7. Conclusions

Introduction

7.1. In this section we summarize the key elements of our findings and seek to explain them.

7.2. We found in Section 3 that:

- The prices of most home credit products are high by comparison with alternative forms of credit and higher than in a broadly comparable overseas market, and are perceived to be high by many customers and observers.
- The price paid by customers when they repay loans early, including when they renew loans, is high, as a result of the low level of rebates paid when loans are settled early.
- Profits substantially in excess of the typical cost of capital for a large home credit lender have been persistently earned by firms that represent a substantial part of the market.
- It is not clear that costs are higher than they would be in a competitive market.
- Most customers are satisfied with the service they receive from home credit lenders and agents.
- Levels of customer switching are not high.
- There has been some innovation, both of products and processes, in recent years.

7.3. We found in Section 4 that the constraint on home credit pricing, both from alternative and from mainstream credit products, is weak on both the demand and the supply side. We therefore concluded that home credit is the relevant product market for the purpose of analysing market features.

7.4. We found in Section 5 that although entry on a small scale is possible, there are substantial barriers to entry on a larger scale, and to rapid expansion by existing lenders. We also found that to the extent that entry has taken place recently, it does not appear to have affected the behaviour of incumbents or their profitability. We concluded that neither new entry nor expansion (or the threat of it) constrain lenders' prices or other behaviour to a significant degree.

7.5. We found in Section 6 that price competition is weak. We found that competition focused on availability of credit, a form of competition in which incumbents hold substantial advantages. And we found no other dimension of competition which appeared to compensate for the weakness of price competition.

7.6. A number of common factors emerged in the course of our analysis which gave rise to these conclusions. In this section we seek to draw these together and to use them to explain why, in our view, this market is not as competitive as we might expect, allowing prices to remain at their current high levels. Two key themes emerge from our analysis.

7.7. First, we found that price competition among home credit lenders is weak. We consider that this arises because of the insensitivity of customers to price and the limited incentive for lenders to compete on price. We summarize our conclusions on this in paragraphs 7.13 to 7.18.

7.8. Second, we found that there are substantial incumbency advantages for established lenders which confer on them a measure of market power in respect of their existing customers.

7.9. Incumbency advantages of this kind exist in many markets, at least on a temporary basis. But we might normally expect them to be broken down over time. In this case, we found three factors which serve to inhibit the breaking down of these incumbency advantages:

- the absence of data sharing among most home credit lenders;
- the importance which customers attach to a relationship with an agent; and
- the regulatory restriction on canvassing.

7.10. In addition, we might normally expect price competition to break down these incumbency advantages over time. However, where price competition is weak, incumbency advantages can persist and high prices can be sustained.

7.11. We discuss these themes more in paragraphs 7.19 to 7.32. Section 8 then identifies which of these factors we have found we consider to be features within the meaning of section 131 of the Act.

Pattern of demand

7.12. We consider that the context for our findings is set by the patterns of demand described in Sections 2 and 4. Some home credit customers (those without a credit record or reliable access to other forms of credit) have limited access to other sources of credit (see paragraphs 2.111 to 2.115). For other customers the absence of realistic alternative sources of credit is, to a greater degree, a matter of their own choice. Although other sources of credit are available to them, they choose to use home credit for some or all of their needs. There might be a variety of reasons for the latter group's choice; some are elaborated in paragraphs 6.62 to 6.69. Regardless of the reasons for it, customers' requirement for a cash loan product offered on terms which do not penalize missed or late payment, and for the discipline of having repayments collected by an agent visiting weekly, both insulates home credit from competitive pressure from other forms of lending (see Section 4) and creates the background for competition between home credit providers.

Weakness of price competition

7.13. We found (in paragraph 6.36) weak price competition. We consider that two factors give rise to the weakness of price competition.

Customers' attitude to price

7.14. We were told that home credit customers are financially astute, and we agree that customers on low incomes have strong incentives to pay close attention to their financial affairs. Yet we have observed a very low degree of sensitivity to changes in

price as measured by APR or TCC (see paragraphs 4.94 to 4.105). We found that in practice, home credit customers appear to pay most attention first to the availability, and then to the affordability, of the credit; that is, to the level of the weekly payment, and less to measures of value of the loan they are taking out (such as the APR or TCC). In practice, we found that customers appeared largely insensitive to changes or differences in the price of home credit loans expressed in these terms (and many thought, erroneously, that all lenders' prices were the same—see paragraph 6.77). We could not be sure whether customers would be at all sensitive to the level of ESR, but found it unlikely that they would be sensitive to it at the point of initial purchase (see paragraphs 6.171 to 6.179).

7.15. We consider that customers' observed insensitivity to price changes is reinforced by their difficulty in assessing and comparing prices. There are several factors which contribute to this difficulty:

- It is not always easy for customers to find out prices of competing products (see paragraphs 6.77 and 6.78). We heard evidence that while some lenders publish their prices and others quote them willingly, in some cases prices are only communicated to customers by an agent visiting the customer's home.

- Products are not readily comparable. Lenders do not offer loans on terms which make their prices easy to compare (see paragraphs 6.73 to 6.76), especially given that the APR is an imperfect basis for comparison. Loans are frequently offered for repayment over similar but not identical periods. We consider it difficult for customers to compare prices effectively in such circumstances.

- The price and value of financial service products are notoriously difficult to understand (see paragraphs 6.70 to 6.72). We have no reason to suppose that home credit customers are more or less able than the population as a whole to assess these issues. However, the APR is a particularly difficult measure to interpret, and may be more so in the context of home credit, where APRs are often very high and are not a good basis for comparison of loans.

- The advertising regulations may discourage direct price comparison in advertising. They require the use in advertisements of APR, which appears high for many home credit products, but is a poor measure of the cost of a home credit loan and not generally one which customers understand or value. We might expect this to discourage lenders from using price comparisons in advertising (though we did not find—see paragraph 6.78—that this effect was in itself very significant).

Lenders' incentives to compete

7.16. In the light of this, the fact that lenders do not appear to compete on price does not appear irrational. The incentive to compete for new customers is muted in this market by the risk of adverse selection—of attracting bad customers who will default on loans (see paragraphs 5.28 and 6.87). There is even more limited incentive to compete on prices where:

- it is possible to compete on availability, because that appears more important to customers than headline price (see paragraphs 6.89 to 6.94);

- there can be no certainty that lowering prices will attract good customers, because customers do not appear sensitive to price reductions (see paragraph 6.84);

- customers may be expected to be particularly insensitive to aspects of price other than the headline price level; this might be the case, for example, for ESRs, which might not be a feature to which customers are sensitive (see paragraphs 6.171 to 6.179); and

- in the absence of differentiated prices, lowering prices would reduce revenue from existing profitable customers (see paragraph 6.87).

7.17. Nevertheless, we found it striking that there was so little evidence of price competition of any kind; not only no lowering of headline prices, but no differentiation of prices, discounting or offering higher rebates (see paragraph 6.51). Any of these might be attempted as a means of keeping customers who might defect or of attracting new ones.

7.18. We consider that the insensitivity of customers to price contributes, alongside the factors set out above, to the lack of price competition on the part of lenders (by reducing their incentives to compete on price). We also consider that the absence of price competition on the part of lenders contributes to the price insensitivity of customers (by denying them the opportunity to respond to price reductions). The two factors might be expected to reinforce one another.

Incumbency advantage

7.19. We indicated in paragraph 6.89 that since price competition is weak, the competition we have observed appears to be to lend more to good customers when they need it (which we termed 'competition on availability'). This is a form of competition in which incumbents have a significant advantage over other lenders (see paragraph 6.95). We consider that incumbency advantage derives in large part from shortfalls of information which inhibit these lenders which do not have a relationship with a customer (whether they are existing or new home credit lenders, or providers of other forms of credit) from competing for that customer's business.

Information shortfalls

7.20. We identified (in Section 6) shortfalls in the information which is desirable for establishing a borrowing relationship. These have effects both from the perspective of a customer and of a lender.

7.21. First, a customer without a portable credit record cannot credibly demonstrate creditworthiness to any potential lender with whom he does not have a relationship, without taking the time to build such a relationship and demonstrate creditworthiness through a series of loans over time. This reduces a customer's ability and incentive to seek alternative sources of credit at the point at which the customer might be seeking to switch (thus erecting a barrier to switching), and inhibits other lenders from competing for the business of a customer of whose creditworthiness they cannot be confident. This inhibition applies to other home credit lenders, to prospective entrants and to providers of other forms of credit. Thus it substantially reduces the competitive pressure on incumbent lenders which might otherwise exist from customers switching, or threatening to switch, to lower-priced alternatives (we noted the reluctance of customers to switch to other forms of credit in Section 4 and the persistence of price differentials among home credit lenders without evidence of significant switching between them in Section 6).

7.22. Second, a lender with whom the customer does have a relationship has more, better information about a customer than one with whom he or she does not (see paragraphs 6.96 to 6.99). This means that an incumbent lender can lend more (because of the lender's knowledge of the customer's creditworthiness—see paragraphs 6.103 to 6.109) to an existing customer than any other lender could. An incumbent lender can also lend more readily (because of the point-of-sale advantages identified in paragraphs 6.100 to 6.102) than any other lender. This also makes customers potentially more profitable to an existing lender than to a new one (see paragraph 6.136), increasing the incumbent lender's incentive to keep them.

7.23. We consider that in practice the effect of these information shortfalls is that once a customer has a loan with one lender, that customer will be more likely to borrow from that lender than to switch to another, even if the other offers better prices. The existing lender has a stronger incentive and more ability to lend to that customer than any other (see paragraphs 6.132 to 6.137), and the customer can borrow more, more readily from that lender than from any other (see paragraph 6.139). We consider that while the practice of multi-sourcing may reduce the impact of these advantages somewhat in respect of some of the customers who multi-source, it does not invalidate them (see paragraphs 6.125 to 6.131).

7.24. These information shortfalls persist in part because of three factors which make them difficult to break down.

Absence of data sharing

7.25. The first factor is the absence of sharing of data on customers' creditworthiness. Data on customers' creditworthiness is not available to lenders other than through direct experience of their payment patterns. If it were, the information shortfalls could be expected to become less significant. The risk for a lender that customers, whose payment records are as yet unknown, would default on loans would reduce. Thus the imbalance of risk faced by a new lender by comparison with an incumbent would also be reduced, and incumbency advantage could be more easily overcome (see paragraphs 6.110 and 6.111).

7.26. However, we found that lenders do not share data. This appears to us to be unusual; in most other credit markets lenders share data on customers' creditworthiness, and appear to gain benefits from doing so.[1] We identified that the lack of data sharing limits access to home credit customers by providers of other credit products (see paragraph 4.72), acts as a barrier to entry (see paragraph 5.30) and reinforces the advantages enjoyed by incumbents over other home credit lenders (see paragraph 6.114).

7.27. We consider that the reasons why lenders do not share data are peculiar to the home credit market. We identified in paragraphs 6.112 and 6.113 that the incentive to share data has been weak (and we have not seen evidence of competitive pressure which might have strengthened it). Lenders have told us that the data currently available through CRBs is not necessarily a good guide to the creditworthiness of their customers (a proportion of whom do not have credit records at all). They have therefore been reluctant to incur the costs associated with data sharing in the absence of any certainty that they would secure benefits. Moreover, step-up lending has served as a substitute mechanism for assessing creditworthiness.

[1]Appendix 2.1 presents some of the evidence in the academic literature for these benefits.

7.28. We identified in paragraphs 6.151 to 6.154 that a further disincentive for lenders derives from the asymmetric pattern of market concentration, with one very large competitor and several smaller ones, which has persisted for a considerable time in the market. We considered it rational for the largest lender (Provident) not to share creditworthiness data on its large customer base. The advantages it might gain (getting information on those customers with whom it does not currently have a relationship, and getting more information on its existing customers' relationships with other lenders) are outweighed by the disadvantages of sharing information on customers with other lenders, and thus sacrificing an element of its incumbency advantage.

7.29. Other lenders' incentives are less clear. They might have less incumbency advantage to lose and more to gain from better access to other lenders' data than Provident. But their incentives to share data are not clear-cut. The risk of exposing data on their best customers to other lenders might well outweigh the benefit of access to data on prospective customers. For a lender with a limited geographical range, access to data on thousands of customers nationwide may be of limited value. Moreover, for another lender, sharing data in a situation where Provident does not is unlikely to be cost-effective; the benefits to them would be limited because information on the majority of potential good home credit customers would not be available to them. Only lenders seeking to expand, who would value data which would enable them to assess new customers better, have an incentive to share data.

7.30. Regardless of the pattern of market concentration, the incentive on any lender to share data is muted if most or all others do not; information on their own customers would be available to providers of other credit products without their having access to data on other home credit lenders' customers.

Importance attached by customers to the agent relationship

7.31. The second factor is home credit customers' requirement for a home collection service operated by an agent they can trust. It is the defining characteristic of home credit that agents visit regularly (see paragraph 2.19) to make collections. We consider that it is rational for them to seek to establish good relationships with their customers and to use the regular contact to assess those customers' circumstances and creditworthiness. But the development of this relationship has competitive consequences. It is important to customers that agents call regularly and can be trusted to treat the customer sympathetically (for example, when payments are missed or when new credit is needed—see paragraph 6.115). A lender or agent cannot communicate trustworthiness to a customer without a track record. This acts as a barrier, making it more difficult for another lender to compete successfully for new customers' business.

Restrictions on canvassing

7.32. The third factor is the regulatory restriction on canvassing which we identified in paragraph 2.41 and discussed in paragraphs 5.21 to 5.25, 6.100 and 6.101 which inhibits companies and agents (both of existing companies and of prospective entrants) from seeking new customers. We indicated in paragraph 5.24 that we do not consider this a major impediment to the acquisition of new customers in this way.

Customer detriment

7.33. The absence of price competition within the market (reinforced by the absence of competitive constraint on pricing from other forms of lending or from the reality or threat of entry or expansion) gives rise to the level of prices we have observed, which we consider to be higher than we could expect to find in a competitive market (see paragraph 3.143), and which we consider constitutes a detrimental effect on customers.

7.34. We considered whether we could estimate the scale of the detriment in broad terms, by assessing how far in excess of competitive levels were the prices paid by borrowers. In a competitive market, we would normally expect prices to reflect the costs, including the cost of capital, of an efficient provider. In paragraphs 3.61 to 3.142 we considered whether profits in excess of the typical cost of capital for a large home credit lender were being earned. We did so because, as our guidance indicates, the existence of profits substantially and persistently in excess of the cost of capital is one among several indications of shortcomings in the competitive process.

7.35. We recognize, however, that our estimates of returns in excess of the cost of capital may be quite imprecise. We can therefore be more confident in concluding from them that profits in excess of the cost of capital have been earned than in reaching a precise conclusion on the absolute level of those profits. Furthermore, while we might expect profits persistently and substantially in excess of the cost of capital to be associated with prices which are higher than could be sustained in a competitive market, there is not necessarily any straightforward or direct link between those estimates and the extent to which prices in the market can be said to be too high.

7.36. In our provisional findings, we estimated that in the five-year period from 2000 to 2004, the relevant market as a whole generated net profit in excess of the cost of capital of around £550 million, of which Provident accounted for around £500 million.[2] Provident disagreed strongly with this assessment,[3] and told us that on its calculations it was earning profits of around £7 million a year in excess of its cost of capital,[4] and that this was explicable not by deficiencies in the competitive process but by its superior efficiency.

7.37. We recognize, given the complexity of the calculations, that any such calculations are subject to quite wide margins of error, and that any conclusions drawn from them have to be treated with some care. We have also, as indicated in paragraphs 3.127 to 3.137, reviewed our calculations of profitability and concluded that it is possible that we may, in our provisional findings, have overestimated the excess of returns over the cost of capital. Our revised conclusions on profitability are in paragraph 3.137. However, the revisions to our conclusions have not led us to change our view that profits substantially in excess of the typical cost of capital for a large home credit lender have been persistently earned across a substantial portion of the market. In making that finding, we do not imply criticism of the companies involved. Rather, given our other findings on the weakness of the competitive process, we would find it

[2]Our calculations were based on the five largest lenders, who together account for over 80 per cent of the market. We have no reason to suppose that excluding other lenders materially affects the outcome of the analysis, though we noted in paragraph 3.79 that at least some small home credit businesses are earning returns which are in excess of the cost of capital. This net figure represents the economic profits (ie profits in excess of the cost of capital) earned by those lenders making them, less the economic losses (profits less than the cost of capital) of other large lenders.
[3]See paragraphs 3.83 to 3.105 for the reasons why Provident considered our assessment of its profitability to be flawed.
[4]Our reasons for placing relatively little weight on these calculations are in paragraphs 3.88 to 3.105.

surprising if profits in excess of the cost of capital were not being earned by efficient companies legitimately concerned with providing good returns to their shareholders.

7.38. These revisions to our calculations have caused us to revise both our estimate of the extent of profits in excess of the cost of capital that have been earned, and to reinforce our reluctance to express it with any precision. We still take the view that profits in excess of the cost of capital of at least £75 million each year have been earned over the period 2000 to 2005. We recognize that there may still be some doubt and contention around this figure. On the basis of our analysis we believe it to be a minimum figure. But we consider that, even if it were proved to be inaccurate by say 20 per cent either way, it would make no material difference either to our findings on the market or to our consideration of remedies (see Section 9).

7.39. As we indicated in paragraph 7.35, it is not clear that there is a direct relationship between this figure and the extent to which prices can be regarded as too high. Even in some reasonably well-functioning markets, some prices will exceed efficient costs, often by quite a large margin and for some time. Moreover, given the number and variety of loans and their prices in the market, even if it were possible to assess accurately the extent by which the price of a notional typical loan exceeded efficient costs, it would not necessarily be possible to draw conclusions about the extent to which the price of any individual loan might exceed what might be expected in a well-functioning market.

7.40. Nevertheless, we estimate, based on the number and value of loans issued during the period and on the figure for profits in excess of the typical cost of capital cited in paragraph 7.38, that the price of an average loan was approximately £20 higher than could have been expected in a market in which competition ensured that prices reflected only the costs of provision. This equates to approximately £7 per £100 of loans issued.[5] For the reasons set out in paragraph 7.39, that does not mean that we can say with any certainty that all prices are that much too high. Rather, we conclude from this analysis that prices are generally higher than they would be in an effectively functioning market to an extent that might be expected to be material for home credit customers, many of whom are on low incomes.

7.41. We found no customer detriment in relation to choice, to quality of product or service or to innovation as a result of the features of the market we identified.

7.42. We therefore conclude that while home credit provides a service which meets a distinct customer need, it does so at a higher price than could be sustained in a competitive market.

[5]Provident's assessment of its excess profit of £7 million a year, if applied to the average number and value of loans issued by Provident in the period 2000 to 2005, equates to an excess price above that which might be expected in a fully competitive market of £2.40 per loan issued or 80p per £100 advanced.