# COMPETITION AND MARKETS AUTHORITY

# PAYDAY LENDING MARKET INVESTIGATION

## RESPONSE OF WONGA GROUP

## TO PROVISIONAL FINDINGS OF 11 JUNE 2014

## 4 JULY 2014

**CONTENTS**

**SECTION** **PAGE**

## 1. EXECUTIVE SUMMARY

1.1 This submission sets out Wonga Group Limited's (**"Wonga"**) response to the Competition & Markets Authority's ("**CMA**") Payday lending market investigation provisional findings report (**"PFs"**) of 11 June 2014. This response should be read in conjunction with Wonga's response to the CMA's Notice of possible remedies of 11 June 1014 (**"Remedies Notice"**).

**The payday lending market is competitive and dynamic**

1.2 There is compelling evidence in the PFs indicating that the payday segment is competitive and dynamic; in particular, there is evidence of:

(a) pressure on lenders to ensure that the cost of borrowing is competitive as demonstrated by:

(i) the launch of products with significantly lower headline prices (e.g. FlexCredit) or risk-based pricing structures (e.g. Sunny) and the competitive responses of competitors to these initiatives (including Wonga);

(ii) the ongoing focus on (and development of) pricing structures and product features which can deliver competitive advantage in particular borrowing scenarios, for example, Wonga's daily interest structure which delivers cheaper loans, compared to many rivals, over shorter loan durations;

(b) competition between lenders on many non-price aspects of the product offering, and compelling evidence that lenders seek to provide good customer service in order to attract and retain borrowers;

(c) levels of profit which have not been shown to be inconsistent with the levels required by venture capital investors, and which are changing as the segment matures, reflecting competition and higher regulatory costs;

(d) competitive pressure from entities beyond the payday lending segment as indicated by the influence of these entities on price and product development by payday lenders, as well as examples of competitive interaction;

(e) a significant degree of customer engagement, with customers consulting a range of information sources, with a particular focus on the total cost of borrowing. Use of multiple lenders is common and cannot be dismissed as reflecting credit constraints rather than choice. Moreover, the clearest explanation for a perceived lack of switching (cited by 61 per cent of customers) is very high levels of customer satisfaction rather than any significant barriers to switching. The product is straightforward, customers use online tools effectively to shop around and learn from their borrowing experiences; and

(f) very significant entry by new firms (at a rate of two to five entrants per quarter, i.e. 8-20 per year) with innovative products, processes and business models and expansion by more efficient firms and the exit of less successful ones.

**Market outcomes provide compelling evidence of vigorous competition**

1.3 Wonga does not consider that the evidence presented in the PFs supports a conclusion that the competitive constraint that lenders face when setting their prices is weak. In particular:

(a) the CMA's analysis of prices has examined the cost of borrowing in different borrowing scenarios but places insufficient weight on competition from the interaction of pricing structures and borrowing requirements, for example, better deals offered by daily interest rate products over shorter durations and better deals where loans can be repaid early at no cost;

(b) the CMA's historic analysis of headline prices understates competition because it has not properly reflected competitively driven initiatives which directly affect the cost of borrowing (but not headline rates), for example, the removal over time of fees for faster payment services;

(c) insufficient weight has been placed by the CMA on the evidence of price competition that is actually occurring today as well as pricing initiatives that are being launched, including a significant reduction in headline rates (CashEuroNet), the introduction of risk based pricing (Think Finance) as well as the launch of instalment products and price reductions for existing products to achieve greater competitiveness (Wonga);

(d) the CMA's assessment of customers' price sensitivity excludes survey evidence from Wonga which indicates that a significant proportion of inactive customers have switched due to price and 46 per cent of inactive customers cite lower pricing and better promotions as the most important way to improve the Wonga service. The CMA's survey also points to high awareness of the total cost of borrowing among customers (89 per cent report looking at the total cost of borrowing before taking out a loan) and a high ranking of the importance of this information; and

(e) the CMA has not sufficiently explored the degree of sensitivity to product value (as opposed to headline price). In particular, the variety of characteristics which contribute to value have not been considered, nor have customers' valuations of these characteristics (and how these might vary in different borrowing scenarios).

1.4 Wonga considers that no reliance can be placed on the CMA's analysis of profitability given:

(a) the likelihood that the asset base calculated by the CMA does not appropriately reflect the economic value of assets;

(b) the insufficient weight given to factors which can result in returns above the cost of capital (even in a competitive market);

(c) evidence of a downturn in the lending cycle and the likelihood that profitability may not persist, which has not been fully considered; and

(d) the benchmark against which returns are measured does not adequately reflect the reality that for many lenders such as Wonga (that were largely funded by venture capital) the returns required by investors would have been necessary to compensate for the risk of failure.

**Competitive pressure exists from entities in the broader short-term credit market**

1.5 Wonga considers itself to be strongly constrained by a range of short-term credit providers. It has invested significantly in developing a product which will attract customers away from mainstream credit products (and other non-standard credit products) and it has continued to improve its product offering in order to dissuade them from switching back, including through careful monitoring of the relative attractiveness of all product features, including price. This is consistent with competitive pressure resulting from potential switching by the sizeable proportion of payday loan customers that do have access to other forms of credit (61 per cent of customers according to the CMA's survey) and could use these alternatives.

1.6 Evidence of competitive interaction in respect of innovation and product development has been identified in the PFs, but is given less weight than price competition without adequate justification being provided. Where evidence has been provided showing the influence of rival short-term credit products on Wonga's price formation (for example, Wonga's assessment of the competitiveness of Little Loans relative to overdrafts), it has been given insufficient weight. Even compelling examples of competitive responses (for example Provident Financial's short-term online product launch in order to stem the loss of home credit customers) are not deemed persuasive.

1.7 Evidence based on customer perceptions is of limited value because: (i) the CMA has not fully explored how choices are made and, in particular, trade-offs between price and non-price attributes; and (ii) the CMA's survey question which was designed to explore the choices which might be made (i.e. hypothetical switching) was not framed correctly and gives results which are inconsistent with a range of other evidence.

1.8 It is inappropriate to focus unduly on differences in products' characteristics as delineating market boundaries. The relevant question is whether the relative attractiveness of these characteristics to marginal customers is such that other products may be considered sufficiently close substitutes that switching to these products would constrain price increases. Wonga considers that a range of credit products (including credit cards, overdrafts and guarantor loans) act as a constraint on payday loans and that customers can (and do), switch between these products notwithstanding certain differences in product characteristics.

**There is a significant degree of customer engagement**

1.9 There is a significant amount of shopping around by payday lending customers. The CMA's survey indicates that 40 per cent of customers have shopped around. This is consistent evidence that customers typically consult a range of information sources; many lenders are considered (around half of customers who shop around report visiting the websites of four or more lenders); the total cost of borrowing is a key focus for customers; and a clear majority (73 per cent) are satisfied with the amount of time spent searching.

1.10 The CMA's analysis of shopping around (and of switching) lacks an analytical framework which would allow the CMA to gauge the competitive significance of the high degree of customer engagement which is indicated by the evidence. In particular, in considering the demand-side constraints faced by suppliers, emphasis should be placed on the preferences of marginal consumers. To date, the CMA's analysis has not given proper consideration to how the preferences of marginal customers might differ from average customers.

1.11 The CMA seeks to explain away the switching which occurs (a significant proportion of customers use multiple lenders) by suggesting that it is largely due to credit constraints and/or repayment problems, rather than active choices which may be expected to constrain lenders. The CMA's survey, however, indicates that a significant proportion (up to 45 per cent) of switching is attributable to preferences between lenders and even where credit constraints are more likely to be an issue (where a customers has taken out concurrent loans), the exercise of choice by a proportion of customers cannot be dismissed.

1.12 The reality is that satisfaction is the reason given by the vast majority (61 per cent) of customers for not switching. This is the hallmark of a competitive market, particularly in circumstances where the factors which contribute to a positive experience are precisely those which online providers have sought to develop and offer competitively in order to avoid losing ground to rivals.

1.13 Notwithstanding the clear evidence referred to above, the CMA identifies a range of barriers to shopping and switching. Not only have these not been weighed against the important factors which point to high customer responsiveness (namely the straightforward nature of payday loans, the ease of online searching, the opportunities for customers to learn through repeat borrowing and the interest of customers in getting value for money), but the evidence cited for each barrier is insufficient.

**There has been very significant entry by new firms and this is continuing**

1.14 The history of entry and expansion documented in the PFs is extraordinary on any measure particularly in comparison with many of the markets considered in previous market investigations. This points strongly to there being both an incentive to enter the segment, and the absence of any significant barriers to entry.

1.15 The PFs provide no adequate explanation as to why this compelling record of recent entry may not be considered a reasonable indicator of future entry and expansion. Whilst the PFs identify certain characteristics which are considered to weaken the potential constraint from new entrants, these are not weighed against the advantages available to entrants, nor is there any proper consideration of the scope for overcoming any initial disadvantages. Evidence set out in the PFs indicates that recent new entrants are optimistic about their abilities to expand successfully to the next stage of development.

**Analysis of customer detriment is flawed and unreliable**

1.16 The CMA's analysis of customer detriment is based on flawed premises and is unreliable. The benchmark for competitive prices based on "*the price paid by some customers for some of the cheaper products*"[1] is arbitrary. In particular, the lower prices selected are unsuitable as benchmarks because they reflect particular circumstances (product launch of a longer term product and a temporary promotion with potentially limited coverage) and do not, therefore, provide a reliable indicator of prices which would be commercially sustainable. There is also no compelling justification for the assumption that all customers should achieve the lowest (or amongst the lowest) price in a competitive market which is inconsistent with how markets operate.

1.17 Moreover, the CMA's assumption that any price above its assumed competitive benchmark constitutes an overpayment is inaccurate and unreasonable in a market which features important non-price attributes (as acknowledged in the PFs)[2], and any assumed gain from a price reduction would need to be adjusted to reflect the loss of any value attributable to these non-price attributes. The CMA is unable to undertake such an adjustment because it has not investigated the values which customers attribute to non-price features, despite Wonga indicating in earlier submissions that this is required.[3] There has also been insufficient consideration of the likely impact on customers of a tightening in risk thresholds which would restrict access to credit where it becomes unprofitable to supply customers with a higher expected risk at a lower price point.

1.18 Wonga does not agree that it could retain "reasonable levels of profitability" in the face of a decline in revenues of this magnitude, without adjusting risk thresholds. [CONFIDENTIAL] Going forward, the pressures of increased competition and regulatory costs are putting significant pressure on industry profitability. Moreover, the potential costs to customers of the CMA's hypothetical "competitive" outcome arising from the likely market exit of firms, tighter risk thresholds (resulting in a contraction in the availability of credit) and less innovation and product variety have not been properly investigated. In particular, the impact of such a scenario in the context of a price cap have not been considered.

---

1 PFs, Appendix 8.1, paragraph 8(a).

2 PFs, paragraph 36 states, "our analysis suggests 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."

3 See Wonga's response to the Annotated Issues Statement ("**AIS**"), paragraph 3.14.

1.19 Lastly, Wonga does not accept that the current use of risk-based pricing and flexible pricing models is undeveloped relative to a well-functioning market. The CMA has failed to take into account what might reasonably be expected given the dynamic market context. In particular early innovators, such as Wonga, adopted one-price-fits-all business models which deliberately emphasized simplicity and transparency (reflecting the need to compete with mainstream credit products). This has proved to be popular such that lenders are naturally cautious about moving towards less transparent and straightforward alternative models. There are also likely to be good reasons why risk based pricing may not be adopted widely (even in a well-functioning market) particularly by lenders that use risk pooling to support a proposition which extends credit as widely as possible (subject to creditworthiness assessments) to the benefit of customers. Nevertheless, alternative ways of pricing are emerging to appeal to different customer groups in line with an industry life cycle which has not yet reached maturity.

## 2. MARKET OUTCOMES – PRICING OF PAYDAY LOANS

2.1 The PFs rightly observe that "*Payday lenders use a variety of different pricing structures*" and that *"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]

2.2 The PFs do not, however, adequately explore the various mechanisms for price competition in this context, in particular, competition which occurs through the interaction of price structure (rather than headline prices) with product features and borrowing requirements. More specifically:

(a) Competition through price structure: Wonga considers that the availability of products priced on the basis of a daily interest rate (such as Wonga and FlexCredit) as well as traditional products priced on the basis of fixed monthly fees is a key dimension of price competition. In particular, it allows certain lenders to be more price competitive than other lenders in a range of borrowing scenarios in order to win and retain customers. The PFs acknowledge that different pricing structures lead to price dispersion[5] but do not attribute any significance to this as a competitive strategy. For Wonga, [CONFIDENTIAL] (as discussed further below); and

(b) Competition through the interaction of product features and borrowing requirements: the PFs do not mention early repayment at no cost as a key dimension of pricing. As in the case of pricing structure, however, this is a significant form of price competition because it allows lenders which offer this feature to be more price competitive than lenders which do not, in circumstances where a customer is able to repay early (in the case of Wonga's customers, this is a significant proportion – [CONFIDENTIAL] per cent). [CONFIDENTIAL]. Wonga advertises the feature to customers, and considers that it forms a central element of its pricing proposal as compared with other short-term credit providers.

2.3 Wonga also notes that the PFs point to both a pattern of clustering around a price of £30 per £100 as well as significant variation in the total cost of credit incurred by customers borrowing from different lenders.[6] There is, however, a lack of clarity as to whether, in a competitive market, the CMA would expect to see less clustering and more dispersion (due to competition through differentiation and the availability of different price points), or less dispersion and more clustering (due to customers shopping around and eroding price differences).

2.4 Wonga considers that clustering predominantly occurs amongst traditional monthly products, and that price dispersion arises from the competition created by having products with different price structures available to customers (as discussed above), and certain optional fees.

---

4 PFs, paragraph 4.99.

5 PFs, paragraph 4.32 "*We also observe variation in the relative prices of different lenders' products across scenarios. That is, a product 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*". PFs, paragraph 4.34(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*."

6 PFs, paragraph 4.24 and 4.28.

### Price competition between lenders

2.5 The PFs state "*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*".[7] Some evidence of price competition between lenders via price promotions is identified.[8] Wonga considers that evidence on the evolution of prices indicates the existence of more competition than is identified in the PFs when all dimensions which affect the cost of borrowing are taken into account. In any event, history is less relevant than evidence of current and ongoing price competition, and the PFs place insufficient weight on the strong indicators of current price competition, in particular, CashEuroNet's introduction of FlexCredit and Wonga's pricing initiatives which have been driven by the need to remain price competitive.

2.6 Taking these points in turn:

(a) a focus on headline rates misses key elements of competition: product development allowing greater repayment flexibility (which can reduce the total cost of borrowing to the benefit of customers) has been a central element of price competition;[9]

(b) insufficient weight is given to competition relating to charges for optional services such as faster payments. These charges are acknowledged as affecting the cost to a payday customer of taking out a payday loan[10] but the competitive dynamic in relation to these charges has not been acknowledged. For example, many lenders that initially charged for faster payment services now offer free expedited funding and this has been attributed by many lenders (for example by CashEuroNet) to competitive pressure;[11]

(c) promotions have been used as a competitive tool: the evidence cited in the PFs indicates that examples of discounting with significant coverage have been identified, in particular by CashEuroNet and by various lenders aimed at customers searching for a loan through moneysupermarket.com (whilst it was available). Wonga considers that these examples, together with Wonga's waiver of the transmission fee, Dollar's use of promotional discount codes and SpeedyCash's free £200 loan promotion are typical of pricing strategies which aim to win market share and which enhance competition; and

(d) history is less relevant than evidence of price competition occurring today and going forward: the PFs have identified a recent example of a lender significantly reducing its price, namely CashEuroNet's recent introduction of its FlexCredit product which is priced significantly below £30 per £100. Moreover, this lender has indicated that the initiative is seeking to address its own lack of competitiveness, and resulting loss of customers, for loans with durations of around 15 to 17 days and in particular to compete with Wonga.[12] The PFs state, however, that, "*the*

---

7 PFs, paragraph 4.102.

8 PFs, paragraph 4.103.

9 For example, in its response to the Annotated Issues Statement, Wonga refers to the introduction by Wonga of its transmission fee in 2008 and subsequent increase from £3.50 to £5.00 (which is referenced in the PFs at paragraph 4.46(a). This fee was introduced by Wonga in order to allow it to earn a reasonable return on loans with short durations. As a consequence, Wonga was able to reduce its minimum loan duration, in due course, to one day, thereby improving repayment flexibility (with maximum and minimum loan duration described at paragraph 4.208 as an important dimension across which lenders' offerings differ). As noted above, most of Wonga's customers take loans of shorter duration than the industry average and therefore are benefitting from this flexibility.

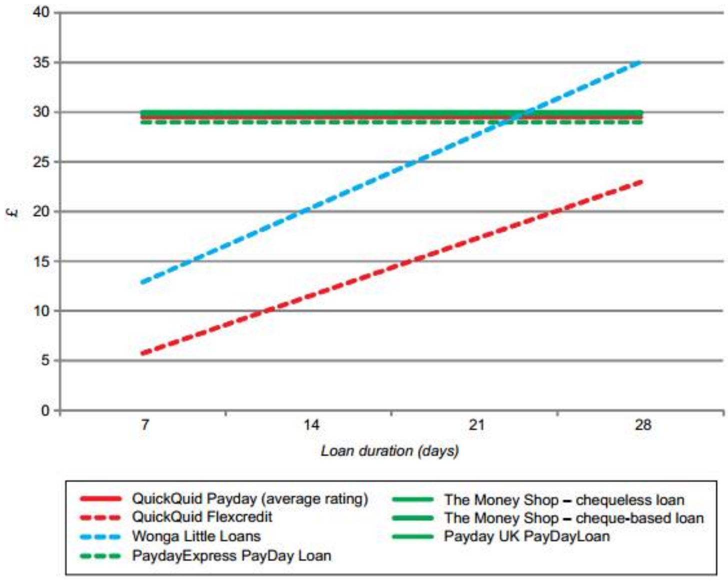
10 PFs, paragraph 4.14.

11 PFs, paragraph 4.200.

12 PFs, paragraph 4.62. Cash EuroNet's hearing summary indicates that "*FlexCredit had a daily pricing structure and lower interest rates on short-term loans to compete with Wongas 20-day product*."

*introduction of the FlexCredit product does not to date appear to have resulted in the other major payday lenders responding by reducing their prices.*"[13] This statement is incorrect. [CONFIDENTIAL] The competitive threat represented by FlexCredit is highlighted by the chart below which shows that FlexCredit is priced consistently and significantly lower than Wonga's Little Loan products over all loan durations.

**Figure 1: Total cost of credit for a £100 loan at different durations—the three largest lenders**




Source: Payday *lender pricing* working paper

The attractiveness of CashEuroNet's flexible products is shown by the migration of customers to these products in recent years. Wonga has estimated (as part of its internal assessment of instalment products) the migration of CashEuroNet's customers to its instalment and line of credit product i.e. FlexCredit (as shown in the charts below). The charts shows that CashEuroNet's instalment product has increased as a proportion of gross revenue by product from [CONFIDENTIAL] per cent in Q1 2013 to [CONFIDENTIAL] per cent in Q1 2014. The line of credit product (FlexCredit) has increased from a [CONFIDENTIAL] to [CONFIDENTIAL] per cent over the same period.

**Figure 1** [CONFIDENTIAL]

[CONFIDENTIAL]

Source: Wonga's internal analysis [CONFIDENTIAL]

The strength and success of CashEuroNet's offer (including FlexCredit) explains its stronger financial performance in recent years as compared to Wonga and Dollar Financial.

**Figure 2 [CONFIDENTIAL]**

[CONFIDENTIAL]

Source: Illustrative analysis based on published accounts from Companies House and SEC filings for the public companies adjusted to normalise for use of different accounting

13 PFs, paragraph 4.64.

standards and policy. UK revenues for Cash America are estimates. All figures relate to UK net revenues.

The influence of [CONFIDENTIAL]. For example, an internal document provided to the CMA describes [CONFIDENTIAL][14] [CONFIDENTIAL][15] These are very significant developments which provide strong evidence of price competition.

**Customer sensitivity to price**

2.7 The PFs state "*Customer demand appears unresponsive to variation in prices. Where lenders have changed their price, 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.*"[16]

2.8 Wonga notes that certain survey evidence of price sensitivity provided to the CMA has not been referred to in the PFs. It is also unclear whether the CMA has considered customer responsiveness in the widest sense – i.e. including switching to different products (or a different pricing tier) offered by the same lender to get a better deal (where the lender has been obliged to innovate to win and retain customers). Finally the evidence appears to be more mixed than is suggested in the PFs.

2.9 Taking these points in turn:

(a) certain evidence of price sensitivity has not been referred to in the PFs. For example, Wonga submitted customer research which indicates that [CONFIDENTIAL], suggesting that switching occurs, and that [CONFIDENTIAL][17];

(b) certain evidence of price awareness has not been referred to in the pricing section of the PFs. In particular, there is evidence that customers clearly do care how much they pay for their payday loan,[18] and there is evidence that a high proportion (89 per cent) of customers report having looked at information on the total cost of the loan before taking it out.[19] Both findings provide insights into the attitudes of customers to price and the degree to which they are informed, and are consistent with a higher degree of price sensitivity than has been identified in the PFs;

(c) it is not clear what measure of customer responsiveness has been adopted as part of the CMA's pricing analysis and, in particular, whether it encompass internal switching (i.e. customer switching to a different product offered by the same lender). This is a valid measure of competitive activity and customer responsiveness particularly where lenders have undertaken product innovation in order to retain customers, and where there is a risk of cannibalisation of revenue and margin. Wonga, for example, anticipates [CONFIDENTIAL] as a result of offering [CONFIDENTIAL];[20] and

(d) the evidence on customer sensitivity is more mixed than suggested in the PFs. For example, the PFs state "*there was some indication that customers may be more responsive to increases in monthly interest rates above 30%.*" In particular, Dollar

---

14 [CONFIDENTIAL].

15 [CONFIDENTIAL].

16 PFs, paragraph 4.104.

17 [CONFIDENTIAL].

18 TNS BMRB Survey page 91. 55 per cent of respondents to the TNS survey indicated the total cost of the loan was "very" or "extremely" important and a further 30 per cent said that the this was "fairly" important.

19 TNS BMRB Survey, page 87. 91 per cent of customers who compared lenders found out how much it would cost to borrow the amount needed, TNS BMRB, page 100.

20 [CONFIDENTIAL].

has provided evidence to the CMA indicating that it has been constrained in its ability to increase its interest rates above 30 per cent, presumably due to a demand response which has made such an increase commercially unattractive.[21] Further, the PFs indicate that "*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 price than others.*"[22] Wonga would agree that price sensitivity will vary between customers (as is often the case in competitive markets), but lenders are not able to target price sensitive customer particularly accurately[23] and therefore must ensure that their offers are competitive in a holistic sense (i.e. across both price and non-price features).

2.10 The PFs state "*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*".[24]

2.11 Wonga considers that little weight can be placed on this observation for the following reasons:

(a) first, the CMA must presumably accept that, even in well-functioning competitive markets, a proportion of customers will not purchase the cheapest product available to them (for a variety of reasons). Where there is a choice of products with different attributes (of which price is only one), it will not always be rational to choose the lowest priced product. It is unreasonable to highlight evidence that some customers are choosing higher priced products to support a theory of price insensitivity without: (i) showing how the result differs meaningfully from what might be expected in a competitive market; and (ii) ruling out through rigorous analysis the factors (in particular the value attributed to attributes other than price) which might explain this and which are unrelated to price insensitivity or other perceived demand side problems;

(b) secondly, there is a very high likelihood, given the strong emphasis on non-price competition and innovation in the payday segment (which is noted in the PFs), that a significant proportion of those found to be purchasing more expensive products are getting value for money when non-price factors are taken into account. The PFs note that this possibility cannot be discounted "*entirely*",[25] and acknowledges that quantifying the extent of any non-price differences that do exist and their value to customers is difficult,[26] but nevertheless reaches the conclusion 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*."[27] Wonga considers that the basis for this finding is weak for the following reasons:

(i) the PFs note a very wide range of non-price characteristics which are important to customers, in particular, access to credit (e.g. availability of top up facilities, faster payment services, mobile access, website functionality,

---

21 PFs, paragraph 4.74.

22 PFs, paragraph 4.77.

23 Wonga, for example, targets promotions at inactive customers, regular customers as a thank you for closing their last loan, customers who start but do not complete an application process, customers using Facebook and customers who search via a price comparison site.

24 PFs, paragraph 4.104.

25 PFs, para 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."

26 PFs paragraph 4.91.

27 PFs, paragraph 4.98.

repayment flexibility (e.g. repayment by instalment, minimum and maximum loan duration) and customer service.[28] However, the CMA's consideration of whether customers are choosing notionally more expensive products due to non-price characteristics focuses only on repayment by instalment and the preference between online and high street products. All other non-price characteristics are ignored;

(ii) as noted above, the CMA is not in a position to reach a conclusion on the value (as opposed to the price) of products to customers, because it has not investigated the value of non-price attributes despite Wonga highlighting this as an important omission in previous submissions;[29]

(iii) Wonga's competitors have stated that the preferences of some customers for Wonga's product, in circumstances where a rival product is cheaper, is likely to reflect non-price features offered by Wonga. CashEuroNet's hearing summary, for example, indicates that "*Although QuickQuid's longer-term loans were cheaper than similar loans offered by Wonga, some customers preferred Wonga products, which CashEuroNet attributed to certain features of the Wonga loan proposition.*";[30]

(iv) the PFs note that Wonga holds [redacted] per cent of the total online loan volume in the 28-day scenario, while cheaper products PaydayUK and QuickQuid Payday hold combined shares of [redacted] per cent. The CMA notes that if demand is driven by superior non-price dimensions of Wonga's product, then in the 14 day scenario customers should always prefer Wonga (since it would be both cheaper due to the daily interest pricing model, and have superior non-price dimensions). To the extent that the CMA considers that evidence of some share of demand being won by PaydayUK and QuickQuid Payday in the 14 day scenario necessarily suggests that customers are unresponsive, this is not a reasonable conclusion.

This is because there are a large variety of non-price dimensions that consumers may put weight on, including repayment flexibility, features which facilitate customers' access to credit, and the quality of a lender's customer services. It is likely that different customers will value different aspects of a particular product offering. Moreover, a given customer could, in principle, put different weight on product attributes in different circumstances. For example, customers may value the flexibility to repay early more highly for a loan of longer duration (such as for a 28 day loan) than they would for a loan of shorter duration (such as for a 14 day loan). There may be a number of reasons for this. For example, the customer may have a more precise view of the required loan duration in the case of the shorter term loan, reducing the value of early repayment flexibility. Secondly, in the event of uncertainty around the required loan period, the value of flexibility will be related to the amount of interest which could be saved by repaying early. The potential amount of savings will tend to be greater in the case of a longer-term loan.

[28] PFs, paragraph 4.188 to 4.213.

[29] In particular, in the context of the Wonga's submissions on market definition, Wonga has previously stated: "*The CC's comparison of products is over-simplistic and does not consider the preferences of marginal customers. Products with very different characteristics can constrain each other depending on how characteristics are valued and traded-off when customers make decisions (in this case borrowing decisions). For example, customers might value more highly a product which offers greater speed, convenience and control at a particular cost of borrowing but would switch to a product with different features if the differential in the cost of borrowing exceeded the value attributed to these quality and service features. Without this evidence the CC cannot draw reliable conclusions on what drives customer choices between differentiated credit products, and the nature of the trade-offs which are made between different product features.",* Wonga response to the AIS, paragraph 3.14.

[30] Summary of a hearing with CashEuroNet, paragraph 16.

(c) thirdly, the difference between price and value has been acknowledged by the Competition Commission ("CC") in previous investigations and it has rightly made the CC cautious in drawing conclusions about market outcomes relating to price. In *Home Credit*, for example, the CC stated that:

"*We accept that many of the characteristics of the home credit product are attractive to customers. Customers value available credit with a weekly repayment schedule which they consider they can afford from their weekly budgets. They also value the certainty that they will incur no further charges… The value they place on these characteristics may help to explain why they pay what appear to be high prices and still secure what they consider to be value for money*…(para 3.30, Final Report) *For the purposes of this section, we consider that the balance of evidence suggests that customers and observers alike recognize that the price of home credit is high by comparison with other credit products. We reach no conclusion, however, on the relative value for money of different credit products. We would expect that to vary between customers according to their perception of the value of attributes of the products*." (paragraph 3.31, Final Report) (emphasis added); and

(d) finally, Wonga notes that the CMA has found evidence of customers choosing the cheapest products. The PFs state "*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 term durations (such as those of Wonga and MYJAR) is greater than the shares of longer-duration loans accounted for by such products.*"[31] Wonga notes that this is consistent with its own experience.[32] Wonga also notes that even if the proportion of customers deemed to be sensitive is limited to this narrow measure (which is inappropriate for the reasons outlined above), there is no consideration in the PFs of whether this might be sufficient to create a competitive constraint.

31 PFs, paragraph 4.80.

32 [CONFIDENTIAL] This is clear indication of the role competitive pricing has played in Wonga's growth to date.

## 3. MARKET OUTCOMES - PROFITABILITY

3.1 Wonga's key comments on profitability relate to:

(a) the CMA's treatment of intangible assets; and

(b) the CMA's choice of benchmarks and interpretation of its profitability results.

**The CMA's treatment of intangible assets**

3.2 Wonga considers that the CMA has not adequately capitalised Wonga's economic assets, particularly in rejecting the capitalisation of (i) customer acquisition costs and (ii) customer knowledge costs.[33] More specifically Wonga considers that:

(a) the approach is inconsistent with that adopted in previous cases, where the CMA has sought to estimate the maximum of plausible values in relation to intangibles;

(b) inadequate justification is provided in the PFs for not capitalising customer acquisition costs. For example, concerns relating to the non-exclusivity of customer relationships and the proportion of costs relating to unsuccessful bids for customer leads do not justify the exclusion of these costs from the asset base. Moreover there is an inconsistency with the approach taken in previous investigations where an asset has been identified which is separate from the general running of the business;

(c) exclusion of customer knowledge costs from the asset base is inconsistent with the treatment of these costs in *Home Credit*, and with statements which imply the existence of the asset elsewhere in the PFs. Moreover, inadequate justification is provided in the PFs for not capitalising these costs; and

(d) Wonga considers that the profitability results are likely to be sensitive to the inclusion of these categories of costs given uncertainty as to the relevant benchmarks and proper interpretation of the aggregate results.

<u>The approach is inconsistent with previous attempts to estimate the maximum of plausible values</u>

3.3 As a general observation, the PFs' treatment of these intangible assets is surprising, given its approach in previous cases, particularly in *Home Credit*, where the CC "*sought to estimate <u>the maximum value of the range of plausible values</u>, above which we considered it highly improbable that the actual valuation would lie*" (emphasis added).[34] Based on this principle, some of the reasons set out in the PFs for not including an estimate of certain intangible assets are inadequate (for example, difficulties in estimation can be overcome with reasonable assumptions). Moreover, excluding these intangible assets altogether will result in a valuation which is significantly lower than the maximum of plausible values and is, therefore, inconsistent with the approach previously taken, which applies the precautionary principle and reflects best practice.

---

33 The CMA sets out in section 4 and Appendix 4.5 of the PFs how it has treated intangible assets in its profitability analysis. The CMA has chosen to capitalise only staff recruitment and training costs (PFs, paragraph 4.160), considering that most employee costs were most likely being treated appropriately as revenue expenses (PFs, Annex 4.5, paragraph 23).

34 *Home Credit* final report (30 Nov 2006), paragraph 3.128.

Inadequate justification is provided in the PFs for not capitalising customer acquisition costs

3.4 The PFs set out a number of reasons why customer acquisition costs should not be capitalised,[35] for which there appears to be inadequate justification. In particular, the PFs state that:

(a) these costs have not created an asset separate from those arising from the general running of the business. This position is inconsistent with a number of other CC reports where customer acquisition costs have been accepted as a separate asset, and the relevant costs were capitalised, including in *Home Credit*,[36] *SME Banking*[37] and *Movies on Pay TV*.[38] No explanation is provided as to why a different treatment is justified in this case;

(b) a significant proportion of leads bought (through ping tree auctions) do not translate into loans issued, and it would be inappropriate to capitalise unsuccessful leads. It is not, however, possible to determine whether a lead will be successful or not in advance, and therefore the cost of obtaining successful leads includes the cost of unsuccessful ones. Even if the risk identified by the CMA were a valid issue (which Wonga disputes), it would not prevent the CMA from estimating and capitalising the proportion of costs that was spent on successful leads;

(c) a significant number of customer relationships are not exclusive to a particular lender. The relevant question, however, is whether customer relationships generate earnings for each lender in the future. Whilst in other markets this non-exclusivity may reduce the likelihood of future earnings, this effect is less applicable in the payday lending segment, precisely because a substantial proportion of customers use multiple lenders;

(d) the relatively short duration of customer relationships in payday lending reduces the extent to which it makes sense to capitalise associated costs. As set out in the CC Guidelines[39] (which have been neglected by the CMA), the criteria for capitalising costs specify that the cost must have "*been incurred primarily to obtain earnings in the future*"[40] – the guidelines do not specify how long-lasting the asset must be to qualify as "in the future". Whilst the average duration of Wonga's payday customer relationships is around 18 months, which is less than for some other financial services (e.g. SME banking, as the CMA points out), this is still beyond the one-year horizon relevant for considering expenditure to represent investment in future earnings; and

(e) there is no reliable basis on which to split marketing costs between those associated with new customer relationships (relevant to intangible assets) and those used to maintain existing relationships. This justification for the CMA's treatment of marketing costs is inadequate because the CMA is not prevented from making reasonable assumptions (as it does elsewhere in its profitability analysis, for example, on other lenders' staff recruitment and training costs).

---

35 PFs, Annex 4.5, paragraph 16-18.

36 *Home Credit* final report (30 Nov 2006), for example, paragraph 3.111.

37 *The supply of banking services by clearing banks to small and medium-sized enterprises* final report (Mar 2002) – for example, paragraph 2.296ff.

38 *Movies on Pay TV* final report (2 Aug 2012) – for example, paragraph 5.104.

39 Guidelines to market investigations, CC3.

40 PFs, paragraph 4.158.

Inadequate justification is provided in the PFs for not capitalising customer knowledge costs

3.5 The CMA does not deny that a separate customer knowledge asset exists, and indeed a separate customer knowledge asset was accepted in *Home Credit*[41]. Moreover, the CMA argues elsewhere in its PFs that there are potential barriers to entry in the form of more established players' superior customer knowledge,[42] implying the asset's existence (although from Wonga's perspective, this does not constitute a barrier to entry given that it is replicable – others could, and have, invested in it as Wonga has done).

3.6 The objections to capitalising Wonga's customer knowledge costs which are described in the PFs are considered by Wonga, therefore, to be inadequate. The arguments made in the PFs, together with Wonga's response, are summarised below:[43]

(a) the PFs suggest that bad debt costs are not a "specific" cost because a percentage estimate needs to be applied to split out the relevant proportion spent on acquiring customer knowledge. This is not a sufficient justification for disallowing the capitalisation of a customer knowledge asset. The need to split marketing costs between those associated with new rather than existing customer relationships does not mean that there are no separately identifiable costs;

(b) the PFs indicate that bad debt costs are in large part the cost of unsuccessful lending decisions, and could, for certain lenders, result from inefficiency or poor management. This consideration, however, applies to all costs that may be capitalised. The CMA has not previously, however, sought to establish whether costs are efficiently incurred as a criterion for allowing costs to be capitalised; and

(c) the PFs suggest that customers who generate bad debts cease to be customers and the bad debts incurred, therefore, do not relate to any knowledge of the remaining customer base. As in the case of unsuccessful customer bids, however, it is not possible to know *a priori* whether customers will incur bad debts, and therefore the costs relating to customer knowledge includes those associated with lending to customers who do not repay. The approach suggested in the PFs would introduce survivorship bias to the analysis.

3.7 The CMA claims that even where both of these intangible assets are included in full in its sensitivity analysis, they are not sufficient to overturn the CMA's findings on profitability (the average profitability over 2009-2013 is found to be 36 per cent[44] under this scenario, compared with the CMA's main cost of capital benchmark of 8-13 per cent[45]). However, this assumes that (i) the benchmarks that the CMA has chosen are the most appropriate ones, and (ii) that any profits earned above the benchmark should strictly be interpreted as "excess" profit which indicates ineffective competition. These points are discussed further below.

3.8 As an additional observation, the CMA rejects AlixPartners' treatment of the depreciation charge[46] on the basis that it is inconsistent with adjustments made elsewhere and with "*precedent for intangible analysis*" (but without identifying such "precedent"). However, any such precedents would have been based on mature industries, which are not

---

41 *Home Credit* final report (30 Nov 2006) – see, e.g., paragraph 3.111.

42 PFs, paragraph 7.115(b).

43 PFs, Annex 4.5, paragraph 19-21.

44 PFs, Annex 4.5, Table 69 (paragraph 95).

45 PFs, Table 4.8 (paragraph 4.184).

46 AlixPartners argued that in a growing business the usual approach of replacing costs with a depreciation charge based on useful economic lives results in lower operating costs. PFs, Annex 4.5, paragraph 31.

considered to be relevant to the payday segment, which has been growing over much of the historic period considered by the CMA.

3.9 Lastly, the CMA had concerns that the capital employed information used in AlixPartners' analysis included non-UK payday assets associated with Wonga's international operations and other UK products (namely Everline and PayLater).[47] Wonga confirms that [CONFIDENTIAL]. The audited WDFC UK figures that the CMA has based its analysis on do not record any of the fixed assets used in Wonga's UK payday loans and hence will lead to an understatement of the underlying assets used in provision of the UK Little Loans product, and (assuming positive EBIT is earned) an overstatement of profitability.

**The CMA's choice of benchmarks and interpretation of its results**

3.10 The PFs acknowledge a number of factors which could allow companies to earn returns above their cost of capital for some period, even in a competitive market.[48] These factors are not adequately reflected, however, in the analysis and interpretation of results set out in the PFs. In particular:

(a) the profitability benchmarks described in the PFs do not appropriately reflect the higher risks associated with innovative start-ups;

(b) greater weight should be placed on a forward-looking profitability analysis as such analysis highlights the significant implications of increased competition and regulatory intervention on market outcomes. Any profitability gap is unlikely to persist in the future given current and projected trends. Failure to recognise these issues could result in counter-productive interventions that put at risk the likelihood of future innovation and entry;

(c) Wonga's low asset intensity has implications for the appropriate interpretation of the profitability analysis which have not been sufficiently acknowledged. In particular, low asset intensity means that ROCE is very sensitive to small changes in profit as well as to capital employed and therefore caution is required in the interpretation of the results; and

(d) references to indicators such as profitability dispersion and increasing customer acquisition costs do not support the provisional finding of weak competition.

<u>Profitability benchmarks in the PFs do not appropriately reflect the higher risks associated with innovative start ups</u>

3.11 The PFs acknowledge that:

(a) higher risk may have an impact on required returns for start-ups;[49] and

(b) an element of Wonga's higher returns in certain years may be explained by its "*position as an innovative early mover in a growing market offering differentiated flexibility to customers*".[50]

3.12 Wonga has consistently submitted that any profitability benchmark would need to account for survivorship bias, in particular, to reflect that investors would have factored the risks of failure into their required returns and, in the event of success, the rewards would need

---

47 PFs, paragraph 4.145.

48 These are discussed in this section, apart from the effect of non-price attributes, which is discussed in relation to the CMA's customer detriment analysis in section 7 below.

49 PFs, paragraph 4.119.

50 PFs, paragraph 4.169.

to be sufficient to compensate for the prospect of any losses. However, this has not been sufficiently recognised in the CMA's profitability analysis which:

(a) does not include Wonga's pre-incorporation costs,[51] which the founders of a start-up would seek to recover with a fair return; and

(b) does not adjust the profitability benchmarks in the main analysis to account for the higher returns required by early stage investors in a risky start-up business where the underlying business model was unproven.

3.13 The required returns for VC investors are, however, considered as a sensitivity. These are significantly higher than the cost of capital benchmarks based on the capital asset pricing model ("CAPM") that the CMA has calculated – for example:

(a) the CAPM benchmarks range from 8-13 per cent; whereas

(b) the VC returns range from 15-50 per cent.[52]

3.14 However, the CMA then calculates a "weighted" benchmark of these two measures that appears to be significantly weighted towards the lower measure (i.e. the CAPM benchmarks), resulting in an overall range of 8-19 per cent.[53]

3.15 The basis for this weighting appears to be an estimate of VC as a proportion of capital (presumably for the industry), which ranges from 14-20 per cent.[54] This proportion, however, could vary significantly for different firms (Wonga, for example, was largely funded by venture capital at its inception). The PFs do not, however, acknowledge that any such industry-wide benchmark based on a weighted average is likely to be significantly lower as compared to the appropriate benchmark for specific companies such as Wonga that have largely been VC funded since inception.

3.16 Moreover, the CMA observes that "*Wonga referred to achieved returns of 41% as the annual IRR of the top-performing 10th percentile of post 1996 vintage funds. We note that the equivalent figure for VC funds, as a subset within the 41% return achieved, is 9%..., 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. 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%…was a more relevant benchmark.*"[55]

3.17 The CMA's focus on the historic performance of VC funds fails to capture the reasonable expectations of early-stage investors in a new (and unproven) business model for the following reasons:

(a) the relevant considerations for selecting an appropriate benchmark are investors' opportunity cost and expected returns. To the extent that MBO funds are viewed as broadly comparable in terms of risk and return to VC funds, and therefore as an indicator of the opportunity cost for investors of investing in VC rather than MBOs, the latter should be included in the benchmark for investors' expected returns for VC;

51 PFs, Annex 4.5, paragraph 27.

52 PFs, Table 4.8 (paragraph 4.184).

53 PFs, Table 4.8 (paragraph 4.184).

54 PFs, Table 4.8 (paragraph 4.184).

55 PFs, paragraph 4.177.

(b) as the CMA observes, the BVCA numbers are "achieved" returns in venture capital. In steady state, expectations of returns should track and adjust in line with returns that are being achieved. However, during periods of high volatility in achieved returns (for example, after the dot-com bubble burst in the 2000s and at the time of the financial crisis), investors' expectations about future returns are unlikely to reflect achieved returns. The median achieved returns for VC funds (1996 vintage funds onwards), for example, was -6.2 per cent,[56] but no investor would make an investment expecting that return. As a second best to surveying investors on expected returns, taking account of achieved returns for a wider portfolio of private equity investments (including MBOs) is likely to be more reflective of investors' expected returns; and

(c) a consideration of the returns achieved by VC funds will also under-estimate the returns required by VC investors in relation to specific companies (particularly companies in the technology sector). The return for a fund will reflect a "portfolio effect" due to the dispersion of returns for the individual companies within the fund (comprising failures with negative IRRs, a proportion with normal IRRs, which accounts for the majority, and a few with exceptional returns). For each individual company in the portfolio, however, VC investors will target a much higher return, typically seeking to generate multiples of 5 or 10 over invested capital over a 5-7 year timeframe, resulting in a target for IRR for successful individual companies within the portfolio in excess of 100 per cent. Moreover, it should be noted that VC investment in technology start-ups is more common than private equity leveraged buy outs involving later stage, high cash-flow generative companies in sectors such as telecoms and infrastructure where there are physical assets against which they can raise debt. These factors further limit the weight which can be placed on the IRR benchmarks identified by the CMA as a proxy for the VC returns which might have been required for entities such as Wonga at the outset.

<u>Greater weight should be placed on forward-looking profitability analysis</u>

3.18 It is observed in the PFs that there is evidence that returns in 2013 were lower than in previous years, caused by factors including a slowdown in lending growth and cost increases.[57] Moreover, the possibility that the profitability observed in 2009-2013 may not persist is also acknowledged.[58] These observations are not, however, reflected in the analysis of profitability, nor in the conclusions on how to interpret the difference between estimated ROCE and the benchmark rate.

3.19 As set out in Wonga's previous submissions, the fact that payday lending was in the growth phase of the industry cycle during the period considered by the CMA – and Wonga itself was an innovator introducing disruptive technology in the market – strongly indicates that a number of adjustments are needed to the way profitability analysis is carried out and interpreted, as follows:

(a) greater weight should be placed on forward-looking profitability analysis, on the basis that such analysis is more likely to reflect the industry in "steady state", and therefore may be more indicative of the market's competitiveness. Such forward-looking analysis should take account of expected regulatory and market developments in the near future, including the FCA's expected price cap, as well as continued competition from innovations such as flexible and risk-based products. These factors are likely to have a significant impact on lending volumes and interest income, as well as increasing costs further. Wonga's EBIT for its UK payday lending business, for example, [CONFIDENTIAL] in 2012 to [CONFIDENTIAL] in

56 BVCA and PwC, "BVCA Private Equity and Venture Capital: Performance Measurement Survey 2012), p.42.

57 PFs, paragraph 4.163.

58 PFs, paragraph 4.171

2013. It is forecast to [CONFIDENTIAL] in 2014. Economic return on capital is similarly [CONFIDENTIAL] rapidly, from [CONFIDENTIAL] per cent in 2012 to [CONFIDENTIAL] per cent in 2013 and [CONFIDENTIAL] per cent in 2014;[59] and

(b) the benchmark against which profitability is measured should also reflect that the market is not in "steady state", recognising any potential survivorship bias in required returns (i.e. the fact that returns would need to be sufficient to compensate investors for the likely prospect of losses if innovative offerings fail).

3.20 In assessing whether Wonga's returns are, in any sense, "exceptional", Wonga invites the CMA to consider carefully what returns an investor would reasonably have expected to justify funding an innovative start-up business in a wholly new market sector, where existing demand was met by a variety of incumbent competitors with long lasting customer relationships, and where its business model depended on internet take up and access by its target customer group. It cannot be disputed that there were significant risks involved in developing the business model as reflected in the losses experienced in start-up and the poor returns of various competitors at various points in time.

3.21 At a minimum, the CMA should interpret its findings with caution, given that any profitability gap is unlikely persist in the future given current and projected trends. Failure to recognise these issues could result in counter-productive interventions that put at risk the scope for innovation and entry.

<u>Low asset intensity should make the CMA cautious in its interpretation of profitability results</u>

3.22 The PFs indicate that Wonga's low asset intensity does not prevent a meaningful profitability analysis using ROCE on reported levels of assets, and the potential variability of ROCE (due to varying capital intensity) is not a valid reason for rejecting its use.[60] It is acknowledged, however, that high levels of asset turnover mean that year-end balance sheets do not capture the full flow of assets utilised during the year.

3.23 Whilst it may be true, in a technical sense, that ROCE can be calculated using the assets reported, the PFs do not sufficiently recognise that any resulting estimates must be treated with caution for two reasons:

(a) firstly, the relatively smaller capital base means that small changes in profits or measured capital employed will have a significant impact on ROCE. Accordingly, the ROCE measure is sensitive to falling earnings both now and in the future, and therefore little weight can be placed on historical ROCEs which will not be reflective of future profitability in the industry.[61] ROCE estimates will also be sensitive to any errors in estimating capital employed, particularly in relation to intangible assets which underlines the importance of precision in the estimation of these assets; and

(b) secondly, Wonga's low asset intensity reflects its high velocity of credit, relying on its ability to "revolve" the credit to provide more loans e.g. a payday lender providing £100 loans of around or less than one month would have £1,200 of principal at risk over the course of a year (unlike, for example, an annual personal loan of £100). Even if the CMA does not adjust its benchmarks for the higher risk resulting from high velocity of credit, it should at least take this into account in its interpretation of the results.

---

59 Wonga's response to the CMA's profitability working paper, paragraph 1.1.3.

60 PFs, paragraph 4.140.

61 For example, the PFs comment on an "inflection" point in Wonga's perceived riskiness and/or expected profitability (where in 2010 Wonga's perceived riskiness appeared to reduce and/or expected profitability appeared to rise) (PFs, paragraph 4.179). The PFs fail, however, to consider whether this is likely to persist in the face of regulatory price caps and competitive developments as the industry matures.

Reference to other indicators do not support the provisional finding of weak competition

3.24 Whilst evidence of profitability dispersion may not indicate unequivocally that competition is working well, neither can it be taken as evidence that competition is ineffective. Even in a highly competitive market, individual firms could have temporary advantages that competitors have not yet replicated (e.g. innovation that leads to cost efficiencies), while other competitors may have business models that are less efficient, resulting in variation in financial performance. Whilst these differences would disappear under effective competition in the longer run, the CMA itself acknowledges that payday lending may not yet be in steady-state.

3.25 The PFs also mention increasing customer acquisition costs as another indicator that competition is not working effectively.[62] Wonga considers, however, that customer acquisition costs are increasing due to the intensification of competition (reflecting new entry and expansion). In the online environment, for example, cost per acquisition has increased due to greater volumes of bids for Google keywords.

---

62 PFs, paragraphs 4.166-4.167.

## 4. CONSTRAINT FROM OTHER FORMS OF CREDIT

4.1 The PFs provisionally conclude "*that competition from other credit products was likely to impose only a weak competitive constraint on payday lenders, and in particular on their pricing.*"[63] For the reasons set out below, Wonga considers that the CMA cannot, on the basis of the evidence set out in the PFs, reasonably conclude that the competitive constraint imposed by other credit products is "weak".

**Competitive interactions between payday lenders and other credit providers**

4.2 The PFs state that "*we saw no substantive evidence of payday lenders taking developments in the pricing of any non-payday products into account when setting the price of their products, although it is possible that some innovation that we have observed in the payday lending sector may be targeted at customers who had previously used other types of credit product.*"[64] Wonga considers that non-price competition has been given insufficient weight in reaching these provisional conclusions and whilst the evidence from market players on competitive interaction is mixed, the examples of competitive interaction which have been identified should be considered carefully, particularly where they indicate customer losses and a competitive response.

4.3 Taking these points in turn:

(a) Non-price competition has not been given sufficient weight in reaching provisional conclusions: the PFs identify evidence of competitive interaction through product innovation both by payday lenders (where innovation is targeted at previous users of other credit products) and by providers of other credit products (by, for example, improving the flexibility of their products).[65] In reaching the provisional conclusion outlined above, however, this evidence appears to be weighed less heavily than the perceived lack of evidence showing competitive interaction relating to prices. A competitive assessment, however, should consider interactions across both price and non-price features. If competitive pressure drives players in the wider short-term credit market to develop non-price attributes which are valued by customers in order to better win and retain customers, this constitutes a competitive constraint and the key question is then to assess the strength of the constraint on suppliers in the market. Wonga considers itself to be strongly constrained in this regard. It has invested significantly in developing a product which will attract customers away from mainstream credit products (and other non-standard credit products) and has continued to improve the product in order to dissuade them from switching back;

(b) Price competition has been under-stated: Wonga rejects the suggestion that the CMA has not been provided with evidence showing how overdraft charges had actually affected the level of prices chosen by Wonga.[66] Wonga has indicated that a key factor in setting the level of Wonga's interest rates and other charges is a comparison against unauthorised overdrafts and has provided the internal documents which support this comparative analysis;[67]

(c) There is clear evidence of competitive interaction. There are a number of indications in the third party evidence provided to the CMA that there are

---

63 PFs, paragraph 5.51.

64 PFs, paragraph 5.51(d).

65 PFs, paragraph 5.50.

66 PFs, Section 5, footnote 31.

67 See, for example, the analysis described in Wonga's response to the CMA's Market Questionnaire (at paragraph 13.9) and the internal documents referred to.

competitive interactions between payday loans and a wide range of other short-term credit products, for example:

- Capital One indicated it had tested two credit card products as potential alternatives to, and partly in response to, the growth of payday lending;

- Leeds City Credit Union indicated that it was trying to win customers from payday lenders, working with local partners and media to raise its profile;

- Mobilemoney said that the growth of payday lending was adversely affecting its business for logbook loans of £200 to £1,000; and

- Provident Financial, a home credit provider, stated that its home credit offer did compete at the margins with payday lenders.

Wonga notes that this evidence includes examples of customers being lost, triggering a competitive response by certain non-payday players. For example, Provident Financial has indicated that a key rationale for the launch of its Satsuma Loans instalment product was the loss from its home credit business of higher credit quality customers who were dealing less in cash.[68] The competitive interaction in this case was strong enough to trigger a product launch to try to retain these customers.

**Access to, and availability of, other types of credit**

4.4 The PFs indicate that "*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.*"[69] It is, however, noted in the PFs that usage of other forms of credit is relatively common.

4.5 In addition to the finding that use of other forms of credit is relatively common among payday loan customers, the evidence outlined in the PFs actually highlights that these forms of credit are also available to a sizeable proportion of payday loan customers as an alternative to using a payday loan. More specifically:

(a) the CMA's survey indicates that 61 per cent of respondents could have used at least one other source of credit; [70]

(b) the PFs indicate that, from other customer research, the proportion of payday loan customers reporting not having access to alternatives ranges from around a quarter up to more than half.[71] Turning this around, and considering the survey evidence specifically, this suggests that a significant proportion of customers report that they do have access to alternatives.[72] More specifically (as noted in Wonga's response to the AIS):

(i) the Bristol University Research found that: (i) 49 per cent of online customers disagreed that they used an online payday loan because they could not borrow from anywhere else; and (ii) 30 per cent of online

68 PFs, Appendix 7.1, paragraph 4.

69 PFs, paragraph 5.51(b).

70 TNS BMRB Survey, page 78-79. Wonga notes that the PFs highlight only the proportions of customers indicating that they could have used either credit cards (18%) or an overdraft (20%) instead or a payday loan, or both (30%). PFs, paragraph 5.21.

71 PFs, paragraph 5.24.

72 This is consistent with Wonga's research which indicates that [CONFIDENTIAL]

customers indicated that they had used a specific form of borrowing because they could not borrow from anywhere else;[73]

(ii) a Consumer Finance Association study indicates that 43 per cent of payday loan customers have access to £200 through other sources had they not taken out their payday loan;[74] and

(i) a Friends Provident, JMU and Policis report indicates that a significant majority (77 per cent) of credit users have access to other credit options; and

(c) an estimation of the extent to which credit is available on credit card accounts when customers take out a payday loan (in the period from 1 April 2012 to 31 March) indicates that 12 per cent have at least one credit card active with more credit available than the amount which was ultimately borrowed using the payday loan. In 17 per cent of cases, credit was available on a credit card but was less than the amount that was ultimately borrowed. In 29 per cent of cases, therefore, there was some availability of credit on a credit card at the time a payday loan was taken.[75]

4.6 These results indicate that a sizeable proportion of payday customers have access to other forms of credit <u>and could use these alternatives</u>. The PFs have not, however, investigated whether switching by these customers would be sufficient to constrain payday lenders. This requires a consideration of the *aggregate* constraint provided by all potential substitutes, given that diversion is likely to be dispersed such that switching to any single potential substitute may not satisfy the standard market definition tests.

4.7 Wonga considers that such a constraint does exist and that the sizeable proportion of customers with switching opportunities is consistent with this view. A range of survey evidence (outlined above), including the CMA's own survey, suggests that access is not an issue and that a very significant proportion of customers have access to, and use, other forms of credit.

**Payday loan customers' perceptions of other credit products**

4.8 The PFs state "*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 per cent 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*."[76] The PFs cite lack of availability of other credit products, preferences for payday loans and negative perceptions of alternatives as factors which might explain this finding.[77]

---

73 Bristol University Research, figures 4.2, 4.3 and 4.5.

74 See www.cfa-uk.co.uk/information-centre/payday-facts-and-research/payday-facts-and-research/the-payday-lending-market.html

75 PFs, Appendix 5.3, paragraph 14. Wonga does not consider that this analysis will provide reliable results given the lack of a reliable real-time measure of credit availability at the time the payday loan was taken out. More generally, the CMA has not investigated the availability of credit from any other source of credit at the time the payday loan was taken out (in particular overdrafts). This omission significantly limits the CMA's ability to draw any conclusions on the constraints which these products can exert both individually as well as in aggregate. In particular, the CMA has not explored the possibility of customers combining the available credit on their credit card with other sources of credit in order to meet their borrowing requirements (particularly in those cases where the available credit is below the payday loan borrowing requirement). The CMA should not confine itself to investigating constraints by reference to the substitutability of product pairs, but should consider the aggregate constraint exerted by a range of products (some of which might be used in combination).

76 PFs, paragraph 5.51(c).

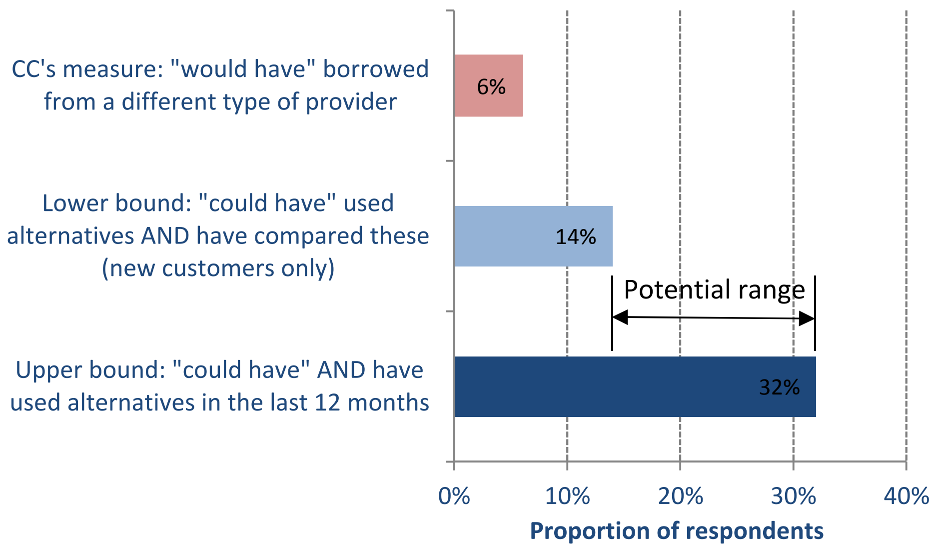
77 PFs, paragraph 5.39-5.43.

4.9 Wonga considers that undue weight is placed on responses to the hypothetical switching question which asks what payday loan customers would have done if they had not been able to take out a payday loan. The responses to the hypothetical switching question cannot be relied upon as an indicator of substitution because: (i) the question was not framed correctly; (ii) respondents were not prompted; and (iii) there are inconsistencies with other survey responses.[78] Wonga's research indicates that many customers consider alternative sources of credit to be relevant options. [CONFIDENTIAL][79]

4.10 The CMA's survey provides indicative evidence that the proportion of marginal customers who may potentially switch to alternative credit sources could range between 14 per cent and 32 per cent. The lower bound reflects the proportion of new customers who indicated having access to alternatives and who compared payday loans with at least one other credit source. The upper end of the range captures the proportion of customers who have access to, and have chosen to use, alternatives sources of credit.[80] [81]

4.11 These estimates of marginal customers are illustrated in the figure below.

**Figure 3: Estimates of switching by marginal customers derived from TNS BMRB Survey**




Sources: AIS**,** Figure 3 and analysis of TNS BMRB survey

**Product characteristics**

4.12 The CMA's view that other types of credit may not be regarded as close substitutes is supported in part, by reference to:

(a) a comparison of product characteristics; and

---

78 Wonga's concerns are explained in detail at Annex 2 of its Response to the AIS.

79 Populus Customer Survey, March 2013, slide 20 at Annex 3 of Wonga's Initial Submission.

80 TNS BMRB Survey pages 83, 81 and underlying tables.

81 The PFs indicate an alternative measure of marginal customers, namely, respondents to the survey who said that they had not experienced any debt problems in the last 12 months, and so are considered to be more likely to have other credit products available (PFs, Section 5, footnote 21). Wonga considers that this is a less reliable measure of whether a customer is likely to be marginal than a measure based on a customer's own indication of whether alternative could have been used in conjunction (for the lower bound) with a measure of shopping around and (for the upper bound) with a measure of actual usage.

(b) evidence from customer research on the perceived attractions of payday loans and the perceived disadvantages associated with alternatives.

4.13 Wonga does not dispute that credit products differ to some extent in their characteristics and that certain preferences are likely to exist. However, without a robust analysis of choice and preference in relation to differentiated products (in particular the value attributed to customer control, transparency, and other features such as speed and convenience), the CMA is not in a position to reach any conclusions on competitive constraints on the basis of the evidence on product characteristics and perceived advantages/disadvantages. In particular, any such differences in characteristics (and perceptions of such characteristics), do not mean that customers would not switch if any price differentials were no longer considered to be justified by product feature advantages.[82]

4.14 For example, the PFs indicate that credit cards and overdrafts share a number of characteristics with payday loans but that there are differences in the terms of the period over which credit is paid back to the lender.[83] This comparison, however, is entirely uninformative about what drives customer choices between these products and the nature of the trade-offs which are made between different product features. Wonga considers that customers do make such trade-offs and evidence on accessibility of, and usage of, credit cards and overdrafts supports this (as discussed above).

4.15 As regards the suggestion in the PFs that guarantor loans differ from payday loans in some key respects,[84] the CMA has also failed to investigate how these differences affect customer choices. Notwithstanding certain differences, Wonga considers that guarantor loans can be (and are) used to meet the same need as that met by payday loans namely, they provide small sum cash loans to cover unexpected costs. Moreover, although the PFs highlight that guarantor loans are typically larger, in fact, the minimum amount offered by Amigo Loans falls within the CMA payday loan definition of "generally" £1,000 or less. Equally, as acknowledged in the PFs, minimum loan terms of 12 months can often be shortened through early repayment. Indeed, this early repayment of longer term instalment products has been identified by the CMA as part of its transactional analysis.[85] More generally, Wonga considers that the differences between guarantor loans and payday loans have been overstated in the PFs. Providers of guarantor loans are online entities with similar customer interfaces to online payday lenders (for example, Amigo Loans uses sliders) with funds paid directly into customers' accounts (following credit checks performed in relation to the guarantor).

4.16 In summary, it is inappropriate to focus unduly on differences in products' characteristics as delineating market boundaries. The relevant question is whether the relative attractiveness of these characteristics to marginal customers is such that other products may be considered sufficiently close substitutes that switching to these products would constrain price increases. Wonga considers that a range of credit products (including credit cards, overdrafts and guarantor loans) act as a constraint on payday loans and that customer can (and do), switch between these products notwithstanding certain differences in product characteristics.

---

82 Wonga's Response to the AIS, Annex 2, paragraphs 2.4 to 2.7.

83 PFs, paragraph 5.10-5.11.

84 PFs, paragraph 5.13. The differences cited are larger loan amounts and longer durations for guarantor loans, less rapid loan approval and payment to the guarantor rather than the borrower.

85 The CMA has identified borrowers using relatively longer-term instalment products for borrowing needs of less than one month by agreeing to a long-term loan but repaying early. (Payday lending price over time working paper, slide 4.)

## 5. COMPETITION FOR PAYDAY LENDING CUSTOMERS

### The extent and nature of shopping around

5.1 The PFs highlight the extent to which payday lending customers do not appear to undertake comparisons before choosing a payday loan. The PFs conclude "*The majority of payday loan customers do not shop around at all prior to taking out a loan.*"[86] This finding, however, does not necessarily support the conclusion that there is reduced pressure on lenders to compete to attract and retain customers. This constraint requires that a sufficient proportion of marginal customers might respond to a deterioration in competitive conditions by switching (to other products and/or other lenders). It does not require that all customers would act in this manner. The proportion required to exercise an effective constraint has not been investigated by the CMA.

5.2 Wonga considers that a sizeable proportion of customers do shop around which is consistent with its view that there is competitive pressure on lenders to attract and retain customers. More specifically:

(a) the CMA's survey found that three in ten customers (27 per cent) shopped around for the sampled loan (the specific loan they were asked about in the interview).[87] The survey also found that four in ten customers (40 per cent) had ever shopped around for a payday loan. This is a significant proportion on any measure, but particularly when compared with the extent of shopping around identified in other market investigations.[88] In *Home Credit*, for example, the CC's survey identified that approximately one in ten customers found out how much it cost to borrow the same amount from another home credit provider;[89] and

(b) other sources also suggest that a material proportion of customers shop around:

(i) the Bristol University Research suggests that around half (46 per cent) of online payday customers compared the cost of their loan with similar or other types of lenders before taking out their loan;[90] and

(ii) Wonga's own customer research has found that [CONFIDENTIAL]. Wonga rejects the suggestion in the PFs that the sample for this research is less representative of the overall population of payday lending customer, and that the question posed is less relevant.[91]

5.3 As regards the nature of shopping around, the PFs highlight the following: "[t]*hose 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*

---

86 PFs, paragraph 6.27(a).

87 TNS BMRB Survey, page 96.

88 TNS BMRB Survey, page 96.

89 *Home Credit* final report, paragraph 6.68.

90 Bristol University Research, page 29.

91 See slide 16 of the Populus Customer Survey, March 2013 at Annex 3 of Wonga's Initial Submission. The PFs highlight certain methodological differences between the Populus Customer Survey and the TNS BMRB Survey. Wonga does not consider that any such methodological considerations justify placing less weight on Wonga's research given that: (a) the Populus Customer Survey covered a total of over [CONFIDENTIAL] respondents (all online customers), compared to TNS BMRB Survey's combined sample of only 1,061 online customers; and (b) the demographics of the respondents to both surveys were broadly similar. Further, the PFs query whether the question posed in the Populus survey (whether customers 'looked at and considered ' alternative lenders') would necessarily involve a comparison of products (PFs, paragraph 6.18). Wonga considers that there can be no serious suggestion that "looked at and considered other cash advance website" means anything other than undertaking an online comparison of rival products.

*survey to suggest that comparisons may often be a 'very cursory experience', and that customers may face difficulties when trying to compare loans*".[92]

5.4 Wonga considers that the following evidence relating to the nature of shopping around should be highlighted, namely:

(a) the range of sources of information available to, and used by customers. In addition to lenders' websites, a sizeable proportion of customers report having used advertising (57 per cent) and price comparison websites (42 per cent) as a source of information);[93]

(b) the number of lenders compared. Around half of the customers who reported using lenders' websites to shop around visited the websites of four or more lenders, which is consistent with a comprehensive search;[94] and

(c) a very high proportion (91 per cent) of customers who shopped around reported finding out how much it would cost to borrow the amount needed from another lender and a smaller, but still very significant proportion (64 per cent), found out the cost of borrowing with another lender if they did not pay back on time.[95]

5.5 The PFs cite the results of the CMA's qualitative survey indicating that search activities may not be thorough, but the CMA cannot place weight on this finding because it has not undertaken an investigation of how quickly a thorough comparison can be undertaken using online tools. The online environment facilitates effective searching and comparisons between lenders as found by the CMA's own survey which states "*it is in theory much quicker and easier to compare lenders online*".[96] Moreover, for many customers a brief search may be sufficient where information is clear and the product is straightforward. The vast majority (73 per cent) of respondents to the CMA's survey indicated that they felt they had spent the right amount of time on shopping around to compare payday loans.[97]

**The extent to which customers change lenders, and their reasons for doing so**

<u>Reasons for changing loan provider</u>

5.6 Wonga notes that the evidence on the factors driving customer' use of multiple lenders is mixed:

(a) the CMA's analysis of borrowing patterns suggests 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*";[98] and

(b) the CMA's survey evidence, however, indicates that a significant proportion of customers are exercising an active choice between lenders (30 per cent) which increases to more than 45 per cent when other competition based switching factors are included, such as "easier option" and "more convenient". This is consistent

---

92 PFs, paragraph 6.27.

93 PFs, paragraph 6.20.

94 PFs, paragraph 6.21.

95 PFs, paragraph 6.22.

96 TNS BMRB Survey, page 97. Independent Mintel research conducted in October 2012 also indicates that consumers actively use the Internet to research loans (including personal loans, secured loans, payday loans) – 39 per cent of loan holders used a search engine and 29 per cent used a price comparison tool (Mintel, "Personal Loans – UK", January 2013, page 83).

97 TNS BMRB Survey, page 150.

98 PFs, paragraph 6.42(a).

with the existence of a significant competitive constraint on payday lenders to offer attractive and competitive products in order to win a share of the significant proportion of customers that are switching on the basis of the attractiveness of these offerings.

5.7 Wonga has raised a number of methodological issues with the CMA's analysis of borrowing patterns, in particular, the sampling of loans instead of customers results in a sample which is skewed towards heavier borrowing.[99] Wonga also considers that the CMA may be overstating the degree to which customers are forced to change lender in order to obtain additional credit. Given the availability of top-up or open credit facilities, customers with existing outstanding loans may nevertheless be able to borrow additional amounts from the same lender and therefore multi-sourcing will, in some cases, represent product preferences. The CMA's investigation of this pattern of borrowing is limited by the small sample of lenders upon which it is based. Nonetheless, in approximately 40 per cent of cases where a customer has multi-sourced when they already had an outstanding loan with an existing lender which offers a top-up facility, additional credit would have been available for the amount borrowed from the other lender.[100] The CMA suggests that top-ups may be relatively unattractive because customers are required to pay back the original and additional credit on the original due date, but customers may have the option to extend the duration if a longer period of time is required.

5.8 More generally, Wonga considers that the significance of repayment problems in explaining multi-sourcing is also overstated by the CMA because repayment problems will be a factor in the willingness of any lender to offer a loan, and the innovations in CRA data (such as real time data sharing) will address any significant asymmetries between a new and previous lender's visibility of a customer's repayment history.

5.9 The PFs note that the CMA's survey "*suggested that some customers had changed lender because they had a preference for a loan or service offered by another lender*".[101] The PFs do not, however, recognise that several of the other reasons cited in the survey are consistent with a choice being exercised (as opposed to a customer being unable to return to the same lender). Although the proportion of customers citing these reasons is individually less than 5 per cent, when added to the 30 per cent citing preferences for a loan or services offered by other lenders, the survey suggests that approximately 45 per cent of customers switch for competitive reasons. As noted in the CMA's working paper on repeat borrowing and use of multiple lenders (but not in the PFs), all else equal, switching of this type would be expected to place a constraint on lenders to improve their loan offering.[102]

5.10 Wonga's view is that it is constrained to improve its loan offering as a consequence of switching of this type. Wonga's research[103] indicates that [CONFIDENTIAL].

<u>Reasons for not changing loan provider</u>

5.11 The PFs place insufficient weight on the fact that the most important reason by far given by customers for not switching (cited by 61 per cent of respondents to the CMA's survey) is satisfaction with the existing service. This is the hallmark of a competitive market, particularly as the factors cited as contributing to customers having a positive experience

---

99 Wonga's response to the CMA repeat borrowing and customers' use of multiple lenders working paper of 10 April 2014, Section 2.

100 Where the credit is measured as the difference between the original amount borrowed by a customer and their original credit limit. PFs, Appendix 6.2.

101 PFs, paragraph 6.34.

102 Repeat borrowing and customers' use of multiple lenders working paper, paragraph 32.

103 [CONFIDENTIAL]

with a lender[104] are precisely those which online providers have sought to develop and offer competitively in recent years in order to meet the requirements of customers (and to avoid losing ground to rivals). This is also entirely consistent with the evidence in the PFs indicating 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.*"[105]

5.12 The attempt in the PFs to weaken this finding by suggesting that these satisfied borrowers were often not aware of the alternative products available in the market because only one in three (32 per cent which is, in any event, a significant proportion) had ever shopped around is misplaced.[106] Customers that perceive a product to be attractive (and ever improving) and the provider to be responsive will have little incentive to shop around. This is not to say that they would not do so if the product became less attractive and/or the provider less engaged, or rivals introduced products with enhanced attributes. In any event, for a third of customers to have shopped around is clearly significant.

**Potential factors limiting customer responsiveness to the price of payday loans**

5.13 Wonga notes that the CMA highlights factors which it expects would help to make borrowers <u>more</u> responsive to differences in product terms but has not investigated these in detail, nor weighed them against the factors thought to limit responsiveness. These factors are important and must be considered and weighed carefully:

(a) "*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*".[107] Not only are payday loans relatively simple, they are highly transparent compared to many other financial products and the total cost of credit is readily available and is considered by customers when they shop around;

(b) "*most customers borrow online, where information is generally relatively easy to access.*"[108] Not only does the online environment facilitate the provision and accessibility of information, but it has a bearing on customer willingness and ability to undertake searches and the speed with which thorough product comparisons can be undertaken, as indicated at paragraph 5.5 above. Customers use the power of the Internet to identify suitable loan products and then manage their loans online, resulting in significant customer engagement and demand-side pressure to which providers have been forced to respond. There is evidence in the CMA's survey suggesting stronger engagement by online customers; in particular, online customers are significantly more likely to shop around than high street customers;[109]

(c) "*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*."[110] The repeat borrowing identified by the CMA, and the short duration of loans provides an opportunity for customers to

---

104 These 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' text after repayment that make a customer feel valued". PFs, paragraph 6.40.

105 PFs, paragraph 4.214.

106 PFs, paragraph 6.41(b) and 6.42(b).

107 PFs, paragraph 6.45(a).

108 PFs, paragraph 6.45(b).

109 TNS BMRB Survey, page 97.

110 PFs, paragraph 6.45(c).

learn from past experiences. There is evidence in the CMA's survey that this learning does occur and that it stimulates greater engagement including in relation to roll over or penalty charges:

(i) of the customers that indicated they had not found out (when taking out the loan) how much it would cost if they needed to extend the loan, almost a third (27 per cent) said this was because they already knew this information;[111] and

(ii) the qualitative survey indicates that "*customers tend to become aware of roll over or penalty charges only when they have incurred them. While it may be late in the day this does prompt customers to look more closely at the fees charged by the lender as well as to start comparing across lenders, should they take out subsequent loans.*"[112]

(d) "*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.*"[113] The PFs find that the average income of payday lending customers is broadly similar to the wider UK population. Wonga considers that payday loan customers are value conscious and that savings on the cost of borrowing are important drivers of behaviour as well as other non-price attributes. Wonga estimates that 80 per cent of its loans are taken for loan term and loan amounts in relation to which Wonga is more competitive. The fact that Wonga's market share for shorter duration loans is higher than for longer duration loans is entirely consistent with customers exercising choice in the marketplace and being value conscious. The PFs also note that:

"*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*."[114]

**Perceived urgency not conducive to shopping around**

5.14 The PFs highlight as a potential barrier to shopping around or switching the perceived urgency of taking out a payday loan and the weight that customers place on being able to access credit quickly.[115]

5.15 It is not disputed that a proportion of customers value the rapid availability of credit and, for this reason, lenders have been obliged to respond and provide faster payment services, which is now largely offered without charge due to competitive pressures. The CMA's survey, however, indicates that other price and non-price product characteristics are also cited as important in the choice of a payday loan, for example "*being able to apply for the loan online/in store*" (67 per cent), the "*total cost of the loan*" (55 per cent) and "*repayment flexibility*" (54 per cent).[116] Wonga considers that the importance of price and repayment flexibility to customers has forced lenders such as Wonga to respond by adjusting prices and launching instalment products (as described in Section 2).

---

111 TNS BMRB Survey, page 124.

112 TNS BMRB Survey, page 113.

113 PFs, paragraph 6.45(d).

114 PFs, paragraph 4.80.

115 PFs, paragraph 6.63(a).

116 TNS BMRB Survey, page 91.

5.16 It is suggested in the PFs that one consequence of the perceived urgency that customers attach to getting a loan is an unwillingness to spend much time, if any, shopping around.[117] The evidence supporting this finding, however, is not compelling. Whilst a shortage of time is the most common reason given by survey respondents for not shopping around, it is only given by 21 per cent of customers and others reasons were given in similar proportions, for example: "*happy with the first one I looked at*" (20 per cent); and "*have used lender before*" (18 per cent).[118] There are, therefore, several factors which explain any inactivity, with some reflecting customer satisfaction and/or the perception that shopping around is less necessary due to knowledge arising from previous use.

**Credit constraints and uncertainty about obtaining credit**

5.17 The PFs point to a number of indicators of financial constraints which are considered to underline the importance of credit availability to payday loan customers. The PFs then make a very thinly supported connection between these indicators and customer behaviour as follows "[u]*ncertainty <u>may</u> also affect the behaviour of repeat customers, who – having been approved for a loan by a lender in the past – <u>are likely to</u> 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 <u>is likely to</u> face greater uncertainty about whether or not they will be approved for a loan if they apply to an alternative lender which <u>may</u> take different factors into account in its credit assessments, and will generally not have access to detailed information on that customer's repayment history."*[119] (the caveats in this paragraph are underlined in order to emphasise that this is a theory developed by the CMA with little, if any, supporting evidence).

5.18 The CMA's survey evidence does not indicate that uncertainty about loan approval is a significant concern. The fact is:

(a) only 4 per cent of borrowers who have not considered going to a different lender for a loan indicate that this is because the current lender is regarded as more likely to approve their application; and

(b) only 9 per cent of borrowers who had considered switching, but had not actually done so, indicated that this was because the current lender was considered to be more likely to approve their application.[120]

5.19 Moreover, there appears to be a suggestion that uncertainty might arise because an alternative lender "*<u>may</u> take different factors into account in its credit assessments, and will generally not have access to detailed information on that customer's repayment history".*[121] It is very unlikely, however, that this would have a bearing on a customer's attitude and willingness to shop around or switch because, although customers generally understand that credit checks are undertaken, they will not generally be aware of any asymmetries between lenders in this regard. In any event, any such asymmetries are becoming much less significant and relevant as real-time data sharing becomes widespread in the industry as discussed further in Section 6.

**Alleged difficulties associated with identifying the best value payday loan**

---

117 PFs, paragraph 6.52-6.53.

118 TNS BMRB Survey, page 103.

119 PFs, paragraph 6.61.

120 TNS, BMRB Survey, page 136.

121 PFs, paragraph 6.61.

5.20 As regards the alleged existence of impediments to customers' abilities to identify the best value loan for their requirements as set out in the PFs, Wonga considers that the evidence is mixed. In particular, key information is generally available on lenders' websites and the CMA's survey indicates that a high proportion (80 per cent) of customers who shop around have found that information to be very or fairly clear.[122]

5.21 Moreover, the CMA itself has concluded that payday loans are relatively simple products.[123] Wonga considers that, whilst there is some product differentiation (consistent with vigorous competition, in part, through pricing structure and non-price attributes), and prices will depend on specific borrowing requirements, it is still straightforward for customers to compare a total cost of credit which reflects specific requirements, and which the CMA has acknowledged is "*universally provided by lenders.*"[124]

5.22 The 11 larger online lenders provide online tools allowing customers to see a total cost of credit which is specific to their requirements, in many cases using sliders similar to those pioneered by Wonga. Wonga notes that such online facilities can readily accommodate instalment payment structures, allowing customers' to compare traditional payday loans with nonstandard products (e.g. instalment loans). Wonga, for example, is designing an online tool featuring an integrated slider on the home page to allow for a smooth transition between days and months, and lower and higher levels of loan.

5.23 Wonga agrees with the PFs' conclusion that "[t]*he regulatory obligations on lenders to disclose representative APRs were unlikely to be much, if any, assistance to customers in making comparisons between payday loans.*"[125] Wonga urges the CMA, however, to go further in this regard and to investigate whether APRs are a barrier to the identification of the best value product. Wonga considers that APRs, when used for comparison purposes, can indicate relative price differences which do not accurately reflect the underlying prices differences when based on a total cost of credit measure, which would prevent customers from accurately selecting the best value product. Further, Wonga does not agree that APRs 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.*"[126] APR is still a misleading measure even where a number of loans are taken over the course of a year because the actual cost of these loans is the cumulative cost of simple interest within each loan period (as well as fees), whereas an APR measure assumes that interest is compounded over the year.[127]

5.24 Wonga considers that price comparison websites do provide some useful information to customers and notes that the CMA's survey indicates that 42 per cent of customers who shopped around for their most recent loan, or had previously done so, reported using a comparison website, which is a significant proportion.[128] Wonga agrees, however, that further development of the price comparison functionality would deliver benefits to

---

122 PFs, paragraph 6.65.

123 PFs, paragraph 4.91 "*we note that at their core, payday loans are a relatively homogeneous product*". PFs, paragraph 6.45(a) "*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*."

124 PFs, paragraph 6.45.

125 PFs, paragraph 6.76.

126 PFs, paragraph 6.77.

127 Consider, for example, a £200 loan borrowed over 30 days from Wonga. Currently the total cost of this loan is £67.15 (33.58% of principal borrowed) with an APR of 3,294%. Assuming this loan was borrowed 12 times during the course of a year (which is well in excess of the average number of additional loans that the CMA has identified that a customer takes out from the same lender within a year of the first which was 3.6) the customer would have borrowed £2,400 over the course of the year at a total cost of £805.80 (assuming all loans were repaid on time). This means that the customer will have paid charges equal to 33.58% of the total amount borrowed, despite borrowing at an APR almost 100 times larger than the actual cost of borrowing.

128 TNS BMRB Survey, page 101.

customers as well as increasing the chances of a website gaining traction and being commercially viable (which is essential for the long run sustainability of any such website). In particular, Wonga agrees that the site should allow the search criteria to be flexed to reflect a borrower's requirements. In this regard many price comparison sites already use sliders like those used by Wonga, enabling customers to choose a loan amount and loan duration. There may also be a need to investigate whether certain rules imposed by Google are creating a barrier to the viable operation of price comparison websites which feature payday loans.

**Customers' sensitivity to fees and charges incurred if a customer does not repay a loan on time**

5.25 The evidence collected by the CMA points to a significant proportion of customers looking at late repayment costs when taking out a loan (67 per cent).[129] A similar proportion of customers who shopped around reported collecting information on late payment fees (64 per cent).[130] As noted above at paragraph 5.13(c) above, there is also evidence in the CMA's qualitative survey that customers learn about late payment fees from experience and this familiarity with fees and charges and how they apply, which remains the same for different loans, may explain why customers do not report looking at this information to the same degree as for the total amount repayable, which varies for different loans as it will depend on loan amount and duration.

5.26 The PFs claim that overconfidence about the ability to repay a loan on time can "cause" some customers to pay limited attention to these costs when taking out their loan.[131] The evidence shows no such causal relationship. Indeed where customers who failed to repay on time reported that the repayment amount exceeded their expectation, there is no evidence indicating that this is due to late payment fees or charges being higher than expected. Indeed there is no investigation as to what precisely has been miscalculated or misunderstood leading to this outcome.[132]

5.27 As regards the clarity of information on lenders' websites, Wonga's homepage has a very prominent click-through entitled "Is a Wonga loan right for you?" allowing customers to see, with one click, information on late payment fees. Moreover, in two clicks customers are provided with information on late payment as well as an explanation of how late interest accrues after the loan repayment date.

**Role of lead generators**

5.28 Wonga agrees with the finding in the PFs that "*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 service that they are being provided by lead generators.*"[133] Wonga also agrees that this lack of transparency might frustrate online customers' attempts to shop around because of the potential inconsistency between advertised prices and the offer received, which might result in a lack of confidence in the search activity and reduce switching.

5.29 Wonga has particular concerns in relation to the following issues:

---

129 TNS BMRB, page 109.

130 TNS BMRB, page 100.

131 PFs, paragraph 6.117(c).

132 As noted in the PFs (at paragraph 6.92(d)), "*TNS noted that this might be due to 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*", but these are suggested interpretations of the survey results, rather than factors which were investigated.

133 PFs, paragraph 6.107.

[CONFIDENTIAL]

**Perceived risks and loss of convenience associated with changing lender**

5.30 The PFs state "*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*."[134] The PFs set out a number of theories in relation to this perceived impediment, but there is no compelling evidence to support the theories.

5.31 The CMA's survey indicates that only 11 per cent of customers cited "*ease/convenience of sticking with current lender*" as a reason for not switching[135], and this does not suggest that this is a significant barrier to switching for most customers.

5.32 As indicated above, the evidence shows (and the PFs accept that) the online environment facilitates effective searching, comparisons, new applications, and switching between lenders, and online customers are comfortable using the internet to help them identify the right product, to apply online and to achieve a swift transfer of funds. Wonga does not consider, therefore, that customers would perceive much difference in topping-up/rolling over with an existing provider or seeking a new loan from an alternative provider.

134 PFs, paragraph 6.117(e).

135 PFs, paragraph 6.38.

6. **ENTRY AND EXPANSION**

6.1 The CMA has reached the provisional view that its 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*".[136] Wonga considers that this provisional view is unsound.

6.2 The CMA has reached this provisional view notwithstanding the fact that the history of entry and expansion documented in the PFs indicates, by any measure, a significant degree of entry and expansion in particular in comparison with many of the markets considered in previous market investigations. This points strongly to there being both an incentive to enter and the absence of any significant barriers to entry. The key findings in the PFs are summarised below to highlight the wide range of strong and consistent evidence which has been identified by the CMA in this regard:

(a) the earliest entrants began offering payday loans only ten years ago and since then the segment has seen entry by 11 major lenders and many others. Currently there are at least 90 additional payday lenders active in the market;[137]

(b) entry has continued to occur throughout the ten year period, including in recent years. Examples of recent entry by well-resourced lenders include Provident Financial (adopting a diversification strategy) and Think Finance (adopting a strategy based on geographic expansion from an existing US business).[138] Smaller entrants have continued to enter the payday segment throughout the period since 2010 at a rate of around two to five entrants <u>per quarter (i.e. 8-20 per year)</u>;[139]

(c) entry has occurred using a variety of business models including privately funded start-ups, expansion from other jurisdictions (in particular North America) often using scalable technology platforms, acquisition of existing businesses and diversification from other product segments;[140]

(d) certain entrants, including Wonga, have grown rapidly and there is clear evidence that the 11 major lenders have evolved over the period by offering compelling customer propositions which is consistent with a competitive market where more successful players have gained market share at the expense of less successful players. It is noted, for example that the share of loans accounted for by Dollar and H&T has contracted markedly;[141] and

(e) the PFs do not comment on market exit, but this is clearly relevant because the cost of exit (i.e. the cost of exiting from the market if the business venture fails) can influence entry decisions and therefore examples of exit suggest that this is unlikely to have a negative influence on entry. Wonga notes, in this regard that several entities have exited the payday segment in recent years, most recently Cheque Centres, which announced in May that it would cease offering single repayment payday loans.

6.3 This evidence points strongly and consistently to a market which has seen significant entry by new firms with innovative products, processes and business models, expansion by more efficient firms and the exit of less successful ones – i.e. precisely the factors

---

136 PFs, paragraph 7.114.

137 PFs, paragraphs 7.7 and 7.13.

138 PFs, paragraph 7.9.

139 PFs, paragraph 7.14.

140 PFs, paragraph 7.8.

141 PFs, paragraph 7.11.

highlighted in the CMA's market investigation guidelines as indicators of a competitive market.[142]

6.4 Despite this, the PFs state that "*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*."[143] However:

(a) the PFs do not adequately explain what has changed such that the historic patterns of entry and expansion can no longer be trusted as an indicator of future trends. Whilst it is relevant to consider whether significant changes that are anticipated in the market in the foreseeable future may change the historic patterns of entry and expansion going forward, and the PFs identify characteristics of the market which, it is claimed, may reduce the strength of the competitive constraint imposed by new entry or expansion, there is insufficient consideration of why these characteristics can reasonably be expected to limit competitive constraints when they have not done so in the past (including the very recent past);

(b) the assessment of entry contained in the PFs does not weigh up the advantages and any disadvantages facing entrants. The PFs focus on disadvantages without considering in any detail, and placing due weight on, the wider set of factors which influence entry and expansion decisions. In this regard, the PFs in fact indicate that potential entrants are able to meet many of the requirements to operate a successful payday lending business, including access to loan management systems; development of customer services and call centres; and financing and access to capital.[144] Moreover, entrants benefit from a number of advantages in relation to many of these factors. The PFs cannot reach any meaningful conclusions on the expected competitive constraint from entry and expansion going forward without weighing up these advantages and any disadvantages in the round, which the PFs do not do; and

(c) the assessment of entry assesses these perceived disadvantages in a static manner – i.e. any disadvantage facing an entrant at a particular moment is highlighted rather than whether there is a sufficient prospect of these claimed disadvantages being overcome. In fact, evidence set out in the PFs indicates that recent new entrants are optimistic about their ability to expand successfully to the next stage of development.[145]

6.5 The sections below consider the market characteristics which the PFs selectively investigate in detail, i.e.

(a) the impact of reputation and regulation;

(b) alleged difficulties in raising awareness of products and attracting new customers; and

(c) perceived disadvantages faced by new entrants and smaller lenders in assessing applicants' credit risk.

---

142 *Guidelines for market investigations: Their role, procedures, assessment and remedies* April 2013, CC3 (Revised), paragraph 10.

143 PFs, paragraph 7.4.

144 PFs, paragraph 7.18.

145 PFs, paragraph 7.12 "*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 project and told us that although it was incurring significant losses, it was making progress, and was comfortable that it would eventually turn profitable*". PFs, Appendix 7.1, paragraph 9 "*Provident old us that the development of its Satsuma product was progressing well*".

6.6 A further section outlines the advantages that new entrants enjoy which needs to be factored into a balanced assessment of the advantages and any disadvantages facing entrants.

**Impact of reputation and regulation**

***Alleged deterrence of mainstream lenders***

6.7 The PF's state that "*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*".[146] This is inaccurate for the following reasons:

(a) the evidence supporting this statement is entirely related to two banks (Barclays and Lloyds) and does not consider mainstream credit suppliers or specialist providers more generally;

(b) in fact, the evidence from the major banks is more equivocal than suggested by the CMA's provisional view, in particular Wonga notes that Lloyds did not rule out entry (or product innovation to meet the needs of payday customers). In this regard, Lloyds did raise, however, significant issues with the mandatory use of APR in relation to payday loans;[147]

(c) there are other parties with the "*capability to transform the nature of competition in the market*"[148], in particular:

(i) entities with experience of supplying personal credit products to the non-standard lending market such as Provident Financial which has recently entered the payday loan segment with an instalment product (namely "Satsuma Loan"). Clearly, Provident Financial was not deterred by issues relating to reputation. On the contrary, Provident Financial told the CMA that "*increasing regulation (from the OFT, FCA and CC) to stamp out poor behaviour in the payday sectors, along with its approach based on its long experience with home credit customers, meant that now was a good time to launch the Satsuma product.*";[149]

(ii) entities familiar with any reputational issues and regulatory uncertainty such as those with experience of the same sector in the US and other jurisdictions.[150] Wonga considers that financial technology companies with international growth plans and, indeed, any company already providing regulated financial services, are accustomed to addressing issues relating to reputation and regulatory uncertainty, and successfully managing these issues as part of their growth strategy;

(iii) entities with disruptive business models such as peer-to-peer lenders which are rapidly evolving, including by offering smaller value loans for shorter durations. RateSetter, for example, has a minimum loan amount of £1,000

146 PFs, paragraph 7.39(a).

147 PFs, paragraph 7.24.

148 PFs, paragraph 7.39(a).

149 PFs, Appendix 7.1, paragraph 4.

150 Wonga has previously provided the CMA with details of European and US-based technology-oriented short-term consumer credit startups, which have received significant funding capital over the last 12-24 months (in many cases inspired by the success of Wonga and other disruptive financial technology startups), such as LendUp (US), Kreditech (Germany and continental Europe), Mogo (Canada), AvantCredit (US), ZestCash (US), RevolutionCredit (US), ProgresoFinanciero (US).

and a maximum of £25,000 and customers may borrow for a minimum of 6 months to a maximum of 60 months (and therefore it offers loans within the CC's duration specification and at the edge of the loan amount specification).

6.8 In any event, the PFs themselves indicate that the potential deterrent effect on entry created by the sector's perceived negative reputation is expected to be short-lived if regulation is successful in improving conduct and thereby improving reputation.[151] This is consistent with Provident Financial's expectation as outlined above and also highlights the need for an assessment of entry to consider the medium to longer term view (which will influence commercial decision making), rather than a snapshot of any particular market characteristics at a moment in time.

6.9 Further, it appears that, to the extent that banks may be deterred in the future from entering, this is related primarily to the distortive effects arising from the mandatory use of APRs when advertising and providing payday loans. As noted by Lloyds, "*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 this issue, then it might make it more likely that …mainstream lenders would consider entering payday lending or developing products designed to meet the same need.*"[152]

***The impact of recent political and regulatory developments***

6.10 The evidence put to the CMA has made it clear that whilst uncertainty arising from regulatory changes may result in a degree of caution, there is sufficient flexibility in the business models of many players that they can operate sustainably whilst waiting for greater clarity before adapting their business models to compete vigorously in the new environment. Provident Financial, for example, considers that the development of its Satsuma product is "*progressing well*" even in the midst of considerable regulatory uncertainty.[153]

***Access to banking services***

6.11 The PFs state that "*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 of suppliers currently willing to provide services to payday lenders*."[154]

6.12 Wonga is surprised at the weight placed by the CMA on this factor given that it has not identified any evidence suggesting that it has actually prevented entry or that lenders have left the market as a result of banking services being withdrawn.[155]

6.13 Further, some of the evidence from banks suggests that the CMA's provisional view may be over-stated, in particular:

---

151 PFs, paragraph 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*".

152 PFs, paragraph 7.24.

153 PFs, Appendix 7.1, paragraph 9: "*Provident told us that the development of its Satsuma product was progressing well. It had deliberately moderated the volume of new loans issued as it built the capacity to support more rapid development, and because of the uncertainty introduced by the impending price cap*".

154 PFs, paragraph 7.39(b).

155 PFs, paragraph 7.38.

(a) Barclays told the CMA that it provided banking services to payday lenders and that it was not aware of rejecting any applicants by payday lenders to bank with Barclays; and

(b) Lloyds noted "*there were reputable and well-managed payday companies that it was pleased to* support".[156]

6.14 Wonga would also expect the CMA to consider recommendations to the FCA as part of its remedies package if it believes that it has identified sufficient evidence of anti-competitive behaviour to warrant further investigation.[157]

**Alleged difficulties in raising awareness of products and attracting new customers**

6.15 The PFs state that "*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 this connection, the PFs highlight "*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*."[158]

6.16 The PFs focus on perceived difficulties facing new entrants or smaller lenders in building a brand and attracting customers, in particular, where established brands enjoy a large share of voice and where there may be difficulties in recouping the cost of advertising. It is unsurprising that second movers should face issues of this sort. The more relevant question is whether sufficient expansion is possible within a reasonable timescale using the strategies available such that new entrants are prepared to invest in customer acquisition. In this regard, Wonga makes a number of observations which have not been adequately considered in the PFs:

(a) any early disadvantages in gaining customer awareness can be overcome and there is no compelling evidence in the PFs showing why this is significantly different now than it was for Wonga and other early movers. When it launched, Wonga was seeking to gain awareness of its product in competition with mainstream credit providers (in particular the banks) which devoted significantly higher levels of expenditure to advertising (and which enjoyed much stronger brands);

(b) new lenders and smaller players have strong incentives to undertake customer acquisition activity because gaining a customer relationship yields benefits beyond initial sales through the possibility of further borrowing (provided that a lender offers a competitive product);

(c) the risks associated with customer acquisition are mitigated because much of the costs are scaleable. The PFs refer to Wonga's advertising expenditure in 2013 but in earlier years, Wonga's expenditure was much lower (consistent with its smaller size). Further, most of Wonga's current and on-going advertising spend is necessary to retain existing customer numbers (which a new entrant would not be attempting to replicate upon entry);

---

156 PFs, paragraph 7.36(b).

157 PFs, paragraph 7.35 reports examples of lenders experiencing difficulties accessing banking services including references to anti-competitive behaviour.

158 PFs, paragraph 7.80.

(d) brands can be established quickly and opportunities exist to leap frog strong brands reflecting the ephemeral nature of brand consciousness and low brand loyalty. Wonga estimates that the [CONFIDENTIAL];[159]

(e) the strategies available to new entrants and smaller lenders to raise customer awareness are very wide-ranging and it is inappropriate, therefore, to focus (as the PFs have done) on whether any single channel can be relied upon to deliver wide access to potential customers.[160] The evidence provided by Provident Financial and Think Finance highlights that both are using a mixture of different sources to generate new business.[161] Wonga also notes that the PFs give no consideration to more innovative and advertising methods such as those taking advantage of social media[162] and mobile apps which can be very successful and can incur significantly lower costs than offline advertising and more traditional online advertising. Furthermore, investment in an informative, attractive and user-friendly website can have a real impact on brand awareness. In this connection, as the TNS BMRB Survey itself indicates, by far the most important source of information for customers (who shop around) is the websites of payday loan companies, and not advertising;[163]

(f) there are likely to be spillover benefits to new entrants and smaller lenders from the advertising campaigns of established players which grow the overall market because they will tend to raise awareness of the product in general as well as specific brand awareness; and

(g) finally, the PFs give insufficient consideration to the options available to certain new entrants to leverage an existing brand. The PFs state "*new entrants with established brands in other markets may be able to overcome this disadvantage more easily than other suppliers*"[164], but the point is not explored in any detail despite Provident Financial providing evidence on how this leverage can work in practice. Provident Financial has decided to launch an instalment product with a new brand (Satsuma Loans) but explains the benefits in generating business from its diversified credit portfolio. More specifically, as the PFs recognise, "*Provident's other products would also provide a source of customers – as well as customers declined from its credit card products at Vanquis Bank, it would be able to generate some leads from customers visiting its home credit website looking for an online product*".[165] Further examples of new entrants leveraging well-known brands include 118118Money (a high profile phone directory brand), and Cash Converters which has leveraged it pawnbrokerage services brand.

6.17 Accordingly, there is a range of evidence which indicates that new and smaller lenders do have strong incentives to engage in activities which raise awareness of their products, and are optimistic about their prospects:

---

159 [CONFIDENTIAL]

160 PFs, paragraph 7.66, for example states "*a lender that expands only by taking customers from lead generators will not access over half of the pool of potential new customers*". Paragraph 7.73 states "*the volume of new customers available via 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*."

161 PFs, Appendix 7.1, paragraph 5: "*Provident told us that it would rely on a mixture of different sources to generate new business including advertising on television and lead generators*" and paragraph 13, "*Think Finance is using a number of different strategies in order to acquire new customers*".

162 Wonga has approximately 400,000 Facebook followers and the social networking medium forms part of Wonga's marketing strategy.

163 TNS BMRB Survey, page 101.

164 PFs, paragraph 7.80.

165 PFs, Appendix 7.1, paragraph 7.1.

(a) Think Finance, for example, is investing significantly in television and display advertising with the expectation that this will build significant brand awareness (albeit this will take some time given the established brands of larger lenders);[166]

(b) MYJAR is testing television advertising and is "*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)*;"[167]

(c) Provident Financial refers in its investor presentation to its "*competitive advantage in its marketing reach, citing its 'financial firepower, existing lead generation capabilities/relationships and links to Vanquis Bank declines*'";[168]

(d) Amigo Loans (Richmond Group) has consistently increased its advertising spend as it has expanded, as shown in the chart below which shows its TV spend as a proportion of total spend increasing from approximately [CONFIDENTIAL] per cent in 2013 to generally over [CONFIDENTIAL] per cent in 2014;[169] and

(e) MyMate[170] has recently (in June 2014) spent significantly on TV advertising (£124k, resulting in a [CONFIDENTIAL] per cent share of total spend) according to Nielsen AdDynamix, as shown in the chart below.

**Figure 4: [CONFIDENTIAL]**

[CONFIDENTIAL]

**Alleged disadvantages faced by new entrants and smaller lenders in assessing applicants' credit risk**

6.18 The PFs state "*[b]ecause 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.*"[171]

6.19 Any such "disadvantage" has been a factor for new entrants over the past 10 years and has clearly not dissuaded entry nor has it prevented growth.[172] The PFs fail to identify why the future should be any different in this regard. Moreover, the PFs fail properly to consider whether prospects might be more favourable going forward due to current innovations in CRA data which reduce any asymmetries between new and existing lenders.

6.20 It is uncontroversial that new lenders will enhance their ability to assess risk as they gain experience and a stock of customers. Risk models evolve and are refined even amongst established rivals because the ability to supply more credit without significantly increasing levels of default is a key competitive factor (and hence there is a strong incentive to

166 Think Finance has spun off its portfolio of branded consumer lending products, including RISE, Elastic and Sunny, creating a new independent company called Elevate.

167 PFs, paragraph 7.61.

168 PFs, Appendix 7.1, paragraph 7.

169 Amigo provides guarantor loans. Entities such as Amigo Loans and GBP Loans have emerged in recent years to offer unsecured loans where a third party acts as a guarantor. These are online entities with similar customer interfaces to online payday lenders (for example, Amigo Loans uses sliders) with funds paid directly into customers' accounts (following credit checks performed in relation to the guarantor).

170 A loan product which mixes characteristics of short-term loans and guarantor loans, see mymate.co.uk.

171 PFs, paragraph 7.111.

172 Indeed, the difficulties in developing an appropriate risk model are actually less now than they were when Wonga entered in 2007 as explained from paragraph 6.24 below.

gather all relevant information and continually develop and refine risk assessment methodologies).

6.21 The more relevant question, however, is whether there is a sufficient prospect of new entrants being able to overcome any disadvantages within a reasonable timeframe, such that they are prepared to invest (in particular, in data, technology and bad debt) in order to benefit later. The historic pattern of entry and expansion indicates that such incentives have existed and that investment has paid off for many players. Wonga considers that there is strong evidence that the same is true today:

(a) MYJAR has told the CMA that it has spent time gathering data in recent years to help refine its underwriting and this has yielded benefits through improvements in MYJAR's ability to write a better loan;[173]

(b) CashEuroNet considers that a good credit model could be built in six months;[174]

(c) Provident Financial is planning to build a bespoke scorecard to assess risk for its Satsuma product using CRA data and its existing customer records and, whilst it will "feel its way" initially, it anticipates learning quickly due to the weekly cycle of its product;[175] and

(d) Think Finance is currently conservative as to whom it offers loans, but expects its risk assessment models to be "*quite a bit better in a year's time*".[176]

6.22 The PFs claim that the information available from the CRAs suffers from various limitations namely: the frequency of the data (monthly updates may be problematic for short-term loans); the level of detail available (e.g. there may be difficulties in differentiating degrees of late/partial repayment); and the completeness of records (repayment history may not be available for all lenders).

6.23 The PFs have not, however, given sufficient consideration to the following developments which will improve the richness and breadth of CRA data and serve to narrow significantly any asymmetry between new and existing lenders by providing new entrants with much more robust data upon which to base their underwriting:

(a) real-time data sharing; two CRAs (CallCredit and Experian) have developed systems to allow for a more frequent update cycle of consumer credit data. Wonga has already commenced a daily contribution of its data to CallCredit and believes that the other larger lenders are either already contributing or have agreed to do so, and are likely to be prioritising this given the close interest of the FCA and the suggestion of regulatory intervention in the event that the industry is unable to overcome any obstacles.[177] Experian is expected to launch its system in the next few months. As a result, the benefits from a more timely indication of a customer's exposure to short-term debt will be available in the near future and will provide a rich source of information for new entrants seeking to assess risk;

(b) development and refinement of products especially designed to provide information of direct relevance to a payday lender, such as CallCredit's "The Affordability Check" data block and its new "PayDay Loans" data block;[178] and

173 PFs, paragraph 7.104.

174 PFs, paragraph 7.106.

175 PFs, Appendix 7.1, paragraph 7.

176 PFs, Appendix 7.1, paragraph 15.

177 Remedies Notice, paragraph 12.

178 Please refer to AIS Response, paragraph 7.22, and Market Questionnaire Response, paragraph 23.8.

(c) development of off-the-shelf risk scoring products which allow smaller new entrants to buy-in credit risk modelling. These products (provided by organisation such as Aire) use CRA data as well data from other readily available sources (e.g. information derived from a customer's online presence) and use behavioural analytic tools to provide predictive credit risk scores.

**Advantages enjoyed by new entrants which were not available to early movers**

6.24 As indicated above, the PFs focus on disadvantages without considering in any detail the wider set of factors which influence entry and expansion decisions.[179] Wonga considers that entrants benefit from a number of advantages in relation to many of these factors. The PFs cannot reach any meaningful conclusions on the expected competitive constraint from entry and expansion going forward without weighing up these advantages and any disadvantages in the round. More specifically, entrants potentially benefit from advantages which reduce entry and expansion costs as compared with 2007 when Wonga entered, namely:

(a) financing and access to capital: as the sector is now more developed and business models have been market tested, there will be more sources of funding than were available to Wonga when it created its new and untested business model and entered the sector in 2007;

(b) the availability of loan management software: new entrants can acquire cutting edge third party solutions instead of undertaking the development themselves. Indeed, Wonga considers that certain third party systems are very advanced, for example, new providers in the US such as Sociogramics;

(c) access to better information from CRAs, in particular:

(i) access to a rich source of data that has been created by the larger, established lenders (because they gain insight from the payment histories of customer of these large lenders when their own contributions will be small);

(ii) access to products which have been refined or developed to assist payday lenders, such as CallCredit's "The Affordability Check" data block and its new "PayDay Loans" data block;[180] and

(iii) real-time data sharing (as discussed above).

179 Although an overview of the requirements to be an effective payday lender is provided at PFs, paragraph 7.18.

180 Please refer to AIS Response, paragraph 7.22, and Market Questionnaire Response, paragraph 23.8.

7. **ALLEGED CONSUMER DETRIMENT**

7.1 Wonga agrees with the CMA that assessing customer detriment is inevitably a complex exercise.[181] The caveats identified by the CMA in relation to its analysis are therefore important to recognise at the outset.

7.2 The CMA identifies two sources of customer detriment which it considers are likely to arise as a result of the provisional AEC:

(a) some customers pay more for their loan than they would if price competition were more effective; and

(b) there is likely to be less innovation on pricing (e.g. the introduction of risk-based pricing) than might be observed in a market in which price competition were more effective.

**Higher prices**

7.3 Wonga considers that the analysis of customer detriment relating to higher prices is based on flawed premises and is unreliable. In particular:

(a) the CMA's assumption that all customers should achieve the lowest (or amongst the lowest) price in a competitive market is inconsistent with how markets operate. It is very common in competitive markets for customers to make variable contributions to fixed costs depending on their price sensitivity;

(b) the CMA's assumption that any price above its assumed competitive benchmark constitutes an overpayment is inaccurate in a market which features important non-price attributes, and any assumed gain from a price reduction would need to be adjusted to reflect the loss of any value attributable to these non-price attributes;

(c) the profitability analysis does not support the choice of benchmark. The implied price reduction would result in Wonga's profitability falling to unsustainably low levels in 2013. Going forward, the pressures of increased competition and regulatory costs are putting significant pressure on industry profitability and the potential costs to customers of the CMA's hypothetical "competitive" outcome arising from likely industry exits and tighter risk thresholds have not been properly investigated. In particular, the impact of such a scenario in the context of a price cap have not been considered; and

(d) the simplifying assumptions which have been made undermine the robustness of the analysis.

<u>The identification of a competitive benchmark is flawed</u>

7.4 A key element of the analysis of detriment is the identification of a "*primary competitive benchmark*" (i.e. the price which might be available if competition was more effective) of £25 per £100 for a one-month loan (compared with the "*typical value*" of £30 per £100). The CMA considers this fall in price (which represents a 16.7 per cent reduction) to be "*realistic and relevant*" since it is "*similar to the price paid by <u>some</u> customers for some of the <u>cheaper products</u> currently available on the market*." (emphasis added) [182] The CMA

[181] PFs, Appendix 8.1, paragraph 2. "*The focus of the analysis presented in this appendix is to enable us to gain an understanding of the ways in which customer detriment arises and the order of magnitude of any effect, <u>rather than to quantify exactly which customers are suffering a detriment and by precisely how much</u>*." (emphasis added)

[182] PFs, Appendix 8.1, paragraph 8. The PFs refer to CashEuroNet's FlexCredit product and Dollar's monthly interest rate offer of 25 per cent until late 2011/early 2012 (with the same rate offered subsequently via moneysupermarket.com, until it closed).

also examines the impact of higher and lower price benchmarks of £27.50 and £22.50 respectively.[183]

7.5 Wonga considers that the few examples of lower prices cited in the PFs do not provide a sufficient or reasonable basis for identifying a benchmark for a notionally competitive price for the following reasons:

(a) the lower prices reflect circumstances which make them unsuitable as benchmarks. FlexCredit is a new, longer term product and whilst it represents a strong competitive threat, it is unclear whether the pricing strategy adopted by CashEuronet will be sustained or whether it is designed to drive penetration in an initial launch phase. Equally, Wonga considers that a benchmark based on a temporary promotional price (offered by Dollar) is unsuitable given that this is also unlikely to reflect a sustainable level of competitive prices. Wonga notes, in this regard, that the coverage of Dollar's promotional price is uncertain as Dollar's promotions during this period were only made available to new customers.[184] In both cases, there has been no consideration of whether, for the entities concerned, these prices would be commercially sustainable;

(b) the assumption (in scenario A) that price dispersion would not persist and that no lender would set prices above the competitive benchmark (which is set at the lower end of the existing price range) is unjustified. The price dispersion which is observed in the market currently does not reflect a lack of competition but rather the adoption of different pricing structures (which deliver different prices depending on loan duration) by lenders and significant differences in non-price attributes. Moreover, many competitive markets have outcomes featuring price dispersion, particularly in the presence of substantial fixed costs where customers may make variable contributions to costs over and above their direct incremental costs; and

(c) the CMA has not used a total cost of borrowing measure, in particular, it has excluded late fees, top-up fees and rollover fees which limits the weight which may be placed on the analysis. The PFs state "*by excluding these fees, we are likely to understate for some customers the extent to which they are overpaying for their loan (potentially by a substantial amount given the extent of variation that we observed in the late fees used by different lenders.*"[185] The CMA cannot draw such a conclusion based only on its observation of price dispersion in relation to late fees. The dispersion of the total cost of borrowing between lenders will depend on the relationship between pre and post due date fees for different lenders which has not been explored.

7.6 The choice of benchmark is particularly important given that the analysis is highly sensitive to the assumed "benchmark price". The CMA's Table 2[186] shows that the average amount saved per loan in Scenario A (in which the prices for higher-priced loans fall to the assumed benchmark) range from £2.74 (benchmark of £27.50 per £100 per month) to £8.26 (benchmark of £22.50 per £100 per month). If the appropriate benchmark were increased further above £27.50, the level of measured customer detriment would fall further.

---

183 PFs, Appendix 8.1, paragraph 10. The CMA considers that the higher price point is considered potentially relevant if recent or expected cost increases mean that lenders could not profitably lend at the £25 level, while the lower price benchmark may be relevant if the lower prices observed in the market (e.g. those offered by Speedy Cash or CashEuroNet through money.co.uk) are representative of what might be seen in a competitive market.

184 PFs, paragraph 4.57(b).

185 PFs, Appendix 8.1, paragraph 18.

186 PFs, Appendix 8.1.

The analysis inappropriately focuses solely on price effects

7.7 The approach outlined in the PFs fails to take into account a range of other relevant characteristics such as the impact of quality of service or brand perception on customers' willingness to pay.[187] In such situations, the CMA's assumption that customers are "overpaying" may not be accurate. In order to properly assess the net welfare impact of any assumed switch by customers to the lowest priced available product, the CMA would need to have a detailed understanding of the various non-price attributes of the products in question. The loss in the value of non-price attributes should then be set off against any identified gains from reduced prices.

7.8 CashEuroNet also considers that customer choices are influenced by the value attributed to non-price attributes. In particular, CashEuroNet's hearing summary, indicates "*Although QuickQuid's longer-term loans were cheaper than similar loans offered by Wonga, some customers preferred Wonga products, which CashEuroNet attributed to certain features of the Wonga loan proposition.*"[188]

7.9 Moreover, the CMA's assumption that the price of a typical payday loan would fall "*as a result of more effective* price *competition*"[189] ignores the likelihood that an increased focus on price-based competition would result in reduced competition on non-price factors. The loss in the value of non-price attributes should then be set off against any identified gains from reduced prices.

7.10 The CMA also recognizes that its analysis "*do*[es] *not take into account any impact of increased price competition on the total number of payday loans issued*",[190] even though it accepts that "*the number of loans might… decrease, to the extent that lower prices cause lenders to tighten their risk thresholds, as it becomes unprofitable to supply customers with a higher expected risk at a lower price point*."[191]

7.11 Wonga considers that a reduction in price to the CMA's competitive benchmark would inevitably lead to some lenders tightening their risk thresholds, as certain customers who are profitable at existing prices would become unprofitable. The CMA's analysis takes no account of the significant detriment that such customers would suffer if they were unable to access the market at all.

The profitability analysis does not support the choice of competitive benchmark

7.12 The CMA considers that the analysis of historical profitability for major lenders shows that efficient operators would have been able to retain reasonable profitability in the face of a decline of revenue (e.g. of 16.7 per cent) even without changing risk thresholds.[192]

7.13 Wonga considers, however, that moving to the CMA's competitive price benchmark could result in a significant reduction in returns. Wonga estimates that a reduction in revenue on this scale would result in Wonga's returns for 2013 [CONFIDENTIAL] per cent to around [CONFIDENTIAL] per cent,[193] close to the range of the CMA's pre-tax nominal

---

187 This is particularly important in situations where there is a positive correlation between price and the value of non-price attributes of the product (i.e. there is a degree of "vertical differentiation" across the set of payday loan products).

188 Summary of a hearing with CashEuroNet, paragraph 16.

189 PFs, Appendix 8.1, paragraph 8.

190 PFs, Appendix 8.1, paragraph 20.

191 PFs, Appendix 8.1, footnote 4.

192 PFs, Appendix 8.1, paragraph 9.

193 [CONFIDENTIAL]

WACC benchmarks (8-13 per cent) and within the range of the CMA's weighted VC / CAPM benchmarks (8-19 per cent).[194]

7.14 Wonga has produced estimates of returns in 2014 which reflect an estimate of the impact of increased competition and higher costs due to the need to meet various regulatory requirements. The economic return on capital in 2014 is estimated to be [CONFIDENTIAL] per cent which is below the lower bounds of the CMA's benchmarks and therefore indicates [CONFIDENTIAL]. Going forward, the pressures of increased competition and regulatory costs are putting significant pressure on industry profitability. Moreover, the potential costs to customers of the CMA's hypothetical "competitive" outcome arising from likely industry exits, tighter risk thresholds (resulting in a contraction in the availability of credit) and less innovation have not been properly investigated. In particular the impact of such a scenario in the context of a price cap has not been considered

<u>Simplification undermines the robustness of the analysis</u>

7.15 A number of relevant factors are excluded in order to simplify the analysis or because they are not deemed to have a material impact, but this undermines the robustness of the analysis. More specifically the analysis excludes:

(a) the effects on prices of any promotional rates (such as discounts offered by Wonga on the transmission fee) on the basis that this is unlikely to have any material impact on the calculation of detriment. However, there is no justification for this position. For example, this exclusion could have a disproportionate effect on customer detriment if firms with a higher average TCC are more likely to adopt promotional pricing policies than those which have lower average TCC. In such a case, inclusion of promotional discounts could lead to a narrowing of the overall net cost of loans across lenders (and hence reduce the measured customer detriment); and

(b) loans of duration greater than 31 days for reasons of complexity. The CMA, however, has failed to examine the possible implications for the analysis of customer detriment. For example, if the average price dispersion for longer loans is less than the dispersion for shorter loans (weighted by take-up of loans) then excluding such loans could lead to an overstatement of average "overpayment" per loan.

**Pricing innovation**

7.16 The CMA also states 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*".[195] While the CMA did not seek to quantify this detriment, it was likely to exist in reducing the overall level of market efficiency and the extent to which prices reflect the cost to supply different customer groups.[196]

7.17 As an initial observation, the CMA has adopted a static approach to analysing the market. The history of the market has been that the initial innovators such as Wonga adopted one-price-fits-all business models that emphasize simplicity and transparency (reflecting the need to compete with mainstream credit products). As the market has matured and margins have been reduced by competition, alternative ways of pricing are emerging to appeal to different customer groups, for example ThinkFinance's Sunny product, which incorporates a risk-based pricing element.[197] The CMA has not assessed whether its

194 PFs, Table 4.8, paragraph 4.184.

195 PFs, paragraph 52.

196 PFs, paragraph 52.

197 This is also acknowledged by the CMA, see PFs, paragraph 7.9.

expectations are reasonable given that the industry lifecycle has not yet reached full maturity (as acknowledged by the CMA and discussed in previous sections).

7.18 Moreover, there are a number of possible explanations for why pricing based explicitly on cost to serve may not be widely adopted even in a competitive and well-functioning market for example:

(a) risk-based pricing may not be commercially viable, particularly in trying to expand to serve additional customers with lower credit worthiness than existing customers. Setting prices based on specific customer group's cost to serve would increase prices for customers with lower creditworthiness as compared with the current prices they face based on the overall risk pool. For those with the lowest credit worthiness, this price increase may be beyond their willingness to pay, effectively pricing them out of the market; and

(b) conversely, when considering whether to lower prices to gain customers with higher credit worthiness, the risks and costs of developing new products that better reflect cost to serve may not be worth the commercial benefits of gaining such additional customers. The risks and costs of developing new products would vary for different lenders and could be substantial, particularly when taking into account potential cannibalisation of revenues from existing products. In contrast, the level of additional demand to be gained from expanding to customers with higher credit worthiness is uncertain, and potentially smaller than the risks and costs involved.

7.19 The example of Sunny, however, indicates that certain lenders do see commercial opportunities in adopting this form of pricing, and Wonga anticipates that others may also do so going forward.