact of this is that lenders rely significantly on repeat business. Around 80% of all loans made by payday lenders in 2012 were to customers to whom a loan had previously been made by that lender.

7.92 A lender's ability to assess the credit risk of a repeat customer is likely to be considerably better than its ability to assess the credit risk of a new customer. In particular, in the case that a customer has repaid the previous loan, that customer has already demonstrated that they are willing and able to repay a loan. Conversely, a lender will know not to lend further amounts to a repeat customer who did not repay a previous loan.

7.93 The existence of differences in lenders' abilities to assess accurately the risk of new and repeat customer groups is supported by evidence on default rates. Figure 7.8 shows the proportion of loans issued to new and repeat customers which were repaid in full early, repaid in full on time, repaid in full late, or never repaid in full. It shows that around 26% of all loans to new customers were never repaid in full, compared with 11% of all loans to repeat customers.

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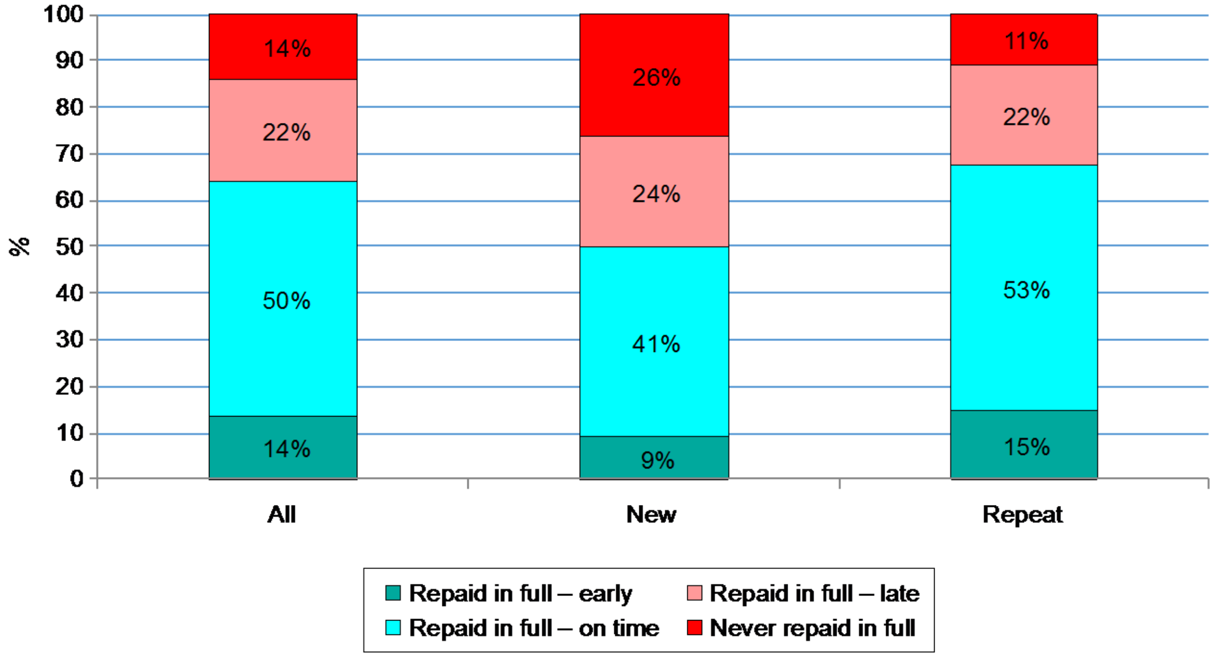
[14] For example, the relationship might be driven, at least in part, by a survival effect, whereby those lenders which start out with superior approaches to judging risk are more successful, and so go on to make more loans.

FIGURE 7.8

Loans issued in 2012, status as of 1/10/2013



Source: CMA analysis of transaction data of 11 major lenders.

7.94 This pattern was also recognised in discussions held with a number of lenders. For example, Wonga said that repayment data for an existing customer was a very valuable data point, and that it was easier to assess a returning customer than a first-time customer. It also provided data showing that principal loss rates for returning customers were typically around [✄] of those for new customers, or less. SRC told us that the riskiest loan was the first loan made to a customer because no prior credit history was available for that customer. Dollar said that there was a difference in credit quality between new customers, and customers who had been lent to previously. This was particularly the case in payday lending because of the relative lack of historical credit information available from CRAs. There was a natural progression as a business grew for the proportion of repeat customers to increase. Evidence provided by Global Analytics showed that its charge-off rates had been consistently higher for new customers compared with repeat customers.

7.95 Because it will take time to establish a stock of repeat customers, new entrants will typically be reliant on new customers to a much greater extent. This implies that they will be serving a riskier customer group and so will be at a cost disadvantage compared with established lenders.

7.96 The key determinants of how long it takes for a new entrant to develop a stock of good-quality repeat customers and overcome this disadvantage will be the number of times that their customers and those of their rivals return for additional credit, and the length of the period over which this takes place. All else being equal, the average longevity of the relationships between existing payday lenders and their customers will tend to increase the length of period for which a new lender will be at a disadvantage.[15]

7.97 Dollar told us that it estimated the average customer life to be approximately [✂], while CashEuroNet told us that the average length of time spent by a payday customer with the same lender in the market was around [✂]. Table 7.4 shows that, looking at customers of the 11 major lenders in August 2013, for around 40% of customers their first loan with a lender was a year or more ago. For around 18% of customers their first loan was more than two years ago, and for 1% of customers, their first loan was five years ago or more. This suggests that while the largest increases in a lender's stock of repeat customers are likely to be made within a year, the stock of repeat customers is likely to continue to develop over a period of years rather than months.

TABLE 7.4 **Length of payday customers' relationships with their lender (ie time since their first loan from a lender), August 2013**

Length of relationship with lender	*Proportion of all payday customers, August 2013* %
Up to one year	59
1–2 years	23
2–3 years	12
3–4 years	4
4–5 years	1
5 years or more	1

Source: CMA analysis of transaction data provided by the 11 major lenders.

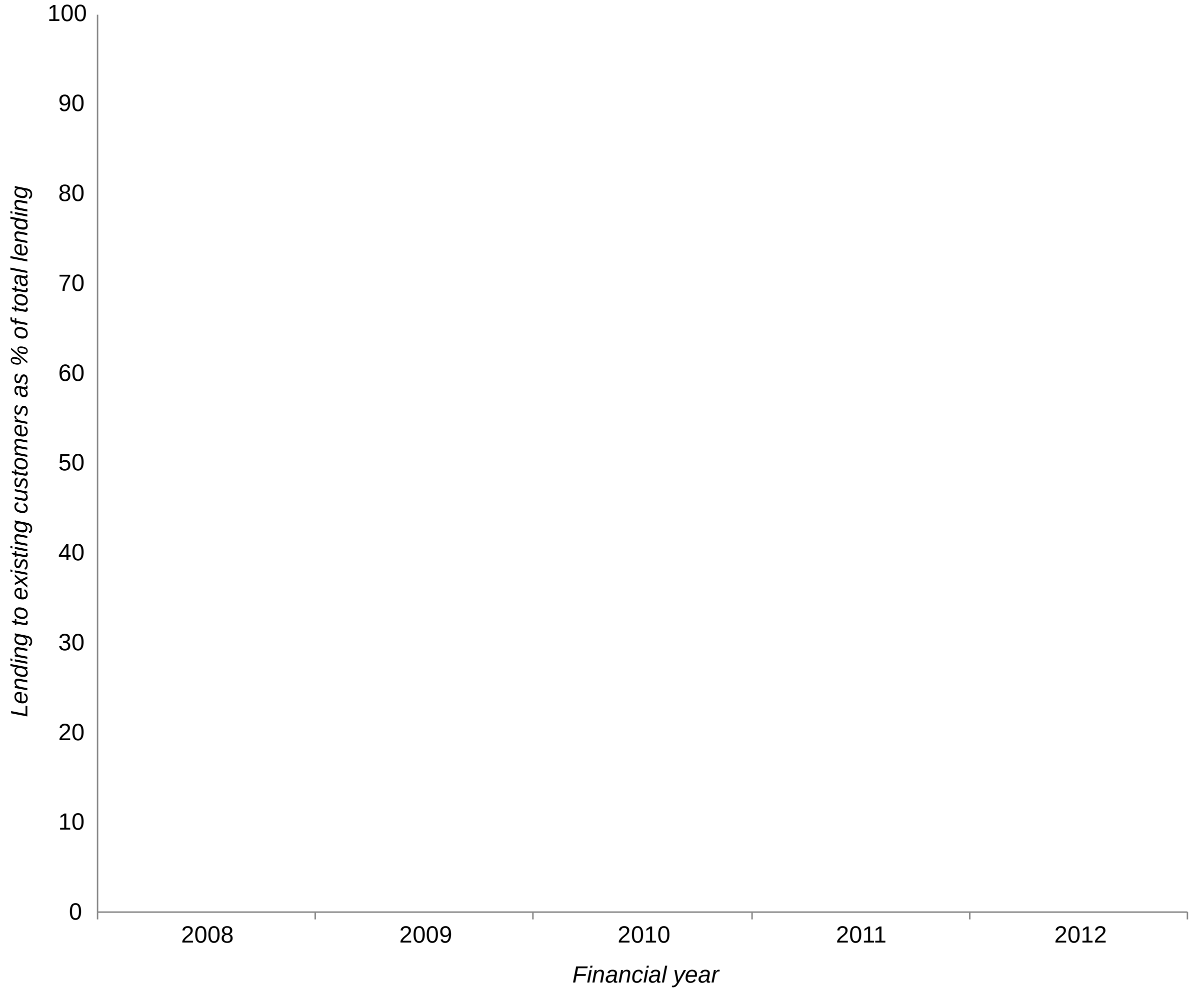
7.98 This observation is also supported by our analysis of the evolution of the different lenders' business accounted for by new customers since beginning payday lending. Figure 7.9 shows how the proportion of loans that went to existing customers evolved in the period financial year 2008 to 2012 for a number of the major lenders who began payday lending in 2006 or later (information for 2006 and 2007 for those lenders that were active in these years is not available). It shows that typically these lenders have observed a considerable increase in the proportion of loans made to existing customers since entering payday lending. These gains have generally been sustained

[15] To give an example – assume that a lender acquires a constant number of new customers per month, and that following their first loan from a payday lender, each customer goes on to take out a further loan with that same lender every two months for a total of six loans. Then it will take a year for a new entrant to reach the same level of reliance on repeat business as established lenders. If each customer returns for six loans in total, but takes out a loan every four months, then it will take a new entrant two years to have the same stock of repeat customers as an established lender. Similarly, if each customer returns for 12 loans at a frequency of one every two months, it will take a new entrant two years to have the same stock of repeat customers as an established lender.

across a number of years, suggesting that the process of accumulating a stock of repeat customers can continue for a significant period.

FIGURE 7.9

The evolution in lending to existing customers as a percentage of total lending, financial years 2008 to 2012

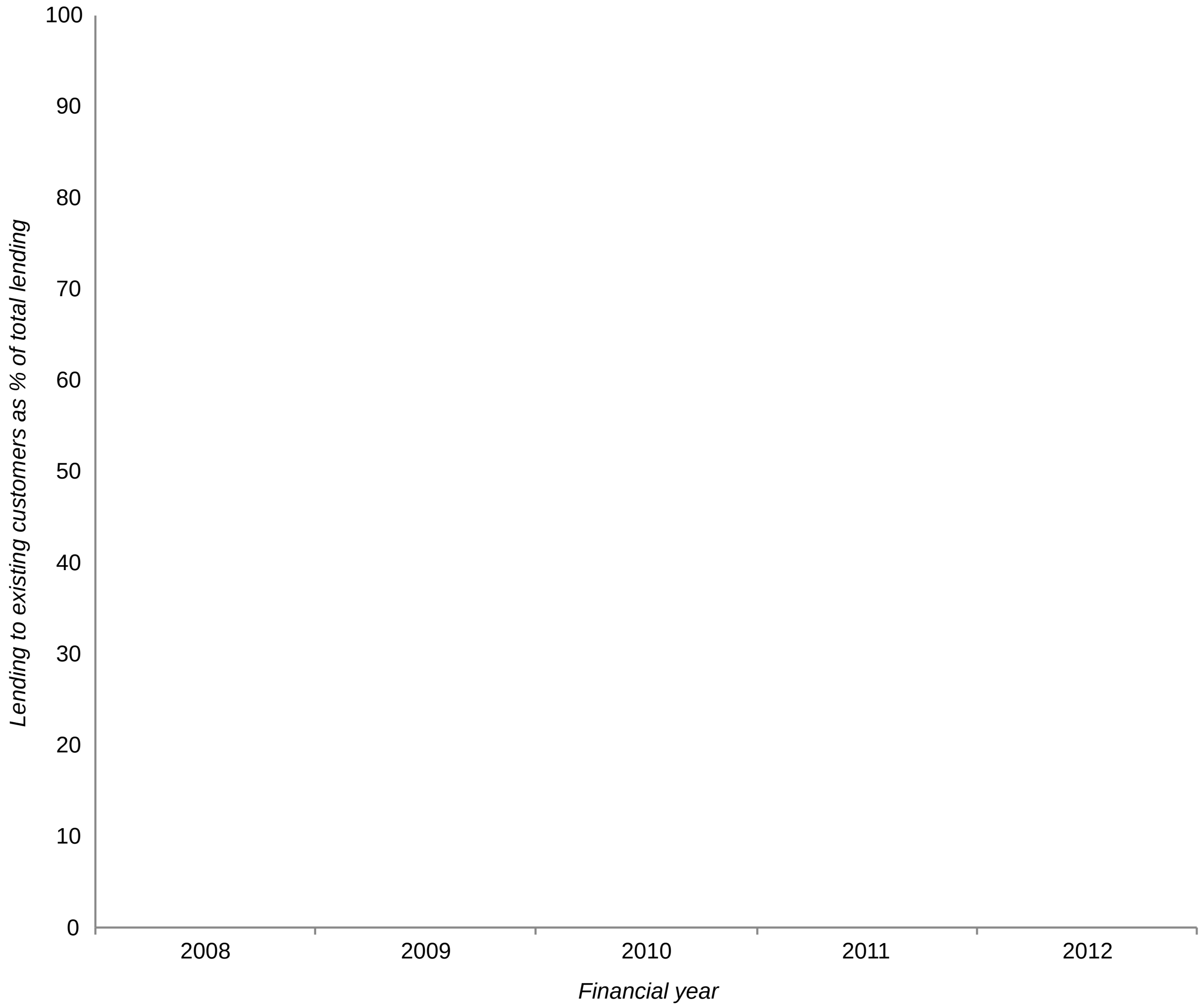


Source: CMA analysis of financial data provided by the major lenders.

7.99 Figure 7.10 shows the same information for [✂], which have both been in the market for longer periods of time. It shows [✂].

FIGURE 7.10

The evolution of lending to existing customers as a percentage of total lending for less recent entrants, financial years 2008 to 2012



Source: CMA analysis of financial data provided by the major lenders.

Information and experience available to develop risk models

7.100 In addition to their greater reliance on new customers, new entrants may face a disadvantage relative to more established lenders because of their relative lack of experience in assessing applicants' credit risk, and lack of information available on historic default behaviour which can be used to test and develop new and improved approaches to credit risk assessments.

7.101 Figure 7.11 illustrates variation across lenders in the proportion of first-time customers that never repay their loan in full. It shows that considerable variation exists in the credit risk of different lenders' new customers, with around [✂]% as many customers of [✂] never repaying their loan in full as is the case for [✂].

FIGURE 7.11

Proportion of loans to new customers never repaid in full

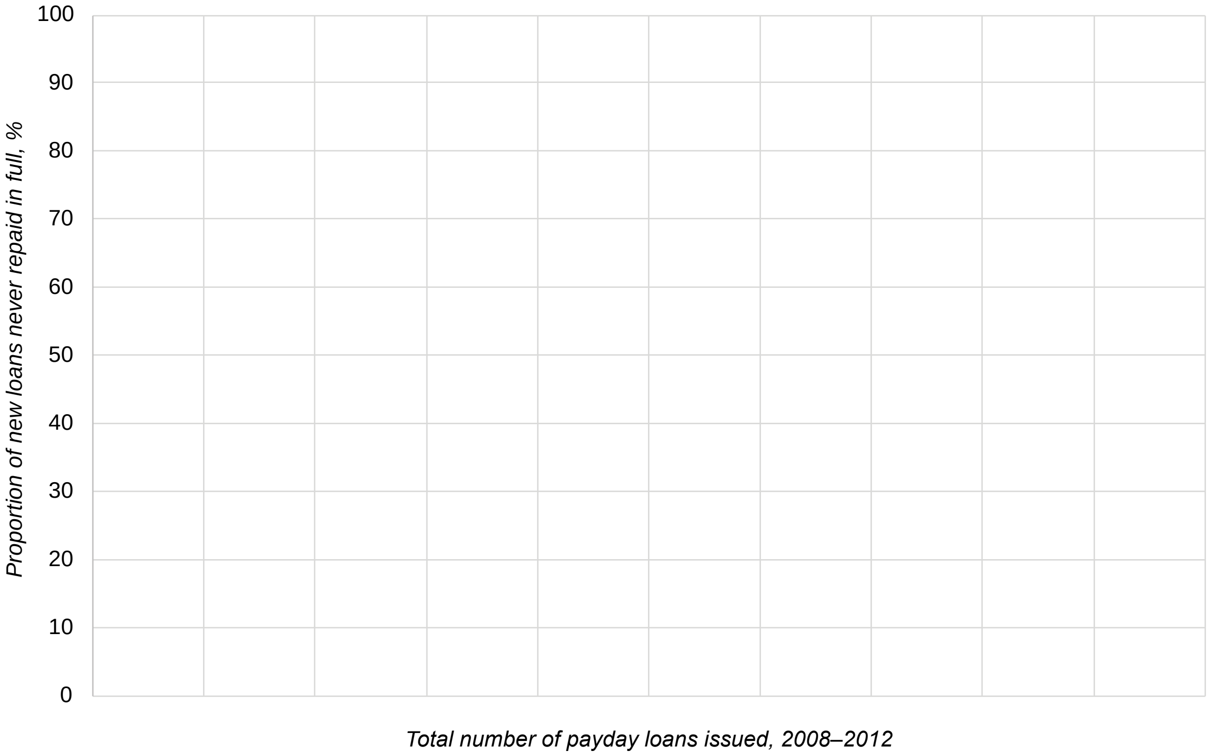
[✂]

Source: CMA analysis of major lenders' transaction data.

7.102 To the extent that we interpret variation in default rates as reflecting variation in different lenders' ability to assess credit risk, then this suggests that in addition to differences in the extent of repeat business between lenders, some lenders are better than others at credit risk assessments. Figure 7.12, which plots these new customer default rates against total number of payday loans issued by a lender in the period 2008 to 2012, shows that there is a tendency for lenders that have higher default rates among new customers to also be those lenders that have issued the fewest loans, although we noted some significant exceptions to this pattern, and acknowledge that the cumulative number of loans issued is clearly not the only factor at play in driving the default rates that we observe (other factors such as lenders' customer acquisition strategies may also play a role).

FIGURE 7.12

How the proportion of loans to new customers that are never repaid in full varies with the cumulative number of loans issued by a lender



Source: CMA analysis of major lenders' transaction data.

7.103 The submissions of a number of lenders supported the idea that lenders' risk models continue to develop with experience. For example, CashEuroNet discussed how it continuously tested new variables in 'dry runs'. It said that the QuickQuid approval model had [✂] variables today, and that it had tested and discarded over [✂] other variables over the last six years. It said that its ability to identify customers able to afford loans was a key competitive advantage, and that it continually developed and improved its methodologies in order to stay ahead of the competition.

7.104 It was clear from lenders' descriptions of their credit risk assessments that historic information often played a key role in model development. For example, Wonga told us that monitoring of arrears was a critical indicator of the success of Wonga's risk management system, and that it used the information regularly to monitor and fine tune its models (although other than in the early stages of a product cycle, model updates were not common). MYJAR described how it had spent time gathering data in recent years in order to help refine its underwriting, and how its business had evolved as a result, such that its ability to write a better loan had improved over the past 18 months. It said that one of the biggest barriers to entry was the amount of data needed in order to make safe underwriting decisions – it cost a lot of money in terms of customer acquisition and bad debt in order to gather data and learn the lessons necessary in order to make credit decisions.

7.105 [✂] also referred to the role of account level historical application data in developing its bespoke scoring system. However, it told us that there were diminishing returns in terms of how much additional customer information allowed a lender to improve its models and decision-making, such that [✂]. It said that it had been able to build a robust high-quality scorecard with a sample of [✂] loans including [✂] 'goods' and [✂] 'bads', and referred to a paper which it said showed that although performance could be improved with a greater number of 'bads', the incremental improvement was very low beyond this point, and models built with this level of 'bads' could still work very well and were robust.

7.106 Further, CashEuroNet said that although internal models for assessing credit risk improved over time, this did not constitute a barrier to expansion because the duration of the loans was so short, which meant that the necessary learning could take place quickly. A good credit model could be built in six months.

Credit reference agency information

7.107 The asymmetry in the amount and quality of information available to new entrants and established lenders about customer repayment behaviour may be offset, to some extent, by the availability of CRA data. CRA records will include some information on previous loans taken by a customer and their repayment behaviour, and is available to lenders irrespective of how long they have been in the market. For example, Wonga said that the information on repayment that it had shared with CRAs meant that a start-up would have very robust information on which to base its underwriting. The breadth and depth of data available would give an entrant today an enormous advantage that was not available when it entered the market.

7.108 However, the information that is available from the CRAs generally suffers from various limitations, including:

(a) The frequency with which it is updated. Typically this is monthly, which may be problematic given the very short-term nature of most payday loans. While some steps have been taken by some of the larger CRAs to develop real-time data sharing, it is not yet clear how effective these systems will be or how long they will take to implement.

(b) The level of detail available. For instance, it may only be possible to observe a single ‘status’ variable for a credit agreement, which may not allow the lender to differentiate between different degrees of late and/or partial repayment.

(c) The completeness of records. For example records regarding repayment history may not be available for all lenders.

7.109 In addition, unlike information about a previous customer’s repayment history, data from a CRA will not allow a lender to directly observe a customer’s willingness to repay a loan issued by that particular lender.

7.110 In keeping with this:

(a) MYJAR said that lending decisions could not be based on CRA information alone, and referred to an example of a lender that had attempted this, and was struggling as a result. It did not expect the developments in real-time data to lead to a big improvement in its risk assessments. It said that increasingly little reliance was being placed on CRA information. Details included within application forms were particularly important predictive factors, and these would not be available in CRA information.

(b) SRC told us that ‘although we have found a variety of CRA data sources and variables that are predictive of performance in the US, we have struggled to find CRAs or payday-specific CRAs that provide the same level of predictability in the UK’.

(c) CashEuroNet said that QuickQuid imported raw data from [✂] and several other specialised identity verification and prepackaged reports. Its experience in modelling sub-prime customers showed that the standard credit scores produced by CRAs were unsuited for its customer base. Accordingly it had built its own credit-scoring system using individual values for numerous [✂] variables.

Provisional conclusions on credit risk assessments

7.111 While the ability to assess credit risk accurately will be important in all credit markets, it is likely to be a particularly crucial determinant of a provider's success in the payday lending sector, because of the relative high credit risk profile of payday lending customers and the significant limitations associated with the information available to lenders from CRAs. Because of their greater reliance on new customers and the role of learning in the credit risk assessment process, new entrants are likely to face some disadvantages in their ability to assess credit risk for an initial period, which – all else equal – will put them at an initial cost disadvantage relative to more established providers. Given the nature of the disadvantage, new entrants with lending experience from other credit markets, or existing customer bases that they can target, may have some advantages compared with other types of supplier.

Provisional conclusions on the constraint from entry and expansion

7.112 The first payday lenders began offering payday loans to UK customers ten years ago or more. Since then, we have observed a large number of new providers enter the market, using a variety of different entry strategies – today there are more than 90 payday lenders active in the market. The size of the payday lending sector as a whole (high street and online) has expanded rapidly over this period, with growth especially high between 2010 and 2012. Within this growing market, a small number of lenders have managed to successfully expand their market shares – Wonga has expanded particularly quickly since its entry in 2007, becoming the largest payday lender by some distance.

7.113 Notwithstanding these historic patterns, and as shown by the evidence set out in Section 4, entry by new firms into the payday market has not resulted in existing lenders being effectively constrained when setting their prices. One reason for this is the barriers identified in Section 6, which reduce payday customers' sensitivity to prices, and weaken price competition between lenders. For example, on many occasions where we observe new providers entering payday lending, these lenders have relied to a large extent on lead generators for new customers: a lender sourcing new customers via a lead generator is likely to have little or no incentive to compete on prices, given the way in which this channel operates (see paragraph 6.107). To give another example, a new entrant may struggle to capture established lenders' customers on the basis of offering a better-value product, given some customers' preference to stay with a provider they feel comfortable with because of the negative reputation of the payday lending sector.

7.114 Our analysis of the conditions facing new entrants and smaller lenders indicates that the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion is likely to be further weakened by the following combination of market features.

7.115 First, new entrants will face certain disadvantages relative to more established lenders:

(a) The ability of new entrants to expand and establish themselves as an effective competitor is likely to be obstructed by the difficulties associated with raising customers' awareness of their product in the face of the barriers to shopping around and switching summarised in paragraph 6.117, the strength of the well-established brands that already exist in the market and the costs associated with advertising on a sufficient scale to be effective in overcoming these obstacles.

(b) While the ability to assess credit risk accurately is a necessary requirement for any provider of personal credit, it is likely to be a particularly important determinant of a provider's success in the payday lending sector, because of the relatively high credit risk profile of payday lending customers and the significant limitations associated with the information available to lenders about these customers from CRAs. Because of their greater reliance on new customers and the role of learning in the credit risk assessment process, new entrants are likely to face some disadvantages in their ability to assess credit risk for a period, which would put them at an initial cost disadvantage relative to more established providers.

7.116 Well-resourced lenders, lenders with established positions in other credit markets or lenders with innovative customer acquisition strategies may be able to overcome these disadvantages to some degree – and some recent entrants that we spoke to were optimistic about their ability to expand successfully to the next stage of their development. Nevertheless, these features are likely materially to increase the time and investment required for small lenders to establish themselves as significant players in the payday market, reducing the constraint that they would otherwise impose on established lenders.

7.117 Second, we found that the history of non-compliance and irresponsible lending by some payday lenders and the resulting negative reputation of the sector are likely to reduce the constraint imposed on payday lenders' pricing by the prospect of new entry. In particular:

(a) The reputation of payday lending is likely to deter some businesses with established reputations in other sectors – such as mainstream credit suppliers – from entering the market. This reduces the likelihood of entry by parties with the capability to transform the nature of competition in the market.

(b) Potential entrants may also be dissuaded from entering payday lending by the difficulty – itself linked to the current reputation of the sector – in establishing banking relationships, and the very small number of suppliers currently willing to provide banking services to payday lenders.

7.118 The level of political and regulatory uncertainty currently affecting the sector may also reduce the current appetite for new entry and for investment by existing lenders. However, to the extent that ongoing reform is successful in improving conduct within the payday lending sector and thereby improving the market's reputation, we would expect the deterrent effect created by the sector's reputation to decline in the future.

8. Provisional findings

8.1 As described in paragraph 1.1, on 27 June 2013, the OFT referred the supply of payday lending in the UK to the CC for investigation, under sections 131 and 133 of the Act. Section 134(1) of the Act requires us to decide whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom'. If that proves to be the case, under the Act, this constitutes an AEC.[1]

8.2 As we set out in Section 4, with a few recent exceptions, there is little evidence of lenders actively using the price of their loans to attract or retain customers. In general, customers appear unresponsive where lenders have offered lower prices, and many customers take out loans with a particular provider when cheaper options may be available from other lenders to meet their borrowing requirements. This evidence indicates that price competition between payday lenders is not working effectively – an observation which is consistent with our profitability assessment, which shows that the largest lenders have earned profits significantly above the cost of capital over much of the past five years although we have observed significant variation in the level of profitability, both between lenders and over time. By contrast with lenders' pricing behaviour, levels of non-price competition appear more consistent with a well-functioning market.

8.3 In Section 5, we provisionally found that competition from other forms of credit only imposed a weak constraint on payday lenders' prices. This was mainly because of the differences that exist between payday loans and other types of credit which serve to limit customers' willingness to substitute between them, and the limited extent to which many payday customers are able to use other credit products when they need to take out a loan, given their prior credit histories. We therefore excluded other forms of credit from our definition of the relevant market.

8.4 For the reasons given in Sections 6 and 7 and summarised below, we have provisionally found that there are a number of features in the provision of payday loans in the UK which contribute to, and help to explain, the failure by many payday lenders to compete on price and which either individually or in combination give rise to an AEC.

8.5 First, we have provisionally identified the following combination of structural and conduct features, which limit the extent to which customer demand is

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[1] Section 134(2) of the Act.

responsive to the price of payday loans, and so reduce the pressure for lenders to compete to attract customers by lowering their prices:

(a) The context in which customers take out payday loans is often not conducive to customers shopping around to find a good-value loan and may amplify the adverse effects of other barriers to shopping around and switching lender. Customers often perceive the need for their loan to be urgent, and attach considerable importance to the speed with which they are able to access credit. Many payday loan customers are also uncertain, often with good reason, about whether, and from whom, they will be granted credit to meet their borrowing requirements. These aspects of the decision-making environment can tend to make customers reluctant to spend time shopping around for the best deal available, and can cause customers to focus on which lender is willing to lend to them (or, for a repeat borrowing, to stay with a lender that they previously used) rather than which lender offers the best-value product.

(b) It can often be difficult for customers to identify the best-value loan product on offer given their borrowing requirements. Despite information on headline rates generally being available on lenders' websites or in the shops of high-street lenders, customers' ability to use this information to identify the best-value payday loan is impeded by the complexity associated with making effective price comparisons given variation in product specifications and pricing structures across lenders, and the limited usefulness of the APR in facilitating comparisons between payday loans. Existing price comparison websites, which might otherwise help customers compare loans, suffer from a number of limitations and are infrequently used.

(c) Customer demand is particularly insensitive to fees and charges incurred if customers do not repay their loan in full on time. Customers tend to be less aware of these potential costs of borrowing than they are of the headline interest rate when choosing a payday loan provider. This is in part because overconfidence about their ability to repay the loan on time can cause some customers to pay only limited attention to these costs when taking out their loan. Even where customers seek to anticipate the costs associated with late repayment, the information generally provided about such costs is significantly less complete, less easy to understand and/or less prominent than information on headline rates. It can therefore be difficult for customers to estimate, and so make effective comparisons about, the likely cost of borrowing if they do not repay their loan in full on time.

(d) Many online customers take out their first loan with a lender via a lead generator's website. Lead generators typically promote their ability to find customers a lender willing to offer them a loan within a short period of time. The value for money represented by different lenders' loan offerings is not taken into account in the auction process operated by lead generators, who instead sell customer applications to the highest bidder. Furthermore, there is often a lack of transparency in how the service that lead generators provide is described in their websites – particularly the basis on which applications are matched with lenders – and many customers do not understand the nature of the service offered by lead generators. An implication of the operation of this distribution channel is that lenders acquiring customers through lead generators are unlikely to have a strong incentive to lower their prices. The lead generator model may also create an incentive for lenders to increase prices to customers, as lenders offering cheaper loans would find it harder to bid high prices in lead auctions and hence acquire valuable leads.

(e) Where their choice of lender is not dictated by concerns about credit availability, customers can be dissuaded from looking at alternative suppliers by the perceived risks associated with using a new lender, particularly in light of the negative reputation of the payday lending sector. Customers may perceive a loss of convenience associated with applying to a new lender, particularly if the alternatives are rolling over or topping up an existing loan with an existing lender.

8.6 Secondly, we have provisionally found that the competitive constraint that might otherwise be imposed on payday lenders' prices by the prospect of new entry or expansion is weakened by the following structural features:

(a) New entrants will face certain disadvantages relative to more established lenders, in particular:

(i) The ability of new entrants to expand and establish themselves as an effective competitor is likely to be obstructed by the difficulties associated with raising customers' awareness of their product in the face of the barriers to shopping around and switching summarised in paragraph 8.5, the strength of the well-established brands that already exist in the market and the costs associated with advertising on a sufficient scale to be effective in overcoming these obstacles.

(ii) While the ability to assess credit risk accurately is a necessary requirement for any provider of personal credit, it is likely to be a particularly important determinant of a provider's success in the payday lending sector, because of the relatively high credit risk profile of payday lending customers and the significant limitations associated with the information available to lenders about these customers from CRAs. Because of their greater reliance on new customers and the role of learning in the credit risk assessment process, new entrants are likely to face some disadvantages in their ability to assess credit risk for a period, which would put them at an initial cost disadvantage relative to more established providers.

(b) The history of non-compliance and irresponsible lending by some payday lenders and the resulting negative reputation of the sector are likely to reduce the constraint imposed on payday lenders' pricing by the prospect of new entry. In particular, the reputation of payday lending is likely to deter some businesses with established reputations in other sectors – such as mainstream credit suppliers – from entering the market. This reduces the likelihood of entry by parties with the capability to transform the nature of competition in the market. Potential entrants may also be dissuaded from entering payday lending by the difficulty – itself linked to the current reputation of the sector – in establishing banking relationships, and the very small number of suppliers currently willing to provide banking services to payday lenders.

8.7 We have therefore provisionally found, pursuant to section 134(1) of the Act, that there are features of relevant markets, which alone or in combination prevent, restrict or distort competition in the supply of payday loans to UK customers, and accordingly that there is an AEC within the meaning of section 134(2) of the Act. The features are those that we have identified in Sections 6 and 7 of this report and which are summarised in paragraphs 8.5 and 8.6 above.

Customer detriment

8.8 We considered the likely nature and potential scale of the harm to payday loan customers arising from the AEC that we have provisionally found. Further details of our analysis of this issue are set out in Appendix 8.1.

8.9 Assessing customer detriment is an inevitably complex exercise and our consideration of this issue is likely to evolve as we evaluate possible remedies. The focus of the analysis that we have conducted to date has been to enable us to gain an understanding of the ways in which customer detriment arises and the order of magnitude of any effect, rather than to quantify exactly which customers are suffering a detriment and by precisely how much.

8.10 We identified two sources of customer detriment which are likely to arise as a result of the provisional AEC:

(a) Some customers currently pay more for their loan than they would if price competition were more effective.

(b) There is less innovation on pricing (eg in relation to the introduction of risk-based pricing or flexible price models) than we would observe in a market in which price competition were more effective.

8.11 We considered the scale of the customer detriment caused by the AEC, and provisionally concluded that it was likely to be material. In particular, on the basis of different plausible assumptions about the level of prices that might be observed in a market in which price competition were more effective, we estimated that on average borrowers are overpaying for their loans by around £5 to £10 per loan. This is relative to a typical loan of £260 taken out for just over three weeks, and with a total cost of credit for a customer who repays in full and on time of around £75. Applying these savings to the total number of loans issued in 2012 that were repaid in full would imply potential annual savings to customers of around £48–£85 million. In addition, we considered that the current use of risk-based pricing and flexible pricing models was undeveloped relative to the level that we might expect to see in a well-functioning market, and so a further detriment (which we did not seek to quantify) was likely to exist associated with the overall efficiency of the market, and the extent to which prices reflect the cost of supplying different groups of customers.

8.12 While we have not conducted a detailed analysis of the relative impact of the AEC on different borrowers, we would expect different groups of customers to be affected to varying degrees. Low-risk customers, borrowers repaying their loan late, borrowers paying upfront fees and borrowers using traditional products to borrow for relatively short periods are particularly likely to suffer a substantial detriment as a result of the AEC that we have provisionally found.