

Home credit

The OFT's reasons for making a reference to the Competition Commission*

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OFT769

- 1 The Office of Fair Trading (OFT) has made a reference to the Competition Commission (CC) under section 131 of the Enterprise Act 2002 (the Act) for an investigation into the supply of home credit in the United Kingdom. For the purposes of this reference, 'home credit' (HC) means the provision of credit, typically small sum cash loans, the repayments for which are collected in regular instalments (often weekly or fortnightly) by collectors who call for that purpose at the customer's home. Some HC lenders also use the sale of shopping vouchers, hampers, or other goods on credit, to attract customers for their cash loans.
- 2 Under section 131 of the Act, the OFT may make a market investigation reference to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts, or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. The OFT believes that this test as to when a reference may be made is satisfied.
- 3 In addition, and in the light of our published guidance on market investigation references¹ (the Guidance), we have also considered the criteria set out at paragraph 2.1 of the Guidance and concluded that they are satisfied.

* Certain information has been excluded from this document in order to comply with the provisions of section 244 of the Enterprise Act 2002. This includes the need to exclude from disclosure (so far as practicable) commercial information the disclosure of which would, or might, in the OFT's opinion, significantly harm the legitimate business interests of the undertaking to which it relates. Excisions are denoted by [...].

¹ *Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act* – see www.offt.gov.uk/Business/Legal+Powers/Enterprise+Act/publications.htm

Sector overview

- 4 HC allows customers to access cash at short notice with a relatively low likelihood of rejection. Regular, affordable repayments are agreed between the customer and the lender's collector, who will call at the customer's home to collect them, making budgeting easier. Together with the knowledge that late or missed payments do not incur additional charges, this can make HC an attractive source of credit, particularly to customers whose access to other forms of credit may be limited.
- 5 There is a clear demand for HC. We were told that around 10 per cent of consumers in Great Britain had used this form of credit at some point in their lives and 5 per cent had done so in the last 12 months. However, APRs for HC are high: we were told that the average figure exceeds 177 per cent.
- 6 Around 500 firms supply HC in the UK, most operating at a local or regional level. Overall, however, the supply of HC in the UK is concentrated, with four firms accounting for nearly 70 per cent of business.

Background to the reference, investigation and consultation

- 7 The OFT's consideration of this market follows a super-complaint made by the National Consumer Council (NCC) on 14 June 2004. A super-complaint is defined under section 11(1) of the Act as a complaint submitted by a designated body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. The NCC's application for designation was being considered by the Secretary of State for Trade and Industry at the time the super-complaint was made. The OFT decided that it was in the interests of consumers to treat the super-complaint as if the NCC had been designated at the time it was submitted.²
- 8 The NCC's super-complaint highlighted the following features of the HC market about which it had concerns:
- little evidence of switching by HC customers, either to different HC suppliers or to other products and providers
 - significant switching costs for HC customers if they wish to change HC supplier
 - information asymmetries which make it difficult for HC consumers accurately to assess the costs of HC or compare them with other types of credit
 - high market concentration which may reduce consumer choice and limit the extent of competition
 - barriers to entry which reduce the likelihood of new lenders joining the market
 - high prices.
- 9 Under section 11(2) of the Act the OFT must, within 90 days after the day on which it receives a super-complaint, publish a response stating how it proposes to deal with the complaint, and what action, if any, it proposes to take. Although at the time it was made the NCC's complaint did not, strictly speaking, fall within the scope of section 11 because the NCC was not yet designated, the OFT considered it appropriate to deal with it within 90 days.

² See OFT press statement of 14 June 2004, at www.offt.gov.uk/News/Press+releases/Statements/2004/Home+collected+credit.htm

- 10 Under section 169 of the Act, before deciding to make a market investigation reference, the OFT must, so far as practicable, consult any person on whose interests a proposed reference is likely to have a substantial impact.
- 11 On receipt of the super-complaint, the OFT invited submissions from interested parties. During the course of investigating the super-complaint the OFT:
- reviewed the evidence on which the super-complaint had been based
 - sent a market questionnaire to the nine largest HC lenders (determined by number of collectors) and, through the HC trade association the Consumer Credit Association (CCA), to approximately 500 other lenders
 - sent a questionnaire on profitability to the nine largest HC lenders – of which seven replied
 - met with five lenders, and the CCA
 - conducted follow-up clarification on profitability and other issues, and
 - met with Citizens Advice.
- 12 Taking into account all the evidence gathered during the course of our investigation, at the end of the 90 day period the OFT took the view that the section 131 test for a market investigation reference to the CC was satisfied. On 10 September, the OFT published its response to the super-complaint.³ Following on from discussions with parties involved in the market during our investigation of the super-complaint, we also published a consultation paper on a market investigation reference to the CC.⁴ Our consultation paper listed (at paragraph 3) and later explained more fully (at paragraphs 8 to 19) the features that we suspected were causing or contributing to a restriction of competition. At the same time we wrote to the members of the CCA, as well as the CCA itself, informing them that the OFT was considering making a reference and asking for comments on this proposal. Taking into account on the one hand the scope and extent of our discussions with the industry in the course of investigating the super-complaint, and on the other the large number of small lenders in the HC market, we allowed a period of five weeks for consultation.
- 13 So far as the issue of high prices raised by the NCC is concerned, the Guidance states that information on pricing and profitability can sometimes be a useful

³ OFT747a *Response to the super-complaint on home credit made by the National Consumer Council*

⁴ OFT747b *Consultation on a market investigation reference on home credit.*

supplement to the OFT's evidence on structural features of a market and on firms' market conduct in deciding whether the section 131 test has been met.⁵ Following the investigation which we conducted in response to the super-complaint, the OFT was not able to reach a definitive view as to whether normal or excess profits were being earned by lenders in the HC market, although our limited analysis indicated that at least some lenders appear to be making substantial profits. Although APRs looked high when compared with other forms of credit, HC lenders told us that the price differential for HC may be accounted for by factors such as the default risk, the nature of the product (unsecured, short term loan with flexible payments), collector network costs, and the lenders' cost of capital. The consultation paper did not, therefore, include pricing or profitability information to supplement the OFT's assessment of the features of the HC market which we suspected were causing or contributing to a restriction of competition.

- 14 In the course of the consultation period, we received written submissions from the five lenders with whom we had already held meetings, the CCA, and a number of other smaller lenders and interested third parties. We also met with three lenders who asked to speak to us in person in addition to submitting a written response.
- 15 In responding to the consultation, lenders generally expressed scepticism about the evidence on which the super-complaint was based. In some instances they presented evidence which, they told us, countered the evidence relied on by the NCC. Their underlying view appears to be that, in the light of their own evidence, there is insufficient basis for the OFT's suspicion that competition in the HC market is restricted. As indicated at various points in the assessment below, we recognise that there is conflicting evidence on some points.
- 16 Some lenders also questioned the validity of some of the survey data that the OFT had considered. One lender, referring to the results it had seen of a survey carried out for the NCC by Leicester City Council, expressed concern that these results appeared to differ from the results that we had seen. In fact we had considered the combined results of an NCC survey carried out in Staffordshire and the survey by Leicester City Council. Thus the results which we considered were from a larger total sample, so may be expected to be slightly more robust.
- 17 Taken as a whole, the evidence presented and representations made during the consultation do not lead us to alter the suspicion expressed in our consultation paper that competition among HC lenders is restricted. Lenders seem to have limited incentive to compete on price or to attempt to win business by taking

⁵ Paragraph 4.5.

over other lenders' loans. The following features of the HC market appear to be causing or contributing to this restriction of competition:

- many HC customers are in a poor bargaining position and their financial need may mean that they are not price-sensitive
- customers may have difficulty comparing loans and do not appear actively to do so
- step-up and 'roll-over' loans may, to the extent that they occur, tend to tie customers in to existing lenders
- collectors' relationships with customers contribute to making them unlikely to switch lenders, and
- aspects of the structure of the market may deter entry on a large scale, although we accept that entry on a small scale is feasible.

Market definition

- 18 In making a market investigation reference to the CC the OFT must specify the goods or services for whose supply or acquisition competition is adversely affected. This will usually involve some consideration of the definition of the relevant market.⁶

Product market

- 19 A product market is typically defined as the smallest group of products for which a small but sustainable increase in price above the competitive level by a hypothetical monopolist would be profitable. Thus if significant numbers of customers would switch to substitutes (known as demand-side substitution), the market definition should be widened to include the substitutes. However, it should be noted that if the current price was already above competitive levels, a price rise might be more likely to induce substitution from other products than if it was not. It would be wrong in this case to argue that these products prevented the undertaking from exercising market power and to include them in the product market.
- 20 Similarly, substitution can also take place by suppliers (known as supply-side substitution). If firms which did not currently supply a product were able to supply it at short notice this would prevent firms charging monopoly prices, so these supply-side substitutes should be included in the market.
- 21 When defining a product market in this way, the OFT will usually consider evidence from a number of sources. In this case, the OFT took into account representations and evidence from lenders and from the NCC. Demand- and supply-side substitution with respect to HC are now considered in turn.

Demand-side substitution

- 22 Some HC customers also use a number of other credit products. For these products to be in the same market as HC there must be a possibility of demand-side substitution influencing the conduct of existing HC suppliers.
- 23 In its super-complaint, the NCC set out a list of distinctive product characteristics which it considered HC consumers look for in credit products:
- trust in and familiarity with the providers, products and procedures
 - simple, straightforward and speedy access

⁶ Guidance, paragraphs 3.7, 4.8–4.12.

- small amounts
- confidence that they will not be refused
- a cash-based system, i.e. not requiring a bank account
- repayment systems that suit household budgeting strategies, e.g. weekly
- repayment discipline – a clear schedule
- flexible repayments
- understanding and recognition of their financial circumstances
- no penalties or charges for default, e.g. for missed payments.

24 A range of other credit products provide amounts that may be comparable with HC loans. These include:

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

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

26 One lender told us that alternative forms of small sum credit, including agency mail order (AMO) and retail credit, have many of the characteristics of HC identified by the NCC. Of these other products, AMO is probably the product closest to HC, in that it also provides for home collection of cash payments on a weekly basis. Consumers enjoy a similar flexibility to vary payments without

incurring extra charges. However, as a source of credit AMO is clearly restricted to the goods on offer in the particular mail order catalogue and, though there is no charge for missed payments, we were told that when customers missed payments on an order, the maximum value of their next order was reduced (whereas paying over say 22 weeks instead of 20 would not be a problem with HC). The closest alternative, AMO, is therefore distinguishable from HC in having less flexibility in terms of missing payments, as well as because customers can only use the credit to purchase goods.

- 27 Some lenders argued that HC customers have easy access to alternative sources of small sum credit, such as credit cards and store cards, and provided the proportions of their customers using these other sources. They argued that these sources therefore exercise a price constraint on the supply of HC. One lender said that it was 'likely that a substantial proportion of HC users able to maintain a regular payment record had made the transition to card based credit'. These lenders did not, however, provide persuasive evidence that customers substitute between these types of lending and HC, rather than using them as complementary sources of credit.
- 28 Furthermore a significant number of HC customers do not have access to such other forms of credit. Some will have exhausted their entitlement and have borrowed as much on, say, credit and store cards as their credit rating will support. Although some 5 million consumers now have basic bank accounts, the evidence we have seen suggests that a significant proportion of HC borrowers are still without a bank account and are restricted to those credit products not requiring an account.
- 29 Products such as credit and store cards, personal loans and overdrafts all involve penalty charges if minimum payments are not made on time or if credit limits are exceeded. Credit and store cards and overdrafts do not provide the borrower with a clear schedule of the repayments needed to pay off the debt within a particular period, nor the total cost of credit for a given purchase. Both the CCA and individual HC lenders have stressed that their product is far more transparent in setting out the total cost of credit than many of the other credit products available to borrowers. They point to the additional charges which users of other products may incur and which are not included within the total cost of credit or the APRs quoted for these products. Examples include charges for missed payments or for exceeded credit limits. Price comparisons between the inclusive price offered by HC and the likely cost of using other credit products are therefore not easily made. We suspect, based on evidence cited by NCC and from comments made in meetings with lenders, that consumers of HC who do have access to these other credit products tend to regard them as

complementary to HC, and use a variety of them to maximise their access to credit.

- 30 One lender said that data on the proportion of HC customers that had chosen a non-HC product for their most recent credit usage constituted evidence of switching between products. We note that, with the exception of home shopping, the alternative credit products chosen were the small sum credit products which this lender had found to have the fewest features in common with HC; that many of those choosing a non-HC product had not considered using HC products; that there were differences in the attributes of credit that were sought by those using HC and those using alternative products; and that different credit types were used for different purchases. These factors imply that non-HC products are not likely to be readily substituted for HC products.
- 31 We were also told that customers considered a wide range of credit options for their most recent credit product. Whether customers considered alternative products does not, however, indicate either the extent to which these products were suitable for substitution, or whether and in what circumstances customers would actually switch to them.
- 32 Overall the OFT is not persuaded that the other forms of small sum credit identified by lenders are sufficiently substitutable to be included in the same market as HC. We doubt that there is sufficient functional similarity between HC and the other credit products available to many HC customers that substitution from other credit products will constrain the price of HC credit. More comprehensive evidence from consumer surveys would be needed to reach a firmer conclusion.

Supply-side substitution

- 33 The question here is whether suppliers of the other products would switch to supplying HC. The timeframe for this is the short run (for example, within one year), whereas new entry into the market occurs over a longer timescale.
- 34 AMO is the closest product to HC in terms of supply as well as demand. Both products require a network of locally-based collectors able to collect relatively small sums in cash on a weekly basis. To support these collectors, both AMO and HC require a network of local or regional offices.
- 35 While a number of non-HC lenders have moved into other forms of small sum credit, there is no indication that they intend to go as far as offering weekly home cash collection. Moreover, many of the existing HC lenders told us that they have moved the other way, diversifying into other forms of small sum

credit. Some had done so in order to take advantage of the increased penetration of bank accounts, to launch credit products which did not involve weekly home cash collection. Indeed, we are aware of at least one CCA member who has ceased weekly cash collections entirely, and lends exclusively to consumers with bank accounts from which payments are collected direct.

- 36 The prospects for supply-side substitution appear relatively limited and do not demonstrate that the market should be defined more widely than HC.

Geographic market

- 37 As with the product market, the objective in defining the geographic market is to identify substitutes which are sufficiently close geographically that they would prevent a 'hypothetical monopolist' in one area from charging supra-competitive prices.

- 38 Home credit is essentially locally based, with collectors providing the contact with the customer. There are limits in terms of the maximum area and minimum customer density which can be handled by one collector if that collector is to earn an acceptable level of remuneration. A large proportion of business is reported to come from word-of-mouth recommendations. A few large lenders operate nationally or over several regions.

- 39 We found no evidence of significant price differentiation either by region or in relation to the degree of competition locally. This might suggest that the relevant geographic market is the UK. However, since collectors conduct business in the customer's home, it seems likely that competition for an individual customer takes place on a local basis, and this suggests that HC may be supplied in localised geographic markets. One HC lender stated that it believed the geographic market for HC was localised. We have not drawn any firm conclusions as to the relevant geographic market for HC.⁷ Our analysis of the features of the market suggests that they are prevalent throughout the UK, whether the relevant geographic market is defined narrowly (local markets) or widely (the whole of the UK).

⁷ Paragraph 4.8 of the Guidance notes that the OFT will give some consideration to the definition of the relevant market. We do not believe that it is necessary for us to come to a firm conclusion on this point.

Features of the market that prevent, restrict or distort competition

- 40 The OFT has reasonable grounds for suspecting that there are particular features that prevent, restrict or distort competition in the market for the supply of HC. This section describes these features and the reasons for our concerns. In doing so we summarise the main points made in respect of each of them by those we consulted, and our responses to their points. At the end of this section we comment on points made by those we consulted relating to the more general issue of switching and the state of competition.

Customers' circumstances

- 41 Customers in the market for HC are generally in a poor bargaining position due to the high perceived risk that they will default on payments, the shortage of alternative sources of credit and their frequently difficult circumstances and pressing need for a loan. Factors such as the amount borrowed, amount of the weekly repayment, flexibility on repayments and rapid availability of the loan may take precedence in the eyes of the customer over the loan's overall cost. This may result in a tendency for customers to make decisions on any particular loan they are offered according to whether their need outweighs the costs and whether they can afford the weekly repayment, rather than whether it represents good value in comparison with other loans.
- 42 In responding to our consultation paper, lenders suggested to us that the factors relating to HC customers' poor bargaining position and lack of price sensitivity were 'facts of life'. In other words, it was a fact of life that some HC customers had pressing financial needs, a shortage of alternative sources of credit and might be at a high perceived risk of default. If these factors might mean that such customers did have a poor bargaining position that was not a failure of competition in the market. We suspect, however, that these factors impact upon the conduct of customers and, as such, may be features of the market that contribute to preventing, restricting or distorting competition. Lenders did not generally address how these factors might interact with other market features and affect competition.
- 43 One lender told us that a survey of its customers had found that a large number of customers who had recently purchased HC claimed that their choice of credit would have been different if the price had been higher. We are sceptical about the extent to which this indicates that HC customers could and would switch, either to other HC lenders or to other forms of credit. Customers responding to a survey might be expected to say that they would switch in order to appear to be making an intelligent response – they might not actually do what they say they would do; many of those who said they would switch had no specific

product in mind; and if prices were above competitive levels to begin with, price rises might be expected to bring about higher levels of switching than if they were not.

- 44 We were also told that loans from alternative HC lenders, as well as other forms of credit, were available to HC customers, who were therefore not in such a poor bargaining position. We accept that many HC customers believe they could change HC lender (although, as we note later in relation to switching at paragraph 78, we were not persuaded by the evidence on the extent to which they do this); however a significant number of HC customers do not have access to alternative forms of credit (see paragraph 28 above).

Customers' difficulty in comparing loans

- 45 HC customers do not appear to be active in comparing the prices and other terms on which credit is supplied by different lenders. We recognise that this may, at least partly, reflect high levels of satisfaction with the quality of service provided by HC lenders generally. Customers seem to appreciate: the convenience of borrowing from HC lenders who are seen as friendly, understanding and helpful; the balance of flexibility and discipline on repayments; the relatively low likelihood of being turned down; the agreed end-date for repayments; the discouragement to over-borrowing from lending only the amount requested or less; the relative lack of paperwork; and the regular, reliable collection service. However, we are concerned that the difficulties customers may face in comparing HC loans may reduce the incentives for the different providers to compete.
- 46 In theory the APR can be used as a measure for comparing the cost of different forms of credit. It was put to us that the HC product is transparent: agreements show the APR; existing customers will have seen APRs previously; APRs are on some company websites and are available from call centres; written quotations are available on request; and all customers have cancellation rights. The extent to which making APRs available in these ways makes HC terms transparent to customers is, however, uncertain. HC customers may not see the APR until they have the credit agreement and are on the point of signing. Customers may in any case not understand APRs and may be largely unaware of current APRs for other types of loan. HC lenders have pointed out that there are no hidden penalties in HC lending and missed payments do not incur charges. These extra costs are included in the cost of HC and are therefore reflected in the HC APR, whereas APRs on other forms of credit generally omit such charges. HC lenders have told us that this means that customers who look only at the APR may not be comparing like with like. We note this point, but consider that it supports the

view that customers have difficulty comparing the cost of HC loans with that of other forms of credit.

- 47 Apart from APRs, customers could also in theory use the total amount payable to compare the prices of different HC loans. Lenders responding to our consultation said that HC customers do not have difficulty in assessing the relative costs of different loans. We were told that while customers do not tend to compare APRs, they do compare the total cost of the loan, as well as the loan term and the size of weekly repayments, between lenders. In our view, customers can, however, only use the total amount payable to compare the prices of different HC loans directly where the amount borrowed and the loan term are the same. Since there is no standardisation of loan terms between lenders, and competing loans being considered by a customer may therefore have different terms, such comparisons are often not possible in practice.
- 48 Some lenders said that (high) HC APRs are not a good comparator with mail order or bank loans which might actually be more expensive (but look cheaper). It was also suggested that the APR does not sensibly measure very small differences in price for short term loans, with small increments in weekly repayments producing large differences in APR. As we have indicated, we acknowledge the potential deficiencies of APRs as a measure in the HC market, but remain concerned about the extent of customers' difficulties in drawing comparisons between different HC loans.
- 49 It was also put to us that the Consumer Credit (Disclosure of Information) Regulations 2004, which come into force on 31 May 2005, will require the disclosure to customers of prescribed information, including the APR, before a regulated agreement is made. We acknowledge that customers will be given this prescribed information. However, there will be no requirement to give this information to the customer before the unexecuted agreement is handed over, or 'in good time' (as with distance sales), and the APR will be of equal prominence to other prescribed information. Thus, while the Regulations will improve transparency of terms generally, they do not provide certainty that a customer will focus sufficiently on the APR before entering the agreement.
- 50 Lenders also said that Ministers had described new rules on the calculation of rebates in the event of the customer settling the loan early, to be introduced from 31 May 2005 under the Consumer Credit (Early Settlement) Regulations 2004, as being intended to improve the switching process. These Regulations will replace the current method of calculating rebates on early settlement (known as the Rule of 78) with an actuarial method. They will also prevent lenders from deferring the period over which the rebate on early settlement is calculated by longer than one month. These changes will benefit consumers generally, but it

is unclear what impact they will have on HC loans, particularly if lenders currently offer more generous rebates than required by law. The settlement date will generally be 28 days following receipt of the borrower's notice to settle, and this will not be reduced for short-term loans, so switching will not be cost-free.

- 51 Collectively, the aspects of consumer conduct described above seem likely to inhibit their propensity to switch between lenders. Furthermore, we have identified several features of supplier conduct that appear to inhibit customers from switching suppliers.

Step up and roll-over loans

- 52 Step-up loans, whereby HC suppliers lend small amounts to new customers and make larger amounts available once customers prove themselves reliable with repayments, are standard practice in the HC market. This means that switching to a new lender can require starting with small amounts again unless the new lender accepts payment books for previous HC loans as evidence of a customer's repayment history.

- 53 Some lenders have told us that they accept other lenders' payment books as evidence of creditworthiness, and we were provided with some evidence to this effect. On the basis of this information we accept that the degree to which step-up loans tie customers in to particular lenders may be less than we considered in our consultation paper. However, it seems likely that step-up loans are still widely used to establish creditworthiness. To the extent that they are used, we suspect that they are a feature that increases the propensity for customers to maintain a relationship with their current HC lender or lenders, rather than switching to a new HC lender or lenders. Lenders told us that step-up loans were common in different forms of lending and constituted a responsible practice. Step-up loans were also defended as enabling lenders to extend credit to more customers and at lower interest rates than if lenders did not use them to assess creditworthiness. In a market where creditworthiness is difficult to establish, step-up loans may be a sensible way for lenders to minimise their own risk, and may also contribute to responsible lending. However, this does not alter our view that lending on this basis tends to tie customers in to their existing lender.

- 54 'Roll-over' loans, whereby customers take out further loans with the same lender before fully repaying their current loan, are used by lenders in the HC market. Some lenders have questioned the extent to which HC loans are rolled over. One lender told us that 78 per cent of its customers do not roll loans over. Nevertheless, to the extent that they occur, roll-over loans will tie customers in to the same lender for a longer period. In our view this is a feature that may

inhibit customer switching. To the extent that this makes it easier for customers to accept new loans or roll over existing loans with the same lender than to go elsewhere, and likely that they will do so, this entrenches borrowing from the current lender.

- 55 It was put to us that roll-over loans allow customers to access additional credit over a longer period without increasing the level of weekly repayments. This is a factor for the CC to take into account in considering remedies if it finds there is an adverse effect on competition, but does not affect our suspicion that roll-over loans are a feature of the HC market that contributes to a restriction of competition.
- 56 It was said that step-up and roll-over loans do not tie a customer in to a particular lender because HC customers do not 'switch' between lenders, but have lines of credit with multiple lenders (between whom they select a lender for a particular loan). We found, however, that the proportions of individual companies' HC customers who also use other HC providers were not particularly high. Furthermore, where HC customers do have lines of credit with multiple lenders, step-up and roll-over loans may still tend to tie the customer to those lenders.

Collectors' relationships with customers

- 57 Switching may also be made less likely by the use of collectors to market HC loans and collect repayments. We were told that a significant proportion of collectors operating in the market are self-employed, and are paid on a commission basis calculated as a percentage of the money they collect from customers. It is possible that the nature of the relationship between collectors and customers creates a feeling of obligation on the part of customers to those who collect repayments from them. Customers will be aware that collectors can allow extra time to make repayments, and may wish not to do anything which might jeopardise a potential source of credit for the future.
- 58 Lenders responding to our consultation pointed to various potential benefits of home collection, such as helping with payment discipline or assessing ability to repay loans. While recognising that this service offers some benefits and is appreciated by customers, these points do not allay concerns about the potential effect on competition of collectors' relationships with customers.
- 59 It was also said that permission to miss repayments is a feature of the market as a whole, so that there would be no obligation to individual collectors. We think that it may not be clear to some customers that this facility would be available with all lenders. In any event, we understand that individual collectors have

significant freedom to decide whether to lend and how much a customer can borrow, and that collectors negotiate with customers on missed repayments.

- 60 We were told that relationships with collectors do not tie customers to particular lenders, as customers choose between lenders for their credit requirements all the time and typically have relationships with a number of collectors representing different lenders. However, if this were the case it would nevertheless remain possible for customers to feel an obligation to collectors (whether to one or to more than one).
- 61 It was also said that in maintaining long-term relationships with customers it would not be in the interest of the collector or lender to threaten not to extend credit because a customer had entered into a credit arrangement with another lender. This may be true once a loan with another lender has been started, but it could be in the interests of a collector to seek to deter other arrangements beforehand.
- 62 In response to our view that customers' relationships with collectors impede switching, one lender cited its own research which, it said, suggested that over two thirds of its customers would remain with it if its collectors moved to another lender. (This also suggests, however, that up to one third of that lender's customers would be loyal to the collector rather than the lender.) Seemingly in contradiction to the argument that customers' relationships with collectors do not affect their choice of lender, another lender told us that HC customers *are* likely to switch lenders if their collector moves to another lender or they fall out with their collector. It seems, in any event, that customers' relationships with collectors are a factor in choice of lender. This may constrain switching, and may also mean that some switching takes place because of relationships with collectors, rather than in order to attain better terms, and so might not be expected to promote competition between lenders to provide better terms.

Structure of the market

- 63 HC in the UK shows high and increasing concentration which is likely to restrict customer choice. The four largest lenders have a combined share of 69 per cent of outstanding HC balances in the UK (up from 60 per cent five years ago). The largest lender alone accounts for 49 per cent of the total UK HC balances. Over the last decade there has been a gradual decrease in the number of smaller HC lenders in the UK, with the largest lenders all expanding their business via acquisition. Some small lenders who responded to our questionnaire told us that they were willing to sell their loan books in order gradually to wind down their business and exit from the market, but that the larger lenders' interest in

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

- 64 Regulatory barriers – the requirements on licensing and terms of agreements under the Consumer Credit Act 1974 – are perceived to be low. The legislation in this area is likely to be changed, with the planned introduction of a Consumer Credit Bill. However, it seems unlikely that this will make entry to the HC market significantly more difficult.
- 65 In terms of other possible entry barriers, we were told by four of the five largest lenders and a substantial proportion of the small lenders who responded to the general questionnaire which we sent to lenders when investigating the super-complaint that 'word-of-mouth recommendations from existing customers' were the most important method of attracting new customers. This could affect a new entrant's ability to win customers, although we were also told that it was possible to gain new business by having collectors knock on doors. One entrant told us that it had built its business on this approach, although we understand that it had also expanded by acquisition.
- 66 The larger lenders' investment in networks of branches and collectors appears to be significant, and in our consultation paper we concluded that it could take an entrant time to replicate this. Furthermore, any entrant would also have a higher bad debt risk than an existing market player.
- 67 However, all of the lenders who commented on barriers to entry in response to our consultation regarded them as being very low. It was suggested to us that, if personal recommendation was the only way in which to enter this market on a larger scale basis, those lenders that had entered the market would have been unable to do so, as they had no customers who could recommend other customers to them.
- 68 We are aware of two significant (though small by comparison with the four largest lenders) entrants since 1994, and we have anecdotal accounts of other market entry by smaller players. Accordingly, we see some strength in lenders' views that barriers to entry are lower than in many other markets, and we accept, in the light of our consultation, that entry on a small scale is feasible.
- 69 [...]
- 70 One lender questioned the reduction in the number of sole traders in recent years that we cited in our consultation paper. It said that this was difficult to assess

and that CCA membership was not an adequate source of data as membership was not compulsory. We take the view, however, that changes among CCA members might reasonably be expected to be representative of changes in the number of lenders operating in the industry as a whole.

- 71 We were also told that the level of concentration is not restricting competition as there remain a large number of HC lenders. While we recognise that the number of firms in the market is large, this does not alter our suspicion that competition, and in particular price competition, is restricted by the aspects of the market discussed above.

Switching and the state of competition

- 72 During our investigation and our consultation with lenders we were told that the characteristics of HC appreciated by customers (set out at paragraph 45 above) include some that suggest that lenders compete on quality. It was said that customers compare loans on the basis of a number of factors other than price, including convenience, flexibility, privacy and lack of social stigma. It was also said that customers might not switch to lower price alternatives if they were happy with service aspects of their existing lender (and customer satisfaction ratings are indeed very high) as service factors are important to customers and they would not know the level of service of a new lender. While acknowledging that the service elements of HC are highly valued by customers, we have seen very little evidence from lenders to suggest that they compete on price, or sufficient evidence to enable us to test lenders' assertion that they compete on the service elements listed above.
- 73 In addition, we think that there are limited incentives for lenders to compete on price. Indeed, a number of lenders told us they did not take others' prices into account when deciding rates and did not attempt to win business by taking over other lenders' loans.
- 74 One lender told us that it did aim to take over other lenders' loans, and had an aggressive policy of targeting new customers, which had resulted in a high incidence of borrowers switching to it from other lenders. It told us that customers would use a loan from it to redeem another lender's loan, and showed us a few instances of payment books of other lenders which showed that it had taken over the existing loan. It is, however, not clear to us whether such commercial strategies are widespread in the market.
- 75 Another lender told us that 'other lenders were always offering their products to [its customers] and [it] believed that its competitors had quite focused marketing strategies'. However, it added that customers were mainly interested in the

affordability of the weekly repayment, rather than the overall cost of the loan. The latter point tends to support the point made in paragraph 41 above that customers may decide on loans according to factors such as weekly affordability and whether the benefits to them outweigh the costs, rather than whether they represent good value in comparison with other loans.

- 76 One lender said that HC consumers typically have loans with more than one lender in order to maximise their lines of credit, and choose between them on the basis of price and service rather than 'switching' from one lender to another. As noted at paragraph 56 above, we found that the proportions of individual lenders' HC customers who currently also use other HC lenders were not particularly high. It should also be noted that whether customers have multiple lenders is not necessarily a guide to the extent to which they switch between them to obtain a better deal on price or service.
- 77 Another lender told us that HC customers often play collectors off against each other. They might do this not just on price but also on repayment terms, speed of granting a loan and the amount lent. Customers would aim to keep two lenders happy, so that if they had a problem with one, they could use the other. This lender noted that it had to be competitive on the amount lent, but said this was not the main competitive factor. This lender did not, however, provide evidence to support its assertion that customers play collectors off on price and other terms. If customers aim to keep more than one lender happy to maximise availability of credit, this tends to support the view that loans from different lenders may be viewed as complements rather than as substitutes (so that lenders seek to expand the market rather than compete). Without pro-active switching between lenders to obtain better terms, pressure might not be exerted on the prices charged.
- 78 Various assertions were made by lenders about switching rates. In our view, however, lenders' evidence and representations on switching did not generally comprise persuasive evidence of switching, much less of pro-active switching to obtain better terms.
- 79 One lender told us that rates of switching between HC lenders should be compared with low rates of switching in banking and credit cards. In our view, however, such comparisons would be of limited value, as switching rates and competitive constraints on prices will vary across markets for a variety of reasons.
- 80 One lender asserted that profit margins in the HC sector are low and that this is an indication that the market is competitive. The limited analysis of profitability

which we have carried out indicates, however, that at least some lenders appear to be making substantial profits.

Appropriateness, proportionality and remedies

- 81 In the Guidance the OFT says that it will exercise its discretion to make references to the CC when the reference test set out in section 131 of the Act and, in its view, each of the following criteria, has been met:
- it would not be more appropriate to deal with the competition issues identified by applying the Competition Act 1998 (CA98) or using other powers available to the OFT
 - it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference
 - the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it, and
 - there is a reasonable chance that appropriate remedies will be available.⁸

Appropriateness of a reference

- 82 The Guidance states that, when dealing with a suspected competition problem, the OFT will only consider a reference to the CC in one of two circumstances: first, when it has reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition but not to establish a breach of the CA98 prohibitions, or secondly when action under CA98 has been or is likely to be ineffective for dealing with the adverse effect on competition identified.⁹
- 83 We have found no evidence of any agreements that could be addressed by action under either the Chapter I prohibition in CA98 or Article 81 of the EC Treaty on the basis that they might prevent, restrict or distort competition in this market. The features which we suspect are preventing, restricting or distorting competition in the HC market include aspects of the structure of the market and of the conduct of customers, as well as of suppliers' conduct. The supplier conduct features appear to be prevalent throughout the HC market and to be unrelated to the market power of individual lenders. Consequently we do not believe that enforcement action against individual market players and, in particular, the largest HC lender, under Chapter II of CA98 or Article 82 of the EC Treaty (abuse of dominance) would be appropriate or effective in addressing the features which we suspect prevent, restrict or distort competition.

⁸ Paragraph 2.1.

⁹ Paragraph 2.3.

- 84 We consider that other powers available to the OFT would not adequately address the competition issues we have identified. Other possible OFT action includes an OFT market study, enforcement action under consumer legislation, and consumer education. While an OFT market study could be used to collect more information that would be needed to test the OFT's suspicions as to the level of competition in this market, the OFT has concluded that a CC reference would be more appropriate at this point. If an OFT market study confirmed the concerns about the operation of the market discussed in this paper, the OFT's powers to put in place the kind of remedies which would be likely to be necessary would be limited. The CC has substantive powers to seek undertakings and make Orders that are binding on undertakings operating in a market. In any event, where the test for a market investigation reference under section 131 has been satisfied, and there is a reasonable chance that appropriate remedies will be available to the CC, we consider that a market investigation reference is more appropriate than conducting a market study.
- 85 In paragraphs 18-19 of the response to the super-complaint we said that we would consider enforcement action and consumer education. We will continue to take enforcement action, when merited, in response to any consumer complaints received. In terms of consumer education, we have recently launched a campaign on credit, in the course of which we referred to home credit, and we plan to publish information on aspects of the new consumer credit regulations. These actions on their own will not, however, address all the features we have identified that we suspect prevent, restrict or distort competition. Therefore a market investigation reference is the most appropriate response.
- 86 The OFT has a power under section 154 of the Act to accept undertakings in lieu of a market investigation reference to the CC (UIL). In considering whether to exercise its discretion to accept UIL, the OFT must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned and to any detrimental effects on customers so far as they result from the adverse effect on competition.¹⁰
- 87 The Guidance considers the circumstances in which it is likely that UIL will be accepted by the OFT. As the Guidance states, undertakings in lieu of a reference are unlikely to be common.¹¹ In many cases the OFT will not have done a sufficiently detailed investigation of a competition problem, prior to making a reference to the CC, to be able to judge with any certainty whether particular undertakings will achieve as comprehensive a solution as is reasonable and practicable. This is particularly likely to be the case when the adverse effect

¹⁰ Section 154(3) of the Act.

¹¹ Paragraph 2.21.

on competition arises from market features involving several firms or industry-wide practices. Moreover, trying to negotiate undertakings with several parties, in circumstances in which the possible adverse effect on competition has not been comprehensively analysed, is likely to pose serious practical difficulties.

88 [...]]

89 [...] Although we have reasonable grounds to suspect that competition in the HC market is restricted, we are not sufficiently certain that it is restricted, of the extent to which it is restricted, or that we have identified all the features that alone or in combination produce any restriction of competition to be able to judge sufficiently either the extent to which UIL are necessary or the precise form any UIL should take. In addition, even if there were sufficient certainty on these points, given the industry-wide nature of these features and the number of parties involved it is not clear to us that sufficient consensus on any UIL could be reached.

90 We are therefore unable to judge whether particular UIL would achieve as comprehensive a solution as is reasonable and practicable to address the adverse effect on competition that we suspect exists and any detrimental effects on customers that result from this adverse effect.

91 In these circumstances it is more appropriate for the CC to consider remedies if it finds there is an adverse effect on competition, in the light of its much fuller investigation following a market investigation reference, rather than the OFT endeavouring to negotiate UIL.

Proportionality

92 The Guidance identifies three factors as relevant to whether an adverse effect on competition is significant, and thus whether a reference to the CC is appropriate, and these three criteria are met by the market for the supply of HC.¹² Firstly, the size of the market is significant, estimated at approximately £2bn per year in outstanding balances. Secondly, a significant proportion of the market is affected by the features that prevent, restrict or distort competition, which appear to be prevalent throughout the UK, as is suggested by national pricing, the low levels of switching and the nature of these features. Thirdly, the features identified as adversely affecting competition are unlikely to be short-lived. While the HC market is said by some parties to be in decline, some of the parties appear to be making substantial profits and there is evidence of some market entry by smaller players.

¹² Paragraph 2.28.

- 93 The OFT has considered the possibility that the concerns which it has identified might be mitigated as a consequence of changes in the market which might be brought about by the proposed revisions to consumer credit legislation, thus making the kind of remedies which might follow a CC investigation redundant. We take the view, however, that the nature of the features of the market in question is such that they are not likely to be significantly affected by the proposed legislative requirements.

Remedies

- 94 If the CC decides that there is an adverse effect on competition it must take action to 'remedy, mitigate or prevent' the adverse effect on competition and to 'remedy, mitigate or prevent any detrimental effects on customers' so far as those effects have resulted from the adverse effect.¹³ In order to achieve that, the CC may accept undertakings from appropriate persons or may make an Order under section 161 of the Act. Such an Order may contain anything permitted under Schedule 8 of the Act, as well as supplemental provisions. Schedule 8 provides the CC with wide-ranging powers falling within the following general areas: general restrictions on conduct, general obligations to be performed, acquisitions and divisions, and the supply and publication of information.
- 95 The OFT therefore believes there is a reasonable chance that the wide range of remedial powers available to the CC, with or without any 'supplementary consequential or incidental provisions' will allow the CC to put in place appropriate remedies to the range of concerns raised, in the event that it finds there is an adverse effect on competition. The extensive powers available to the CC, we believe, provide the best means of remedying any adverse effect on competition, and any detrimental effects on customers, and of making the supply of HC work better.

¹³ Section 138 of the Act.

Conclusion

- 96 HC is a significant market which meets a demand from consumers. We recognise that there are strongly held views about the market, exemplified on the one hand by the NCC super-complaint, which gave rise to the investigation and decision to make a reference to the CC, and on the other by the response from the industry to the super-complaint and to our consultation. In spite of this difference of opinion, and conflicting evidence on some points, we remain of the view that the test for a reference to the CC has been met. We believe that a reference to the CC is the most appropriate step to ensure both that this market is investigated with the thoroughness we believe is needed to come to a definitive view and – in the event of an adverse finding – that appropriate remedies are put in place.
- 97 Following the consultation carried out in accordance with section 169 of the Act, the OFT has therefore decided to make a market investigation reference to the CC under section 131 of the Act.