Anticipated acquisition of Purpose UK Holdings Limited, together with certain shares in the capital of MEM Holdings Limited by Dollar Financial UK Limited

ME/4842/11

The OFT's decision on reference under section 23(1) given on 4 March 2011. Full text of decision published 24 March 2011.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Dollar Financial Corporation ('Dollar'),** listed on the NASDAQ stock exchange and based in Berwyn, Pennsylvania, is an international diversified financial services company primarily serving unbanked and under-banked consumers. In the year ended 30 June 2010, Dollar achieved worldwide revenues of US$610.9 million. For the same period, UK revenues were £115 million. Dollar operates in five countries, Canada, the UK, the Republic of Ireland, the United States, and Poland.

2. In the UK, Dollar principally serves customers through its network of high-street stores which trade under the names The Money Shop and *C*ash A Cheque. The Money Shop operates as a high-street payday lender and pawn-broker. Dollar also operates two pawn shops in Edinburgh and Glasgow under the name Robert Biggar Ltd and three high-end pawn shops in London under the names TM Suttons, Robertsons, and Robertson and Suttons.

3. Dollar also offers online payday loans to UK customers under the name Payday Express as well as a number of other domain names. Dollar provides merchant cash advances which are repaid by future credit card receipts under the business name Business Cash Advance.

4. **Purpose UK Holdings Limited ('Purpose')** is a wholly-owned subsidiary of **CompuCredit Holdings Corporation**, an Atlanta based international provider of various credit and related services and products to financially underserved consumers. **MEM**, a subsidiary of Purpose, is a specialist provider of online payday loans in the UK, operating under the brand name Payday UK. Purpose's UK revenue for the year ended 31 December 2009 was £41 million.

TRANSACTION

5. On 31 December 2010, the Parties signed a Share Purchase Agreement, which will allow Dollar to acquire the entire issued share capital of Purpose, together with certain shares in the capital of MEM Holdings Limited, a subsidiary of Purpose for consideration of US$195 million.

6. This transactional is conditional on clearance from the OFT.

7. The OFT received a satisfactory submission on 13 January 2011. The administrative deadline is 4 March 2011.

JURISDICTION

8. The OFT believes that the transaction would result in two or more enterprises ceasing to be distinct for the purposes of section 23(1) of the Enterprise Act 2002 (the Act).

9. The OFT believes that it is or may be the case that the share of supply test in section 23(2)(b) of the Act is met and, therefore, that a relevant merger situation has been created. This is because the parties' combined share of supply of pay day lending in the UK is estimated to exceed 25 per cent.

RATIONALE

10. The parties expect the acquisition to consolidate Dollar's position as a 'leading provider of internet loans across the United Kingdom and to allow Dollar access to Purpose's scalable technology platform, strong business acumen and industry expertise'.

BACKGROUND

11. In 2007, the OFT considered the acquisition by Albemarle and Bond Holdings plc of Herbert Brown and Son Limited, predominantly a merger of two high-street pawn-brokers both of whom offered payday loans on the high street. That merger was cleared after consideration of competition in local markets.

12. More recently, in June 2010, the OFT published its High Cost Credit Review, which amongst other things considered competition between different types of high-cost credit including the payday loans market.

13. In its review, the OFT found that there was little substitutability on the demand side between payday lending, pawn-broking[1] and home credit[2] because of:

- different lending criteria by lenders, which result in different demographics for borrowers of different products, and

- different inherent characteristics of the products, such as the length of the loan period, which limit the choice of products for different groups of customers, because of affordability constraints.[3]

14. Substitutability opportunities between different high-cost credit products appeared to the OFT to be limited, since different products require different business models and skills so that, as a result, most suppliers specialise in offering one product. The most notable exception is the joint provision of payday lending and pawn-broking, which are frequently offered by the same suppliers who take advantage of economies of scope by better utilising their high-street premises to attract a broader range of customers.[4] However, few high-street payday lenders offer online lending and those that do have generally entered the online market through acquisition.

15. Given its direct relevance, the OFT has used the information obtained in its review to inform this investigation. It therefore takes as its starting point

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[1] Pawn-broking is defined as the provision of small monetary loans secured on items of value (typically jewellery) which the pawn-broker accepts from the borrower and holds as collateral for a minimum period of time (usually six months).
[2] Home credit is defined as the provision of small unsecured loans repaid in instalments to a collection agent who calls at the customer's home on a weekly basis.
[3] High Cost Credit Review, page 18.
[4] High Cost Credit Review, page 18.

the assumption that payday lending is a separate market from other high-cost credit arrangements.

MARKET DEFINITION

16. Consumers borrow money to smooth their consumption over a period of time. If consumers' consumption expenditure followed income closely, they would be unduly constrained at times when their income was relatively low and have more income than needed for consumption at times when their income rose. For payday borrowers, the period of time over which their expenditure exceeds their income is very short, suggesting that payday borrowing serves largely to alleviate intermediate and short-lived cash-flow problems.

17. Dollar itself refers to an ALICE demographic, being 'asset limited, income constrained, employed' and notes that the size of this customer segment is increasing.

18. Payday lenders generally require that borrowers show proof of their identity, their address in the UK, their employment status and information about their income and bank account. Online (and increasingly high-street) lenders use the services of credit reference and fraud prevention agencies. Payday lenders will generally limit the value of the first loan made to less than £300, to limit exposure to customers with unknown repayment history. Borrowers are generally employed, with personal bank accounts, and may well have access to overdraft facilities and credit cards from mainstream lenders.

Product market

19. The parties overlap in the provision of online payday loans. These are the shortest loans available from specialist lenders and are so-called because the loan period normally ends on the borrower's pay day.[5] High-street cheque-cashiers developed the payday loan product and many lenders still offer this service as well as international money transfers. Some companies have developed organically as online payday lenders or moved into lending to customers through acquisition of an online lender. No high-street lender

[5] The OFT found, in its High Cost Credit Review, that some suppliers of short-term loans offer products which charge daily interest according to the actual loan period and irrespective of when the payday occurs.

has developed a significant online presence: for most, they use the internet to advertise the location of their stores.

Online payday loans form a separate market to high street payday loans

20. In its review, the OFT found that online payday lenders serve a different type of customers to borrowers than high-street stores because:

- online borrowers were more likely to make multiple online applications because the number of declined applications is high
- borrowers prefer the anonymity and convenience offered by online lenders
- lenders are less able to assess risk (and must take steps to avoid fraud) since they are less able to assess a borrower's creditworthiness, and
- the prices charged by online lenders are generally much higher than those offered on the high street (and the value of loans is generally lower).[6]

21. The OFT found that a wide range of borrowers use payday loans. Many are unmarried with no children. Borrowers may choose to use payday loans because their main financial supplier will not know of their borrowing, for the ease of the transaction or because there is more certainty in the charges levied for payday loans than those levied for banks for (particularly unauthorised) overdrafts. Returning customers are often given better loan rates than new customers, reflecting the reduced risk they pose to lenders.[7]

22. The OFT concluded in its review that the differences between high-street and online payday lending would tend to put them in different product and geographic markets but that further analysis would be needed to assess the extent to which the high-street constrains the online market.[8]

23. Since the OFT review, Consumer Focus and Datamonitor have published research that considered the payday lending sector although neither report

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[6] Annexe E, page 22, paragraph 3.25.
[7] Annexe E, page 15, paragraph 3.4.
[8] Annexe E, page 23, paragraph 3.28.

considered whether or not high-street and online payday loans were in the same market.

24. The parties argued that the product market in this case was wider than payday lending and should include unauthorised overdrafts since avoiding charges incurred by banks for these is a key reason why customers use payday loans.

25. Set against this, the OFT review considered the substitutability of payday loans against unauthorised overdrafts from high-street banks, and found that they are more straightforward and easier to calculate than the cost of an unauthorised overdraft and may indeed be cheaper.[9] However, a small scale survey undertaken by Consumer Focus found that payday loan borrowers had generally reached the limit of their overdraft facility[10] and did not believe that credit cards were a viable option because of their low monthly income or poor credit history.[11]

26. Further, the OFT's market investigation in this case confirmed the position taken by the OFT in its review – that the high street and the online markets were separate. Most third parties were generally agreed that online payday lenders serve a different type of customer to those served by the high street, although one competitor noted an overlap. Two competitors noted that online customers could comparison- shop more easily and did not have to risk face-to-face rejection and this remoteness and relative anonymity, as well as convenience, speed and ease of application encouraged people to borrow online. On the supply side, online competitors noted the importance of lead generators as a means of acquiring new borrowers, and that they risked higher bad debts than high-street lenders but significantly lower overheads and discontinued operations expenses.

27. In addition, the parties provided us with internal research that showed that only three per cent of online borrowers, comfortable with borrowing online, would consider switching to high-street payday lenders. Consistent with this, our investigation found that rates for online payday loans are higher than rates charged by high-street lenders.

28. On the supply side, most payday lenders specialise in high-street or online lending, with few lenders operating in both markets. Switching from

[9] Annex E, pages 17-20, paragraphs 3.11 – 3.19.
[10] Consumer Focus, page 33.
[11] Consumer Focus, page 32.

offering payday loans on the high street to offering them online is not that straightforward and many high-street lenders (including Dollar) have entered the online market through acquisition which provides a means of gaining the relevant technical and technological skills required.

29. On the basis of the above, the OFT has adopted a cautious approach and assessed the merger in a product market for online payday lending.

Geographic market

30. Online payday lenders need to have a presence in the UK if based outside the EU[12] (as do payday borrowers) and the licensing regime is UK wide. Some competitors reported that they had more borrowers in the north of England and Scotland while others that their borrowers were located throughout the UK and Ireland. Some had not undertaken any analysis on this.

31. On this basis, the OFT has assessed the merger by reference to a geographic market that is UK–wide because this is consistent with the location of borrowers, the licensing regime and the geographic presence of online competitors.

COMPETITIVE ASSESSMENT

HORIZONTAL ISSUES—UNILATERAL EFFECTS

Market shares

32. The parties submitted that accurate market shares are not available in this market. Nonetheless the parties have estimated their combined online market share as [25-30] per cent with an increment of [five-10] per cent when measured by gross receivables and as [25-30] per cent with an increment of [five-10] per cent when measured by number of loans outstanding.

33. They submitted that their two largest competitors are QuickQuid with a market share of [15-20] per cent by gross receivables and [10-15] per cent by loans outstanding, and Wonga with a [15-20] per cent market share by gross receivables and [15-20] per cent by loans outstanding. The parties

[12] Lenders based in the European Union do not need to be based in the UK, although they are subject to the UK's licensing regime.

believe that other medium sized lenders include Pounds Till Payday (between [less than five] and [five-10] per cent), Wage Day Advance (between [less than five] and [less than five] per cent), and Mr Lender (between [less than five] and [less than five] per cent).

34. The OFT's investigation has found information on the size of this market and its players is not readily available. While the OFT contacted known competitors to establish the total number and value of payday loans made, not all competitors were willing or able to provide the OFT with information.

35. On the basis of the information available to it, the OFT estimates[13] that the parties have a combined market share of less than 40 per cent with an increment between 10 and 15 per cent, by total number and value of loans made in 2010. While this estimate is higher than the parties' estimates, it is not at a level which would typically give the OFT prima facie cause for concern over unilateral effects (given that the OFT has considered a narrow market on a cautious basis).

36. What is clear though, from the information provided by the parties and some of their competitors, and from independent research is that the growth of payday lending in the UK has been significant, both in terms of lending volumes and the number of competitors. The parties submitted that online growth is particularly fast as there have been a high number of successful new entrants in recent years. Given this level of new entry, and the new loans consequently being made (which have trebled over the last three years), MEM's market share has eroded over the last three years. It is clear that some of the parties' competitors have gained market share from the parties over this time.

Loans derived from lead generators

37. One third party told the OFT that high market shares may not confer market power because large lenders may find it more difficult to generate new sales. Many online lenders source new customers by buying leads from lead generators. The lead generators set up websites and buy 'words' from search engines such as Google. This gives their site more prominence than sites owned and operated by online lenders and may mean more

[13] Based on the total value of loans made in 2010 and data received as part of the High Cost Credit Review.

traffic to the lead generator's site. Prospective borrowers fill in application forms on the lead generator's website, agreeing that their details can be shared with online lenders. The lead generator creates a 'ping tree'[14] and sends the leads to lenders who pay either for the lead or when a successful loan is made.

38. This is a market that is growing significantly, with the value of loans trebling in the past three years, and it may be that shares of new business are better indicators of the effects of a merger than overall market shares.[15]

39. In this regard, one third party (a lead generator) submitted that MEM's purchase of leads is low partly because of its 'dup rate'. If a lender has a policy of not lending more than one loan concurrently then a lead for a borrower seeking a second loan will be a duplication ('dup'). This lead generator told the OFT that lenders such as MEM might have a 'dup rate' of 98 per cent and that new entrants could build their 'dup rate' as fast as 30 per cent a month. In the lead generator's view, the merger would increase the 'dup rate' and reduce market power.

40. The evidence available to the OFT suggests that in 2010, the top three buyers of leads were: QuickQuid ([around 20] per cent), Pounds Till Payday ([around 15] per cent) and Wage Day Advance ([10 to 15] per cent). Payday Express purchased [under 10] per cent of leads sold, Wonga purchased [under 10] per cent, and MEM purchased [under 10] per cent. Consistent with this, the parties submitted that their shares of new business were [much] lower than their overall market shares, at [less than five] per cent (for Dollar) and [10 to 15] per cent (for MEM).

Closeness of competition

41. The parties do not consider themselves to be close competitors: Dollar's main business is focused on the high street where it has 359 shops trading under The Money Shop brand whereas MEM is only active online.

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[14] A ping tree describes a panel of online lenders, lined up in order of who pays the greatest commission. As a lead or customer completes the application form and clicks submit, their details are passed across this tree of lenders until a real-time acceptance is given by one of the lenders.

[15] See Merger Assessment Guidelines, paragraphs 5.4.5 and 5.4.12 and Anticipated acquisition by Lloyds TSB plc of HBOS plc, Report to the Secretary of State for Business Enterprise and Regulatory Reform 24 October 2008 , paragraphs 109 -112

42. Consistent with this, several third parties told the OFT that QuickQuid and Wonga are stronger competitors to the parties than they are to each other.

Conclusion on unilateral effects

43. On the basis of the above, the merger does not appear to give rise to a realistic prospect of an SLC on the basis of horizontal unilateral effects.

HORIZONTAL ISSUES—COORDINATED EFFECTS

44. Coordinated effects may arise when firms operating in the same market recognise that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate to limit their rivalry.

45. Coordination may involve firms keeping prices higher than they would be in a more competitive market. In its review, the OFT found some evidence of price competition among suppliers of payday loans, and that there was a degree of price dispersion in the sample, leading to levels of profitability generally in line with (or slightly above) the normal level, and different across lenders.[16]

46. This absence of price coordination was confirmed by the OFT investigation which found some variation in the **typical** total cost of credit (TCC) charged by online payday lenders, ranging from between £25 to £35 per £100 borrowed.[17] In addition, some lenders offer preferential rates to more creditworthy borrowers or those with a good credit history.

47. Competitors have confirmed that they compete not just on price but on the speed in which a loan is arranged and other factors such as the need for credit clearing. Innovation appears to be a feature of this market, with Wonga (and some other lenders) offering loans for a variable period, and some repayments being payable on an instalment basis.

48. The OFT does not believe coordination as a result of the merger is likely given the above factors.

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[16] Annexe E, page 79, paragraph 8.30.

[17] The short length of loans means that payday loans have high Annual Percentage Rates (APRs) because the APR is a measure of the cost of the loan over one year rather than the shorter period typical to payday loans. While lenders are required by legislation to specify the APR, many quote the Total Cost Credit (TCC) by reference to the cost per £100 borrowed.

BUYER POWER

49. Customers are individuals and unlikely to have, or be able to exercise, buyer power.

50. However, one competitor noted that online borrowers were very 'savvy' and compared deals more quickly online by means of lenders' websites and price-comparison websites and were generally less likely to seek a loan from the same lender than to seek the cheapest loan available.

51. Given its conclusions on unilateral and coordinated effects, however, the OFT has not needed to conclude on this point.

BARRIERS TO ENTRY

52. The parties argue that entry barriers are low, evidenced by a double-digit number of successful entrants over the last five years. The OFT confirmed evidence of entry into the payday lending market, particularly from US firms that have entered directly or through acquisition.

53. Consistent with this, the online market is characterised by the presence of lead generators who do not themselves provide payday loans but instead act as a portal to guide users to actual providers of loans. Lead generators told the OFT that they play an important role in facilitating new entry because they provide new entrants with access to a large existing customer base.

54. Set against this, other third parties told the OFT that new entrants require a good understanding of the online payday loans market and access to funds and one third party said that some companies have entered and failed.

55. Given its conclusions on unilateral and coordinated effects, however, the OFT has not needed to conclude on this point.

THIRD PARTY VIEWS

56. The OFT consulted a range of third parties and any comments made have been discussed above where they have been relevant. Several competitors indicated that they felt that this was a market which was experiencing considerable growth in recent years.

57. Several competitors expressed a concern that the merged entity would be significantly larger than other competitors and would be able to drop rates significantly in the short-term to drive out smaller rivals (that is, that the merged entity would engage in predation). No evidence of this strategy was provided by third parties. The market shares estimated by the parties are not sufficient in themselves to lead to presumption of dominance in the market for online payday lending. For these reasons, a strategy of predation does not seem profitable in the longer term or likely in the short term.

ASSESSMENT

58. Both MEM and Dollar are providers of online payday loans in the UK.

59. The starting point for the OFT's assessment of the relevant market in this case was the OFT recent review of high-cost credit. Third parties consulted by the OFT supported a separate market for online and high street payday lending.

60. In relation to the geographic market, third parties agreed that competition occurred on a national basis consistent with the conclusions in the High Cost Credit Review given that regulation of the sector is on a UK-wide basis and providers compete for customers online on a UK wide basis.

61. Unilateral concerns do not arise as a result of the proposed transaction. The parties' combined market share is less than 40 per cent and there are several other competitors to rival the parties. It is a fast evolving market which is growing rapidly and there has been a plethora of recent successful entry. Moreover, most competitors were unconcerned by the merger.

62. The OFT does not consider that this proposed transaction will significantly increase the likelihood for co-ordinated behaviour.

63. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

64. This merger will therefore not be referred to the Competition Commission under section 23(1) of the Act.