
The Store: evaluation

A confidential report
and recommendations
on the first year of
trading activity of *The
Store* a rent-to-own
service in County
Durham

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1.0 Executive summary

1.1 The purpose of the evaluation

Derwentside Homes, Prince Bishops Community Bank (PBCB) and their funders and stakeholders, in particular the Friends Provident Foundation and Northern Rock Foundation, wanted to assess the sustainability of the rent-to-own model developed by *The Store* social enterprise in Stanley, Co. Durham.

The stakeholders also wanted to look at whether it could be either scaled up or replicated elsewhere.

Niall Alexander and Alistair Grimes were commissioned to carry out this evaluation over a six week period in January/February 2013.

We have examined the performance of *The Store* against the predictions of the business plan and reviewed the implications of this for sustainability, scalability and replicability.

This examination involved looking at financial and sales information, modeling the conditions required to make *The Store* sustainable, interviewing staff and customers and holding a focus group with customers.

1.2 Introduction: the theory behind The Store

The concept of creating an affordable, ethical alternative to rent-to-own stores that increasingly occupy the secondary High Street in the UK is fundamentally attractive. The idea is relatively straightforward; bulk purchase quality white, brown and electrical goods and sell these with a gross margin and applied interest rate that is both cheaper than commercial competition and generates sufficient surplus after write off to covers costs.

The beneficiaries will be both the individuals who purchase the same quality goods for a significantly lower price and the backers of such a concept, in this case a social landlord, a social enterprise and a credit union who derive multiple benefits in terms of:

Just the facts

The Store sold £165,000 of goods in 2012, to 373 individuals. Loans repaid weekly on 104 week term

Sales were 57% of Business Plan (BP) target. Current sales trajectory indicates £1m in 5 years

Interest applied on retail cost at 24.19% APR typical; generates sufficient income (alongside wholesale margin) for sustainability

Portfolio at Risk (PAR) of 14% (of volume), higher than BP projection of 10%, although, in reality the figure is lower as it includes wholesale margin

Admin costs of £113 per sales, BP projection £65

Customer demographic is similar to BrightHouse:
58% < 35 years old
73% < 45 years old
65% female
80% not working
40% lone parents
55% with dependents
97% renting

- sustaining tenancies (however it is too soon to evaluate the success in this area)
- an opportunity to generate income and membership for the credit union;
- access to longer term ethical savings through a cashback scheme; and
- an improved standard of living and quality of life for social housing, low income customers.

The goods sold by The Store are estimated to be around 40% cheaper than other for-profit rent-to-own stores, though making like-for-like comparison on savings is difficult. There will be additional benefits when the following are factored in:

- Wholesale-to-retail margin;
- No late fees applied;
- No cross selling of expensive (and often irrelevant) warranties; and
- Greater flexibility in managing arrears and payment difficulties (for example, no late fees applied at *The Store*).

The reality is, of course, significantly more difficult to achieve than the theory is to explain. Over the last year, Derwentside Homes, with Social Housing Enterprise Durham (SHED) and PBCB has trialled its alternative to rent-to-own stores. Derwentside Homes promotes the service to social tenants living in County Durham, SHED is the legal entity which houses the hire purchase transaction and holds the relevant consumer credit license and PBCB administers the loans. The decision to use a third party vehicle (SHED) to host the agreement was taken after discussions with the FSA who advised that under current regulation credit unions could not provide hire purchase finance, furthermore this arrangement of using SHED has the added advantage that it protects the core activities of the credit union. The experience to date is of a similar customer to the person who typically buys similar goods from national branded outlets such as *BrightHouse*, *Perfect Home*, *Buy-As-You-View* and catalogue companies.

The business plan which was used to raise external funding to support the start-up of *The Store* and the financial model that

Just the facts

Sales pattern differs from other non-standard lenders, the anticipated rise in sales during Oct-Dec didn't occur - needs monitoring.

Customer considers "*The Store*" a value proposition with their emphasis on weekly cost, cashback, brand name products, and staff empathy

Customer identified weaknesses in marketing and promotion; confusion around goods being available to all tenures

Evidence of customer savings against for-profit alternatives. Subsequent improvement in tenants' standard of living and quality of life.

To maintain current pricing structure, sales must rise to c£300,000 per year and arrears held under 10%. Cost of sales needs to be identified as current fee per loan cannot be assumed for replication

Replicability of model is realistic and, given economic climate and limited choices, required.

underpins it is discussed next.

1.3 The business plan and financial model

The Store business plan projected £2m of sales over a five year period. The administration costs are undertaken for a fee (currently £64) by PBCB. This fee forms part of the weekly payments from the customer.

The Store is located within PBCB offices. The fee per loan issued covers a contribution to rent, heat, light, telephone and staffing costs. The volume of sales is a critical factor in the administration cost payable to PBCB, with lower sales than anticipated resulting in a lower administrative total to PBCB of c£25,000 (against a projection of £42,000).

The Store's business plan identified £2m of sales. The gross profit is derived from the wholesale to retail markup and the interest applied on the retail price of c22% (24.194% APR typical) on a decreasing 104 week loan term balance.

With the surplus from margin and interest on £2m of sales over five years, the eventual return¹ would generate c£1.1m of income if there was no bad debt. After the cost of sales (£455,000) is covered, the net income would be c£658,000 over that five year period.

With the projected bad debt of 10% there would be proportionally less income per £100 issued along with an erosion of £200,000 from the loan capital. This loss would need to be covered. The income earned with 10% bad debt would reduce by £100,000 to £1m but to replenish the loss of capital (£200,000) and cover the same cost of sales (£455,000) a further £655,000 would need to be accounted for, reducing the net income to c£347,000.

Any expansion of the business into new areas of the UK may have an impact on the bad debt rate however since the customer base (social tenants) would be the same it is envisaged that any expansion would experience the same rate of bad debts. If *The Store* was to be made widely available to the community as a whole the potential impact that this would have on the level of bad debts would need to be evaluated.

1.4 A review of the business plan and performance

We have reviewed the business plan at a technical level and note that the projected £2m sales figure includes:

¹ Some of the eventual return would not be realised within the five years as it would be part of the outstanding gross loan book

- the repayment of the principal sum;
- the interest charge,
- the VAT payment, with the VAT element being included in the weekly charge to the customer offset by reclaiming the VAT element on the purchase value of the goods and
- the credit union cashback amount to customers from the mandatory £0.25 per week saving.

The loan projections detailed within the business plan are not the multiplier of the retail cost to customer (the loan amount) multiplied by the number of loan projections. When these are stripped out, we believe that the actual cost of sales projected (in the business plan) is nearer to £1.65m.

Sales of £1.65m would be sufficient to operate a sustainable operation with even a 15% write-off.

Similar to many business plans, the first year does not correspond to the written word. In this case, sales were lower than anticipated, at 57% of the planned figure. However, it is worth noting that the actual performance of c£165,000 in sales is the roughly the same as other similar start-ups we have evaluated. For example, the Scotcash expansion in Glasgow to a second outlet generated similar customer and turnover levels of 305 loans to a value of £154,000 to a very similar demographic. Moneyline, (now the leading personal lending CDFI in the UK) in year one of its operation in Blackburn advanced £309,000 to 496 customers. The plan may have been over optimistic, rather than the performance poor.

1.5 Reviewing the customer perspective

Through discussions with customers it has become evident that *The Store users* are very similar to the customer of *BrightHouse* and *Perfect Home*. The eight customers we spoke to in a focus group expressed considerable satisfaction on the brands and quality of the goods, the range of products, the speed of delivery, the lack of pressure sales, the understanding of their financial circumstance and both the price (of products) and, more importantly to them, the affordable weekly cost.

One customer advised us that she had been paying over £36 per week for a pre-owned sofa, new cooker and pre-owned television with *BrightHouse*, and was 78 weeks into a 156 week agreement. She had no home contents insurance (HCI) and had been obliged to take out damage liability and service cover insurance with them.

After visiting *The Store*, she cancelled her agreement with *BrightHouse* and halved her weekly payments for what she asserted were better quality goods.

Her new agreement with *The Store* will result in a total cost of credit (TCC) of £1,848 for brand new goods and in her opinion better, goods. She will own these items (sofa, cooker, television) after 104 weeks but will pay £1,000 less than she would have done on the remaining 78 week *BrightHouse* term. Overall, had she bought the goods from *The Store* initially instead of *BrightHouse* she would have paid £1,848 against £5,616, a price difference of £3,768.

Her savings of £18/week are, she says, spent on her son and making additional purchases in anticipation of the imminent birth of her daughter. She said she slept and ate better, felt relieved at the noticeable difference in income per week, especially as the current economic climate was taking its toll elsewhere.

1.6 The Store: performance overview

In the calendar year, 2012, *The Store* sold around £165,000 of goods (retail price including VAT) to over 370 individuals.

Sales in year 1 are 57% of projected sales. In order for PBCB to realise the income they need to cover costs we recommend (and have modelled) a higher fee per loan of £100.

If the model is to be replicated then a fixed cost of operating an independent Store franchise will need to be covered through trading. The one-off set-up costs excluding on going operating costs of staff and premises was £64,000 this comprised of legal and accounting costs, up grades to the accounting and computer systems and brochure design, of this we estimate that it will cost around £25,000 to replicate the project in another organisation. The arrangement in Stanley, because of the shared premises with PBCB, means overheads are being met. If replication is undertaken then this arrangement will be the exception, not the norm. To make the operation viable as a stand alone high street operation would require increased turnover or an increase in the margin. These issues are discussed further in the body of the report, Staffing and running costs, however they are configured will be relatively fixed, with limited scope for adjustment if significantly fewer items (than projected) are sold. To build a sustainable model - one that can be replicated - the income from lending must cover the costs of lending; after the written off percentage (estimated at 10% in the business plan) of interest earned, (and, more significantly the replenishment of the capital loss) is accounted for.

Within the existing arrangement we believe that to achieve parity for PBCB on their

administration costs an uplift in administration fee from £64 to £100 is required. We have modelled this, projecting a total cost of sales at:

- £227,000 (over 5 years) on sales of £1,000,000
- £375,000 (over 5 years) on sales of £1,650,000
- £455,000 (over 5 years) on sales of £2,000,000

We selected these three sales figures on the basis that they are (or were) either in the original business plan (£2m) or in our recalculation of that figure (£1.65m) or extrapolated from actual sales (£1m):

- £1,000,000 is the current trajectory
- £1,650,000 is the amended business plan projection
- £2,000,000 was the original business plan projection

The margin on wholesale-to-retail price, and subsequent interest applied on retail is sufficient to cover £1,000,000 of sales over 5 years within the current arrears forecast of c14%. Indeed, there is scope to increase margin to provide additional comfort if sales are lower or arrears are higher without compromising the value of the proposition to customers. The component parts to replicate the model and provide similar outlets in other towns and cities are in place.

1.7 Can The Store be sustainable?

We suggest that there are five critical aspects to *The Store*'s sustainability:

- Sales volumes;
- Write off (of capital issued, and projected interest income);
- Cost of sales/administration costs; and
- Margin on products from wholesale-to-retail.
- The cost of capital required to fund product acquisition

Adjustments to any of these key levers will have a substantial impact to the long term sustainability of *The Store*, and any potential replication of the model.

If the pattern of the first year of sales continues on the same trajectory, this would result in around £1m of sales over five years. The early indications on write off appear to be around 14% of sales volume, (representing 15% of customers), although this write off figure is, in reality, smaller as it contains the markup wholesale to retail portion, therefore the actual write off of the capital is significantly less than the write off cost.

If these two trajectories were to continue and the fee income per £100 and cost of sales (modeled at £100 fee per sale) were to remain the same, the effective Year 5 surplus of income after write off and cost of sales would be £95,000. This is too close for comfort, and, critically, the cash balance would be in deficit as substantial amounts of the income (interest) and capital would still be outstanding in the loan book.

There is much that *The Store* can do in the intervening four year period to alter this. Relatively small adjustments to margin, cost of sales, arrears management and volume of sales would alter the position substantially. There is scope to re-calibrate income from lending upwards by relatively small amounts whilst remaining both a value proposition to the customer, and true to the social enterprise ethos and purpose.

The table below shows the effective year 5 position within a range of scenarios based on year 1 actual sales and margin, and sales scenarios of £1.65m and £2.0m. The cost of sales increases with the volume of sales, but so too does the income from sales.

Chart1: Sales scenarios and year 5 cash flow forecasts

		On £1m sales	On £1.65m sales	On £2m sales
Average loan value	(based on Y1)	£440	£440	£440
Number Sales	(based on Y1)	2,274	3,752	4,547
5 year sales	(three scenarios)	£1,000,000	£1,650,503	£2,000,000
Income 100%	Commercially confidential	Commercially confidential	Commercially confidential	Commercially confidential
Cost of Sales	£100/sale	£227,330	£375,208	£454,659
Cash balance	at Year 5	£329,099	£543,180	£658,199
After 10% w/o	Capital & Interest	£173,456	£286,290	£346,913
After 15% w/o	Capital & Interest	£95,635	£157,846	£191,270
After 20% w/o	Capital & Interest	£17,814	£29,401	£35,627

We believe that *The Store* has made an impressive start. 370 customers in Year 1 may be lower than projected but is still about 40% of the average customer numbers seen at an average mature *BrightHouse* store with all their advantages of brand recognition, advertising and marketing.

The lending volumes indicate a market for the products. We have a slight concern over the lower sales figures during the pre-Christmas months, where traditionally non-standard lending tends to increase, but believe that this is a blip, not a trend however lending volumes needs to kept under constant review.

The enquiries per week appear to be around 50 decline rates are high as there is an emphasis on minimising bad debts, a further indication that the products are attractive to a certain cohort. Significant learning on the customer, sales and margin has taken place in the year and the senior management team and Directors are open-minded to modifications that will assist the business growth.

1.8 Conclusions

For *The Store* to achieve a sustainable model it must do one or some combination of the following:

- Increase volume of sales to £250,000 + per year per outlet;
- Consider a small increase in the gross margin on wholesale-to-retail;
- Keep write off under 10% of capital issued, and preferably lower
- Determine the realistic “cost of sales” figure for rollout purposes.

Our other conclusion is that there is considerable learning to be gained from the first year of operation; with some minor adjustments and considerations, *The Store* will continue to offer a value proposition to customers against their likely rent-to-own high street competition, Our focus group with customers clearly indicated that the goods were high quality and the product offer and price compelling.

We conclude overall that the start made by *The Store* displays significant potential for both sustainability and for replication.

2.0 Introduction

2.1 What we were asked to do

Niall Alexander and Alistair Grimes were commissioned to carry out an evaluation of *The Store* over a six week period from January to February 2013. We were asked to draw on analysis from the collected demographic data and financial transactions undertaken to date, and discuss with stakeholders and customers the benefits and challenges of the initial period of operation and outline the learning from the venture to date.

Our task was to:

- capture and analyse the demographic and customer transaction data, including default and sales;
- consider this data against the demographic data known in other non- standard lending segments;
- determine through focus groups and face to face discussions with service users and staff whether the products are viewed as a value proposition by customers, assessing whether purchases are displacing other higher cost credit purchases, or are being used in addition to other credit;
- consider the costs incurred in establishing the project, including staff, office, storage, insurance and other overheads;
- consider the costs of any potential scale-up or roll-out, including the costs of capital and the potential supporters or funders;
- detail in case studies the experiences of service users including the social and financial impact of their relationship with *The Store* and with the Prince Bishops Community Bank (PBCB); and
- make a presentation to appropriate stakeholders.

Along with reviewing *The Store*, we were also asked to look at the potential for scaling up or replicating the operation and the implications of this for the partners involved.

2.2 What we did

We analysed *The Store*'s loan data, undertook research on *BrightHouse* and considered the non-standard market across the North East. We interviewed the key personnel from Derwentside Homes, PBCB and *The Store* and undertook a focus group with eight customers including an in depth follow up.

3.0 Background

3.1 Non-standard lending: The UK context

Ten million people in the UK are considered to be non-standard borrowers, borrowing an estimated £65 billion² annually through a variety of sales channels including face-to-face, telephone, and increasingly the internet. Within this market there are different types of customers accessing a range of products, usually unsecured, from:

- payday loan companies;
- pawnbrokers;
- home collected credit agents;
- credit unions;
- Community Development Finance Institutions (CDFIs);
- catalogues; and
- rent-to-own stores.

The rent-to-own stores in the UK are epitomized by *BrightHouse* and *Perfect Home*. They are accused by their critics of:

- over inflating the gross margin from wholesale-to-retail;
- charging excessive interest; and
- cross-selling expensive and arguably obsolete warranties and damage liability insurance policies to customers who lack appropriate cover for goods on home contents insurance (HCI).

Whatever the truth of these accusations, providing a sustainable alternative to rent-to-own stores has been discussed and attempted by a number of social lenders and other organisations in recent years. Housing providers already promote low cost home insurance, The Store focuses on making weekly payments affordable, although it must be recognized that there are inherent costs with providing a facility to pay weekly and therefore this can never be as cheap as a cash sale. However by providing ethical affordable lending without expensive cross selling The Store offers an ethical alternative. Some providers of high quality, low cost, new and pre-owned goods do not offer credit facilities³ and some credit providers (like Scotcash in Glasgow or Moneyline) struggle to

² PFG Annual report 2010 (page 2)

³ *New Too* a subsidiary of *Second Opportunities*, Glasgow operates two outlets selling new and pre-owned goods. *Bethany Trust*, Edinburgh operates nine outlets selling new and pre-owned goods, neither offers credit facilities.

link their successful credit provision to the direct purchase of white, brown or electrical goods.⁴

The credit crunch, global financial meltdown and recession have led to a tightening of lending criteria by mainstream lenders. Pressures on household incomes, caused by inflation, and freezing of wages alongside the impact of the UK government's austerity policies, including welfare cuts and impending welfare reforms (especially the introduction of Universal Credit from October 2013) are anticipated to have a bearing on the non-standard customer and market in the coming years.

3.2 The North East context

The growth of weekly payment stores offering non-standard borrowers loans has been identified as a significant problem within County Durham. Statistics from *The Store's* business plan show that those who are particularly excluded from mainstream credit are social rented tenants who are forced to turn to these stores to purchase basic furniture, white goods and electrical items. A working group has been established by the Financial Inclusion Capability North East Group (FINCAN) to look at ways of providing affordable alternatives to these sub-prime lenders.

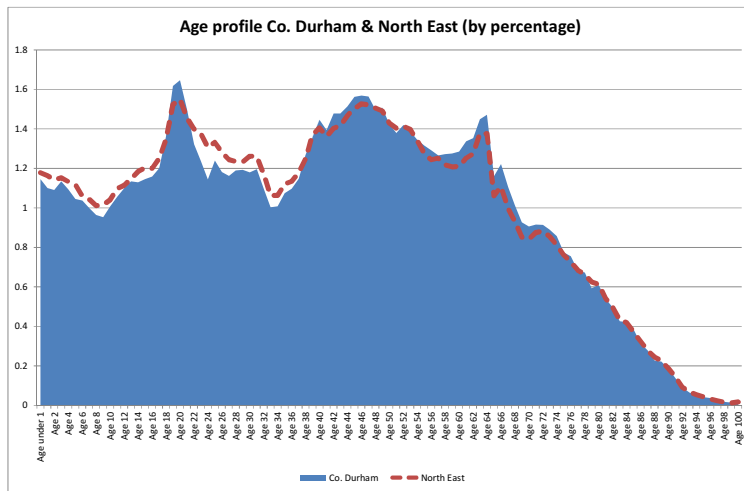
We know from our own and other research that social housing tenants are invariably paying the so called poverty premium on goods and services. We also know that home credit, payday lending, *BrightHouse* and catalogues are used by predominantly younger (under 45) age customers who rent their homes.

The Store's area of operation covers County Durham: (Chester le Street, Durham, Sedgefield, Easington, Wear Valley and Derwentside) these are serviced by a number of housing providers Cestria, Livin, East Durham Homes, Dale & Valley Homes and Derwentside Homes.

County Durham UA has a combined population of 513,242 (Census 2011). Within this figure the 18-64 year old working age population, entitled to participate in credit agreements is 320,806 (62.5%). Across the wider North East the equivalent figures are 2,596,886 (whole population) and a working age population of 1,621,359 (62.5%).

⁴ *Scotcash, Moneyline* and many credit unions offer a white or brown goods deal (usually with a chosen supplier). Anecdotal feedback suggests a very low take up of these products.

Chart 2: Age profile Co. Durham and North East (by percentage)



In 2010 the multiple indices of deprivation identified the most deprived wards at lower level super output area by geography and by number. The map below shows the distribution of the most deprived LSOAs across County Durham.

Chart 3: map of County Durham

Map 1: Index of Deprivation 2010: Deprived Lower Super Output Areas in County Durham

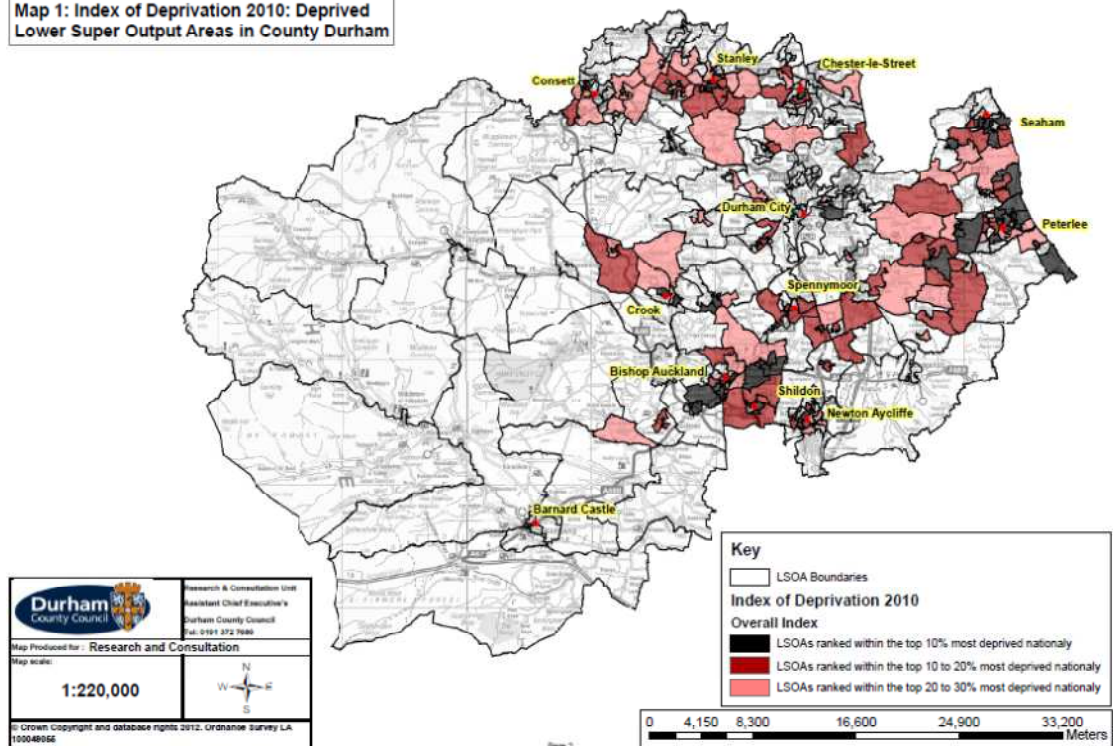
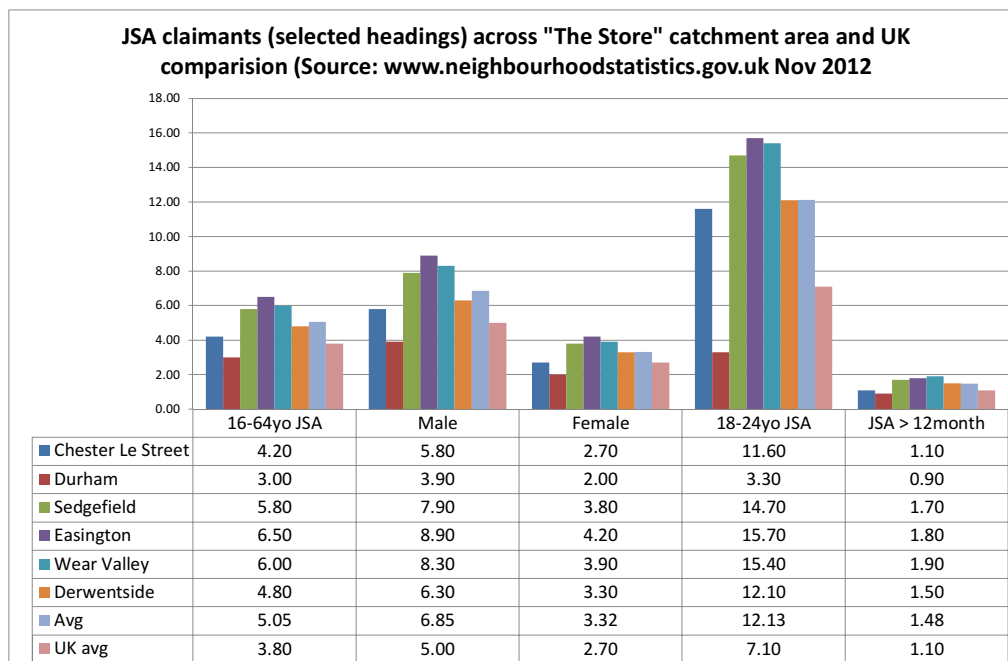


Chart 4: Deprivation figures County Durham

Area Action Partnership	ONS 2008 Population	Overall	Income	Employment	Health	Education	Housing	Crime	Living Environment	IDACI	IDAOP1
Bishop Auckland and Shildon	41,731	70.1%	62.7%	83.8%	96.7%	56.4%	11.0%	48.2%	6.6%	55.2%	62.7%
Chester le Street	53,020	35.9%	32.8%	49.4%	53.6%	33.7%	13.3%	30.2%	0.0%	15.3%	30.5%
Derwent Valley	42,988	33.1%	36.4%	65.3%	60.8%	33.9%	4.6%	4.4%	0.0%	21.5%	39.7%
Three Towns	24,270	60.1%	53.7%	79.9%	100.0%	54.5%	4.6%	34.7%	0.0%	40.9%	46.8%
Durham City	64,353	13.8%	15.9%	23.6%	36.9%	20.7%	6.3%	3.3%	0.0%	9.9%	15.4%
East Durham	94,024	73.9%	59.4%	89.2%	92.1%	73.2%	4.6%	37.1%	0.0%	54.3%	47.2%
East Durham Rural Corridor	25,558	40.9%	40.9%	60.1%	65.5%	40.9%	8.3%	5.5%	0.0%	37.4%	17.0%
Four Together	18,078	63.1%	55.0%	93.0%	100.0%	73.7%	0.0%	21.6%	0.0%	46.6%	57.8%
Mid Durham Rural	33,285	28.7%	28.7%	54.3%	45.1%	40.4%	9.1%	0.0%	0.0%	35.7%	40.4%
Great Aycliffe and Middridge	26,363	42.1%	36.2%	77.1%	93.1%	48.0%	0.0%	21.2%	0.0%	30.5%	42.3%
Spennymoor	20,451	39.4%	39.4%	68.4%	82.6%	48.0%	4.7%	17.2%	0.0%	35.5%	46.6%
Stanley	31,334	70.5%	85.2%	90.7%	80.2%	75.2%	0.0%	37.3%	0.0%	70.3%	80.2%
Teesdale	24,803	10.3%	10.3%	26.2%	34.8%	10.3%	37.6%	0.0%	3.8%	4.0%	15.1%
Weardale	8,192	2.1%	2.1%	23.8%	61.4%	2.1%	39.2%	2.1%	0.0%	2.1%	2.1%
County Durham	508,451	45.4%	42.3%	64.7%	70.7%	46.7%	8.2%	21.6%	0.7%	34.6%	39.9%

Forty-five percent (45%) of the population in County Durham UA are considered to be in the most deprived 30%. There were (in the period Oct. 2011 – Sept. 2012) almost 85,000 people who were considered economically inactive (including those who were retired). Unemployment and underemployment are both higher than the national average as the chart (below) showing JSA claimants indicates:

Chart 5: JSA Claimants across County Durham (Nov 2012)



The high levels of deprivation demonstrate the need for a sustainable means of accessing affordable credit within County Durham to provide an alternative to more expensive sub-

prime lenders.

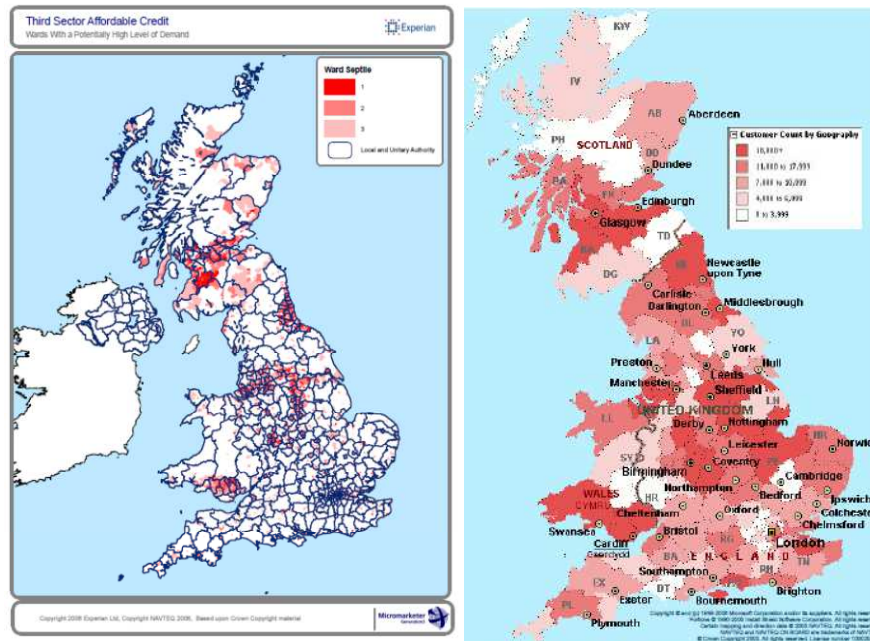
The high number of social rented homes in the North East means that there are a disproportionately higher number of people likely to use expensive credit because they cannot access more affordable loans. Provident Financial Group (PFG), for example, now refuses credit to 80% of new applicants.

Experian research for the Financial Inclusion Taskforce in 2007 identified the likely demand for affordable credit across all local authorities in the UK. Out of 409 local authorities the six areas within the catchment area of *The Store* were ranked in the highest demand quarter, and three were ranked within the 10% with the highest demand:

- Easington 3 (of 409)
- Sedgefield 10 (of 409)
- Derwentside 35 (of 409)
- Chester le Street 55 (of 409)
- Wear Valley 57 (of 409)
- Durham 103 (of 409)

The Financial Inclusion Taskforce mapped both demand and “mismatch” where there was demand but limited supply of affordable credit throughout the UK. This mismatch was then graded as either red alert areas or amber alert areas. The report highlighted pockets of both high deprivation and demand for affordable credit within County Durham. The deeper the red the greater is either the likely demand for credit or the need for credit. Easington, Chester le Street and Derwentside were all considered red alert areas; Wear Valley was considered amber alert.

Chart 6: Experian credit demand map (2007) & Provident customer heatmap(2010)



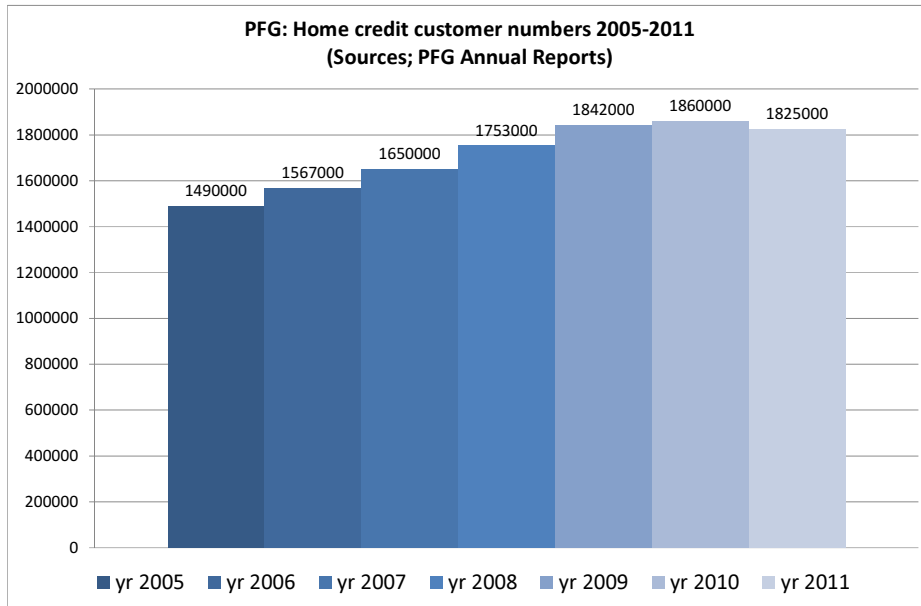
Evidence shows that the social housing tenant experiences the most acute difficulty in accessing mainstream credit alongside a series of interlinked difficulties such as fuel poverty, lack of savings, being unbanked or under banked, lacking home contents insurance and having lower financial capability and resilience.

DWP statistics show that 74% of heads of households in social housing are not in paid work. The DWP Family Resource Survey in 2004/5 in England identified that 46% of all households in social housing earn less than £200 gross per week compared to 12% of all owners and 69% of all households in social housing earned less than £300 per week, against 24% of all owners.

PFG, with an estimated 60% to 65% market share of home credit, charges £82 for every £100 it issues⁵. In 2011 PFG had 1.8m customers borrowing an average of £500 each (and therefore typically repaying £910).

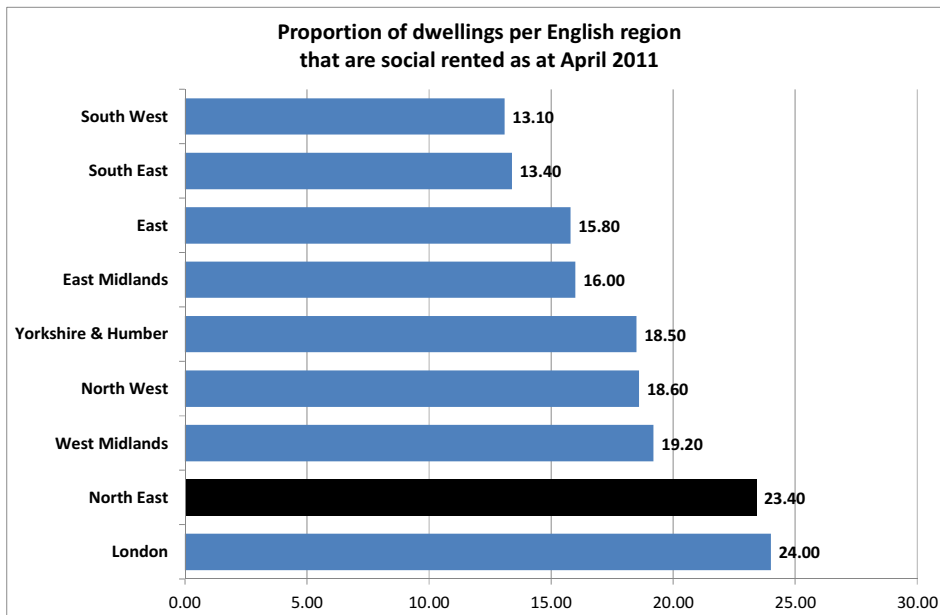
⁵As at February 2013 PFG charged £82 for every £100 borrowed on a 52 week term.

Chart 7: Provident customer number 2005 - 2011



83% of PFG’s home credit customers rent their home⁶. The North East of England is a known hotspot for home credit, and it is also, outside London the region with the greatest proportion of social housing stock at 23.4%.

Chart 8: Social rented dwellings (England) as percentage of all dwellings



⁶ PFG Investor analyst presentation 2010

It appears that a “perfect storm” is brewing comprising age, tenure, household composition, income, exclusion, austerity, credit squeezing, welfare cuts, welfare reform and limited choice that will disproportionately impact upon *The Store*’s potential customers.

With 3 million acknowledged home credit customers in the UK and the overwhelming majority of them within the working age category (93% of PFG customers are under 65 years old) we can extrapolate that they represent around 8.45% of the working age population. The working age population (18-64) across County Durham at the 2011 Census was 320,806⁷

8.45% of the working age adult population would mean around 27,000 adults borrowing at any given time from home credit companies across County Durham. PFG noted that the average loan to home credit customers was £500 in 2011; this would mean a minimum of £13.5m is issued by home credit companies across County Durham.

BrightHouse reported in 2009 that the average customer spends £23 per week on its items. The company’s annual report identifies 227,000 customers across 253 stores. Newer stores will have fewer customers but a relatively crude average would indicate around 900 active customers per branch, meaning around 9,000 *BrightHouse* customers across the North East. At an average of £23 per week this results in around £10.8m being repaid across the North East to *BrightHouse* each year.

Beyond both of these non-standard lenders are a myriad of payday, short term, catalogue and internet lenders, who, along with pawnbrokers offer loan products for similar customers.

The requirement for a more affordable alternative seems overwhelming.

⁷ <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-286348>

4.0 Current commercial offerings: *BrightHouse*

In 2007 as the global financial crisis developed and the credit crunch began, rent-to-own store *BrightHouse* had 153 stores serving around 125,000 customers across the UK, with ambitions to open more stores. The company declared a pre-tax profit of £12.6m on a turnover of £129.5m.⁸ A spokesman for *BrightHouse* said they “*were not affected by the credit squeeze as few of their core customers had mortgages.*”⁹

By 2012, in the teeth of the worst economic crisis in the past sixty years in the UK, with rival stores like *Sofa Workshop*, *Land of Leather*, and *Comet* closing or going into administration, *BrightHouse* had increased its stores by 100 to 253¹⁰ stores nationwide, with the scope to extend this to over 600 stores.¹¹ The company’s pre-tax profit had risen to £28.5m on revenues of £266.5m.¹²

In an interview with *Credit Today*, Leo McKee, the Chief Executive of *BrightHouse*, detailed the typical customer in 2008 as:

- *female;*
- *aged 25 to 45;*
- *with children;*
- *a household income of less than £18,000; there is a good chance she is*
- *wholly or partly dependent on benefits; and*
- *likely to be a lone parent living within three miles of a store with no access to a car..*

The average shopper pays £23 a week and has an average of three and a half items out on loan. *BrightHouse* believes it knows detailed customer behaviour down to how much daytime television their customers watch.

BrightHouse is prospering in the current economic climate. In 2012 it had over 227,000 customers, an increase of 24,000 on the previous year. There were no signals of retrenchment, indeed the opposite remained the case. In the company’s annual review for 2011/12, the Chairman noted:

⁸Tom Braithwaite, *BrightHouse rental business circumvents the credit crisis* (Financial Times) 17/11/2007

⁹Tom Braithwaite, *BrightHouse rental business circumvents the credit crisis* (Financial Times) 17/11/2007

¹⁰*BrightHouse annual report 2011/2012*

¹¹Nicola Harrison, *BrightHouse's Leo McKee: Safe as Houses* (Retail Week) 13/11/2008

¹²*BrightHouse annual report 2011/2012*

“Whatever the macroeconomic conditions, the products and services we offer remain an essential element in the lives of our customers. Our chosen market is large and stable, and opportunity for customer growth is substantial.”

The annual review continued:

The global rent-to-own industry is thriving. Adverse economic conditions have had less impact than other sectors. Around 4% of households in the alternative credit market are BrightHouse customers. The BrightHouse portfolio of 253 stores provides access to a significant proportion of this market.

The UK rent-to-own market has attractive fundamentals:

- *The number of credit impaired households is substantial yet the range of borrowing options is narrowing;*
- *Substitutional channels remain disparate and more expensive;*
- *The complexity of the business and required investment are barriers to market entry;*
- *Consumer confidence indicators, such as movement in house prices, have less impact on this market.*

BrightHouse is attractive to particular customer groups. They are provided with “high quality household goods in a straightforward way” with products that “have to be aspirational; we can’t sell entry level products. Some retailers can target the first time buyer or the budget buyer, but we can’t do that because our customers are looking for the telly that gives them bragging rights”¹³ “the BrightHouse proposition is quality products and brand names they (the customer) recognizes as well as classic and contemporary styles at absolutely competitive prices”¹⁴

Typically BrightHouse offers goods over 156 weekly payments, although terms of 26, 39, 52, 78 and 104 weeks are available. Customers are “targeted with precision, using postcode analysis and demographic data, most do not drive, so the company builds stores within three miles of customers’ homes and checks the bus routes before committing to locations.”¹⁵

BrightHouse is apparently wary of seeking customers outside its particular identified demographic. It believes there is a market of 5.2m “credit constrained” potential

¹³ Sarah O’Connor, *BrightHouse proving recession proof* (Financial Times) 17/11/2008

¹⁴ Ben Sillitoe, (Retail Week) 8/11/2012

¹⁵ Sarah O’Connor, *BrightHouse proving recession proof* (Financial Times) 17/11/2008

customers, and believes it currently operates within three miles of 1.4m of these customers. Ten *BrightHouse* stores are located within a 40 minute driving time of Stanley; with probably 9,000 customers repaying a total of £10.8m annually.

Bishop Auckland	Newton Aycliffe
Peterlee	Seaham
Sunderland	Washington
Chester le Street	Consett
Gateshead	Newcastle

Some of the criticisms leveled at the company's offer by some observers is that *BrightHouse* over inflates the price of the goods, charges an APR of 29.9% and cross sells obsolete damage liability and insurance products to over 90% of its customers. Further information can be found at http://www.friendsprovidentfoundation.org/wp-content/uploads/2013/04/Church_Action_on_Poverty_-_Improving_Practice_in_the_Rent_to_Own_Market_-_Full_Report.pdf

The Store attempts to address some of these criticisms.

- Prices are transparent, there are no upfront fees, charges for missed payments or requirement to take out insurance or other additional charges.
- There is no pressure selling with affordability checks in place to ensure that customers can afford the weekly payments. Furthermore customers are not encouraged to take multiple loans as is the practice in some weekly payment stores. It is the long term objective to move customer's away from weekly payment stores and into mainstream credit.
- As a not for profit organization The Store strives to deliver excellent customer service in the areas of repairs, and consumer rights over profit.
- Customers are provided with six monthly statements clearly showing how much has been paid and what is outstanding.
- The Store offers only one range of payment and this simplifies the transaction options to the customer.

The gross margin on wholesale-to-retail cost is not known although research undertaken by the Guardian newspaper in 2012 identified four *BrightHouse* products' cash prices and compared these with identical or largely similar products. They found the following price differentials:¹⁶

¹⁶ Emma Lunn, *BrightHouse and the heavy price of paying by the week* (The Guardian) 23/11/2012

<i>Item</i>	<i>Brighthouse cash price (rounded)</i>	<i>Other retailer identical or similar (rounded)</i>	<i>Price difference</i>
Beko 60cm double oven (steel)	£562	£389 (Co-op)	£173
Hotpoint Ultima 9kg washer	£562	£469 (Tesco)	£93
Hotpoint slimline dishwasher	£422	£310 (Appliances Online)	£112
Acer Gold 15.6" laptop	£580	£350 (John Lewis)	£230

The retail price offered to the customer is just one criticism of *BrightHouse* and other rent-to-own outlets; the inference of the criticism is that their margins on wholesale-to-retail are excessive.

The interest rate then applied over 156 weeks is 29.9% representative APR which in itself is not a significantly outlandish price. It is the cross-selling of optional service and damage liability cover that increases the costs dramatically, and many commentators question whether these insurances are worth the money or simply taking advantage of the low take up of comprehensive home contents insurance amongst social housing tenants. A government report in 2010 identified that “*Around 85% of BrightHouse customers purchase optional service cover and 90% purchase damage liability cover*” once cross-sales of insurance cover is included “*BrightHouse charge £100 per £100 borrowed*”¹⁷

According to *BrightHouse* the key element of its 156 week rent-to-own proposition is “*returnability*”. Finance Director, Giles David told *Credit Today* magazine in 2009 that “*Customers can return goods, trade up to a more expensive model or move on by paying off the cost at any time which offers the peace of mind of cancellation*”

Chief Executive Leo McKee told the FT that “*where the rent-to-own proposition really works is that if you come in and decide to rent a telly or a sofa, if in six months you want to return it, you can and there’s no charge. If you’re a poorer person, you avoid the debt trap.*”¹⁸

BrightHouse rejects claims that it is preying on the poor and vulnerable, Leo McKee telling an interviewer “*It’s of no interest to me to take someone and push them further into debt than they should be*”¹⁹ *BrightHouse* has invited Credit Action to audit its staff training and has developed a partnerships with Learn Direct to improve financial capability and understanding.

¹⁷ *Mainstreaming Affordable Credit* (FI Taskforce) March 2010

¹⁸ Esther Bintliff *Double Digit growth for BrightHouse* (Financial Times) 9/11/2009

¹⁹ *BrightHouse Chief Executive denies taking unfair advantage with high charges for poor customers* (Daily Telegraph) 30/5/2010

Understanding the motivation of the customer is fundamental to understanding the success of *BrightHouse* and the continued appeal of catalogues amongst a similar customer group. Credit Action is on record as stating that “*Most people would be better off not using BrightHouse, instead saving to buy items over a longer period*”²⁰ yet, as *BrightHouse* demonstrated with its spike in television sales prior to the Olympics and presciently noted in an article by Helen Edwards in July 18th 2012: “*Sure, people could put aside £4 a week at near 0% interest and get a new HD TV in time for the Olympics – but it will be the one held in Rio, not London.*”²¹

The reality is that, for different reasons, customers seek the goods now, not 13 weeks or 104, or 156 weeks from now. Their lack of savings, vulnerability around financial capability and a lack of knowledge or awareness of lower cost credit options will continue to drive *BrightHouse*'s shop openings and will make the need for a viable, sustainable alternative even more pressing.

²⁰ Chris Tapp, Director Credit Action quoted in *BrightHouse Chief Executive denies taking unfair advantage with high charges for poor customers* (Daily Telegraph) 30/5/2010

²¹ Helen Edwards *Credible brand lessons from Wonga and BrightHouse* (www.marketingmagazine.co.uk) 18/7/2012

5.0 An alternative: *The Store*

5.1 History

The Store is the trading name of Social Housing Enterprise Durham (SHED). It is located in a 115sq metre shopfront premises in Stanley, County Durham. The premises are shared with Prince Bishops Community Bank (PBCB).

It began as an initiative set up by Derwentside Homes, a social landlord with 7,000 units, to allow its tenants to buy new, branded, high quality furniture, and electrical items without incurring the charges and pressure sales applied by for profit rent-to-own stores like *BrightHouse* and *Perfect Home*.

Initially, the plan was to provide Derwentside Homes and tenants of other social housing landlords exclusive access to the products via a catalogue. Indeed, *The Store* began trading as a catalogue-only offer. By coincidence, the opportunity for new premises at lower cost but with increased floor space became available within Stanley, Co. Durham and the decision was made to operate *The Store* as both a catalogue and in shop premises. Recently, the offer has been extended to anyone who seeks the products on offer, although the catalogue advertising is solely distributed to social housing tenants. (In our focus group there was confusion on whether goods were available to people from all tenures or simply those in social housing).

Derwentside Homes collaborated with SHED and PBCB (the local credit union) to ensure the logistics, the financial regulations, the loan administration and the route to market could each be delivered. Derwentside Homes role is to promote the project to social housing tenants. SHED is the legal entity in which the transaction sit which are administered by PBCB. In the event that a customer is refused a loan, they are referred to a local charity (East Durham Partnership) with a view to supplying nearly new items.

After two months as a catalogue-only operation *The Store* shopfront was opened in March 2012. £250,000 of financial support to cover the set up costs, and provide initial loan capital was provided via:

- £150,000 interest-free loan from Northern Rock Foundation;
- £50,000 grant from Friends Provident Foundation;
- £30,000 grant from Derwentside Homes; and
- £20,000 loan from Prince Bishops Community Bank.

A five year business plan set a target of full sustainability by the end of year 5 with an

anticipated:

- 4370 loans issued at an average of £462;
- £362,000 cumulative operational costs;
- £20,000 set up costs;
- £2.0m of loans issued;
- A (Year 5) loan book of £434,000;
- £100,000 saved in credit union accounts;
- £0.7m “saved” to the local economy in displacement costs;
- Bad debts under 10%.

We have observed that, although the projections differ from the reality of *The Store*'s experience in its first year, (for example 373 loans issued versus a target of 650), and we have identified some other differences with Business Plan projections, there are significant causes for optimism that a sustainable business can be created and replicated.

5.2 The market size:

The original business plan targets were partly based on a survey of 300 tenants, of whom 84% said that they had previously purchased goods via a weekly payment store or home collected credit lender; of these 41% indicated that they would use this source of finance again. Of the total sample 57% indicated that they would be interested in purchasing from *The Store*.

Using these research figures and extrapolating from the known number of social housing residents across the geography *The Store* estimated that there was, potentially, a target market of 25,650 homes within the social rented sector from which to achieve 1,530 loans within the first two years. Within County Durham there are around 45,000 homes owned by social landlords with an estimated 75,000 residents.

Chart 9: Social housing stock across County Durham

Sedgefield Borough Homes	8555
East Durham Homes	8547
Derwentside Homes	6705
Durham City Homes	6110
Dale & Valley Homes	4329
Cestria Community Housing	4255
Home Housing	2967
Three Rivers	1857

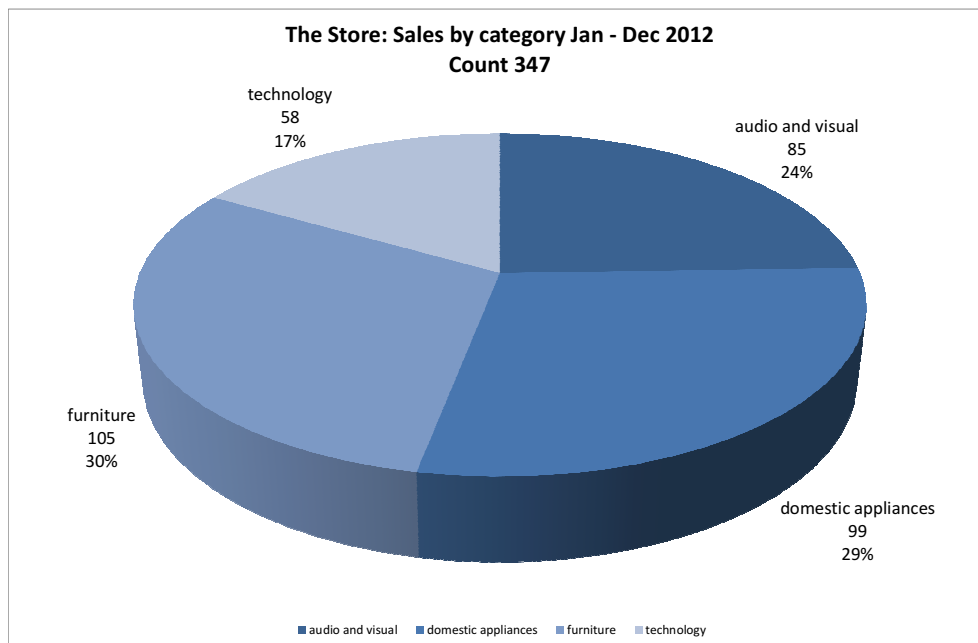
Durham Aged Miners	1280
Accent HA	948
Total Social Housing Dwellings	45553

The combination of the demand for credit in the non-standard market, the proliferation of home credit and rent-to-own alternatives, the financial climate and the credit crunch all indicate that demand will continue across the North East for the range of goods offered by *The Store*, not simply because of price but also because of choice.

5.3 Performance against projections

Between January and December 2012, 1108 applications were received of which 373 customers were approved for goodsworth £164,000. The main reason for rejection was County Court Judgements or defaults on other payment management arrangements. The average price paid by borrowers in 2012 was around £440. Typically customers were purchasing televisions, white goods, beds and mattresses; the full breakdown is shown below:

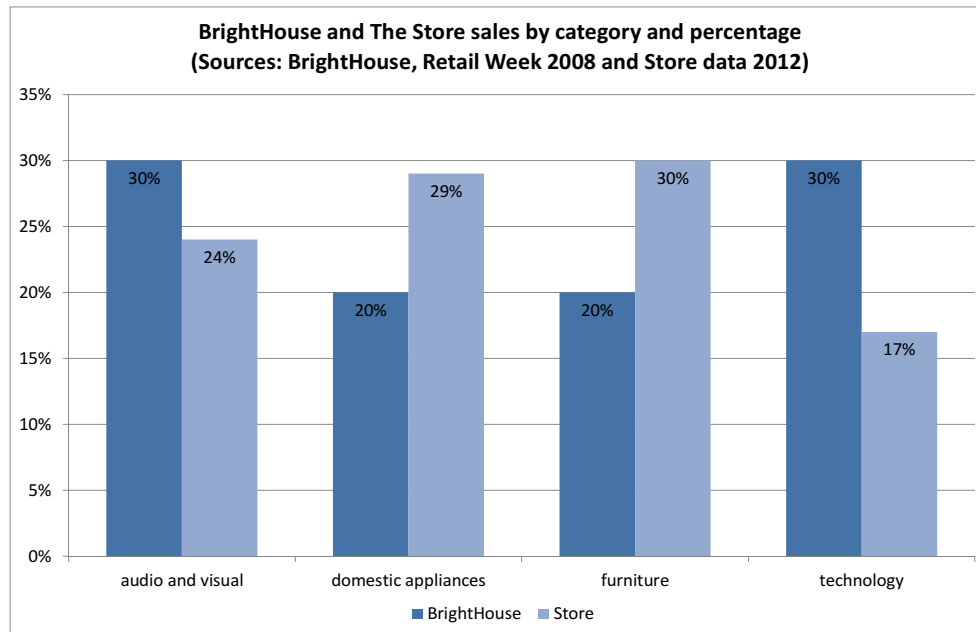
Chart 10: Store sales by category (2012)



The categories of goods purchased between *BrightHouse* and *The Store* is illustrated below; generally the spread appears similar, although the *BrightHouse* information is

drawn from 2008 and since then media reports indicate that the demise of *Land of Leather* and *Sofa Workshop* has led to a sharp increase in sofa sales.#

Chart 11: Store sales by percentage compared to BrightHouse



5.4 Sales

The pattern of sales is varied, and may be taking time to replicate all known non-standard traits of cyclical and seasonal purchases. Typically, rent-to-own stores will see a peak in their lending around October-December, and social enterprise lenders, like Scotcash and Moneyline and for-profit lenders like PFG, will see a spike in their lending around the same three months prior to Christmas.

Moneyline (a not for profit social enterprise lender of similar amounts to similar customers) had an average net loan in 2012 of £436, almost identical to *The Store* (£440). Over the same 12 month period Moneyline issued 37% of its loan volume for the year in the final quarter, and 39% of its customers sought credit in the same period. The percentages for *The Store* are just 19% of loan volumes and 19% of customers over the quarter ending December 2012. It must be noted that a direct comparison may be difficult to make since Moneyline provides personal loans and does not engage in a Rent to Own model.

Chart 12: Store sales per month compared to Moneyline sales by percentage of total sales

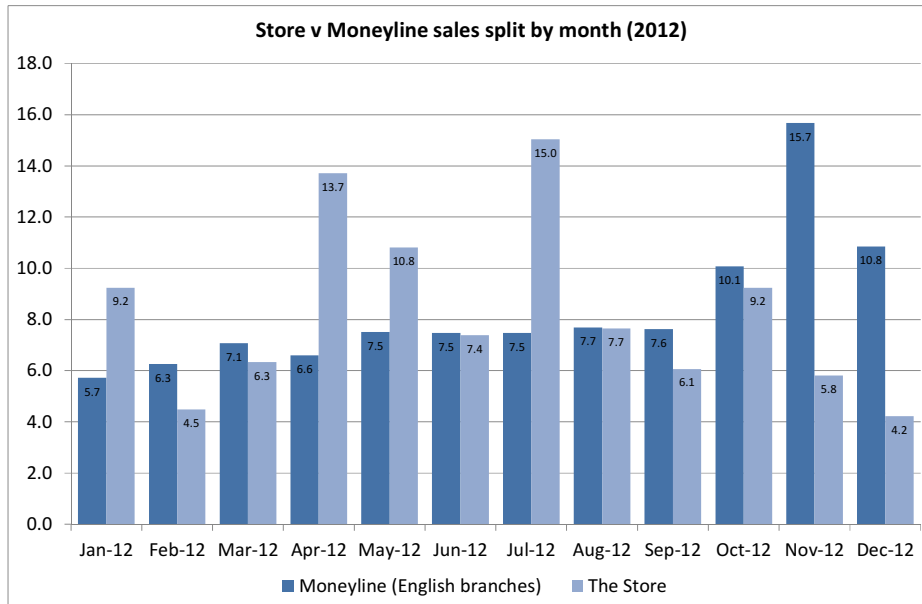
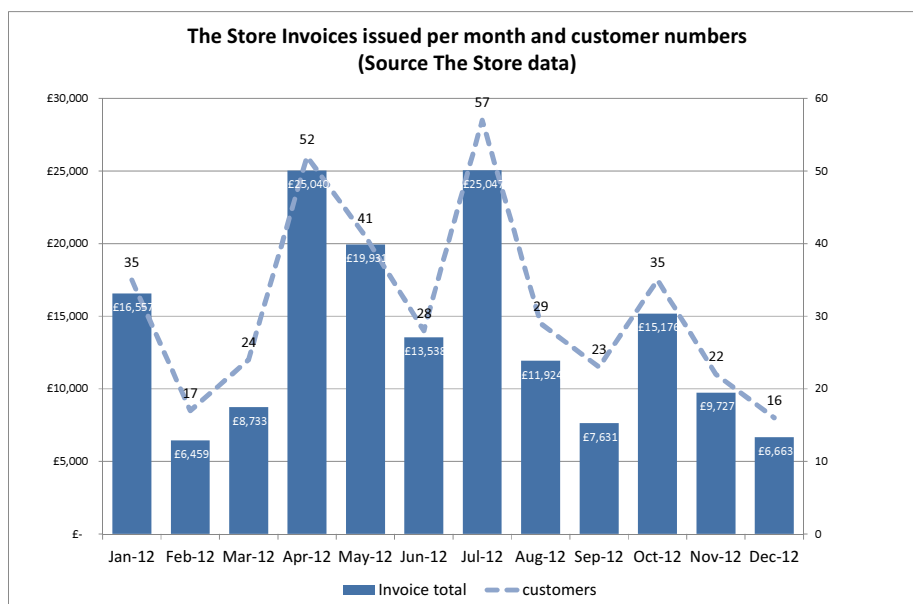


Chart 13: Store sales by number and by invoice total per month



Should the pattern of decline in loan volumes and customers continue this would obviously be a concern. We are however, confident that a plateau has not been reached and instead the decline in sales in the vital pre-Christmas period is more symptomatic of

a marketing campaign and pitch that has not quite reached its customer base in the manner that it needs to.

We know that after interviewing key personnel and undertaking the focus group that the spike in April can be attributed to the shop launch, and July co-incided with a catalogue delivery. Focus group participants believed that neighbours (and potential customers) who owned their homes, or who were private renters were unsure whether purchasing from *The Store* was limited to social housing tenants. An advertising campaign to this group might produce a similar spike in demand.

5.5 Margin, arrears and payment method

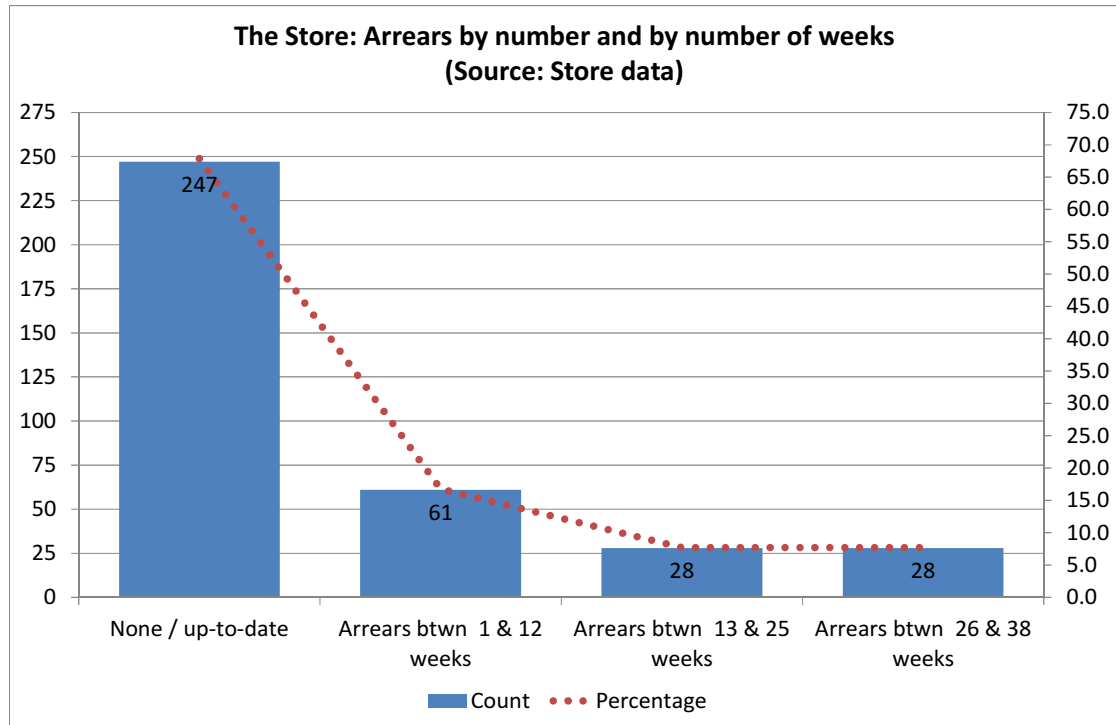
The goods are competitively priced, with a favourable margin on the goods' wholesale cost price to retail advertised selling price. It is commercially sensitive to divulge the margin, suffice to report that on the projections and trajectory, we are content that it remains a value proposition for the customer and will cover the costs of delivery, and write off if the sales figures exceed £250,000 annually.

An interest rate of 24.19% APR is applied on retail price or cash price. We calculate the average income per £100 in interest received is £28.

A mandatory sum of 25 pence is added to each weekly payment and offered as a cashback incentive (of £26) at the end of the 104 week loan period. (25p is the minimum saving). Some customers choose to save a higher amount.

The business plan anticipated a write off over the duration of the five years at 10% of capital issued. 91% of the loans are repaid weekly over 104 weeks, so the actual write off of capital has not yet materialised. The write off does not take into account the value of any goods which may be recovered which would improve the write off position. Of the 364 current loans, 67% are being paid on schedule. The remainder are in arrears of between 1 and 38 weeks. The evidence from other non-standard lenders (like PFG and Moneyline) is that customers need, and value, flexibility. An occasional missed payment is expected, and provided the customer and lender relationship remains positive and communication remains open, offering payment flexibility will be valued by the customer and may, incongruously lead to greater customer loyalty. Further evidence of the value customers place on this flexibility is identified within the case study. This provides hope that the loans in arrears will eventually be repaid.

Chart 14: Store arrears on invoices issued by customer number and by weeks in arrears



With a handful of exceptions all loans for the goods are still in the process of being repaid. Getting an accurate picture of arrears is therefore qualified as no loan has yet been written off. Looking at the Portfolio at Risk (PAR) over 13 weeks, we observe that around 15% of customers are in arrears of 13 weeks or more. The amount owed by the 56 customers is (on retail invoices before interest is applied) around £20,000. This represents around 14% of the outstanding loan book of £146,000.

It is important to note here the distinction between the amount that the customer owes The Store and the amount The Store owes its suppliers.

The gross margin that is contained within the outstanding loan amounts means, in reality, a £20,000 loan capital debt risk on paper will not materialise as a £20,000 loan capital write off within the Store's accounts were those loans to be irrecoverable.

The adjusted write off would not represent 14% (or indeed £20,000) as the Store purchased the goods for less. Without breaching commercial confidentiality of the wholesale to retail margin we consider the "true-value" arrears within the margins established in the original business plan, i.e. under 10%.

Keeping on top of arrears is vital to *The Store*, as illustrated in the opening section where we discussed the impact of write off on the overall sustainability of the model. We note that a new part time arrears officer has been recruited whose salary costs due to the increase in volume can be accommodated within the model and there is confidence amongst the management that this renewed focus will prevent arrears becoming an issue. Should the arrears rise above 15% the sustainability of the model will be tested.

The target of maintaining arrears under 10% is sensible. *BrightHouse* has a marginally lower arrears rate of around 8%. The longer arrears are allowed to build up the greater the challenge of collection, and the greater likelihood of word of mouth spreading that repayment is optional. We acknowledge that there are circumstances with both Christmas arrears being higher than other parts of the year, and the net loss of capital is not as severe as the 14% (overdue over 13 weeks) but we still think this is an area that ought to cause some concern.

The overwhelming majority of customers (93%) pay for their goods weekly on a hire purchase agreement over 104 weeks. Title is transferred from PBCB to the customer at the end of the HP agreement. There is, as yet, no ability to repay by Direct Debit (DD), 39% of customers have established a standing order, the remainder (61%) repay in cash weekly at a local store or post office via a payment card

The lack of DD facilities is being addressed and will be an option by April 2013. In addition we recommend that a merchant services account with an ability to accept card payments remotely, i.e. on the doorstep is also investigated and the cost of such a collection method ascertained. This action will help to reduce arrears.

5.6 Customer demographics

The customer using *The Store* appears to fit a very similar demographic profile to the known characteristics of rent-to-own store *BrightHouse* and short term, small sum social enterprise moneylenders like Moneyline. The characteristics of *The Store* customer are:

- 65% female;
- 58% under 35 years old;
- 80% not working;
- 97% renting;
- 55% with dependent children;
- 40% lone parents.

When compared to the known characteristics of these lenders there appears a very similar

demographic using *The Store*, suggesting that it is indeed meeting the needs of the specific customer group that it set out to address, the two charts (below) show the characteristics of Moneyline, Scotcash, Provident, and *The Store*. The first chart shows, in addition, the characteristics of credit union customers.

Chart 15: Store customer granulation compared to other lenders inc credit unions

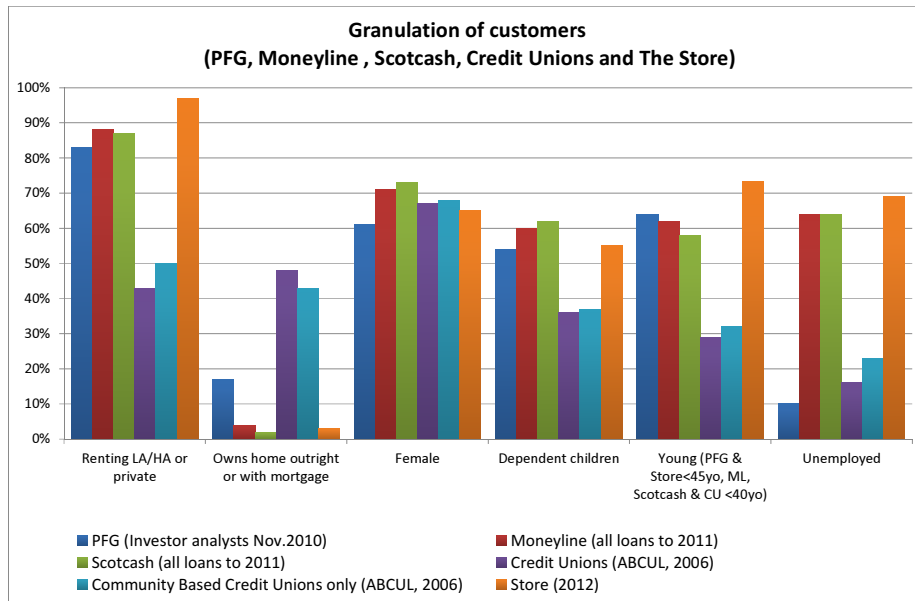
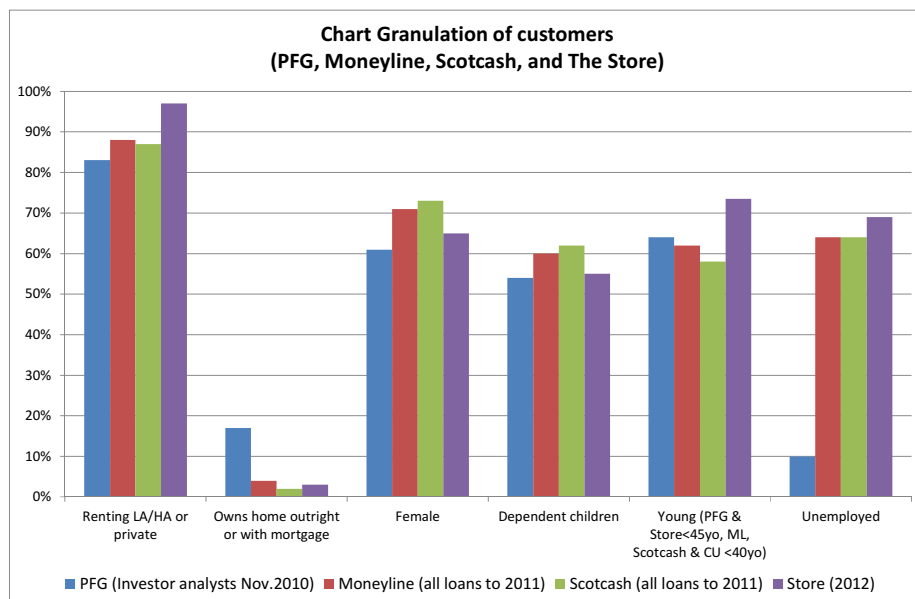


Chart 16: Store customer granulation compared to other lenders excl credit unions



The detailed characteristics of *The Store* customers are shown (below)

Chart 17: Store customer household composition (2012)

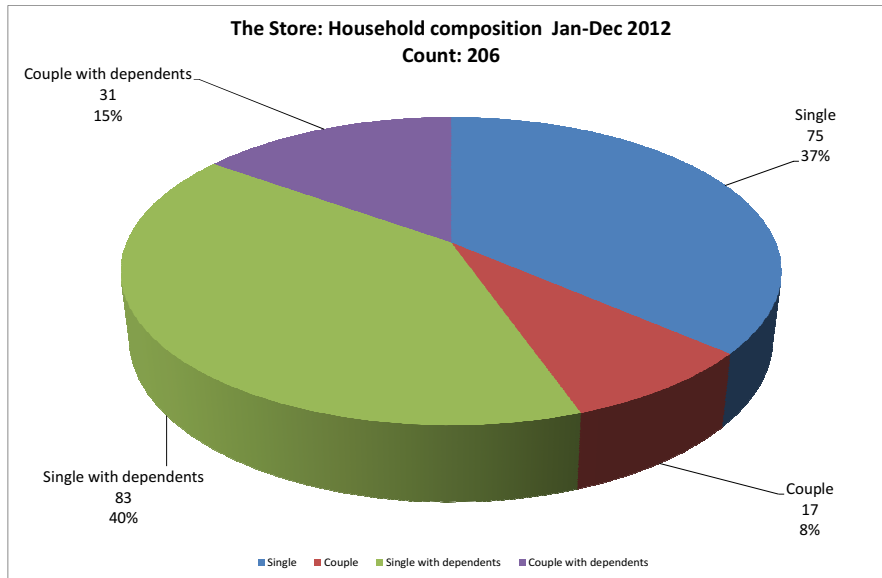


Chart 18: Store customer age group (2012)

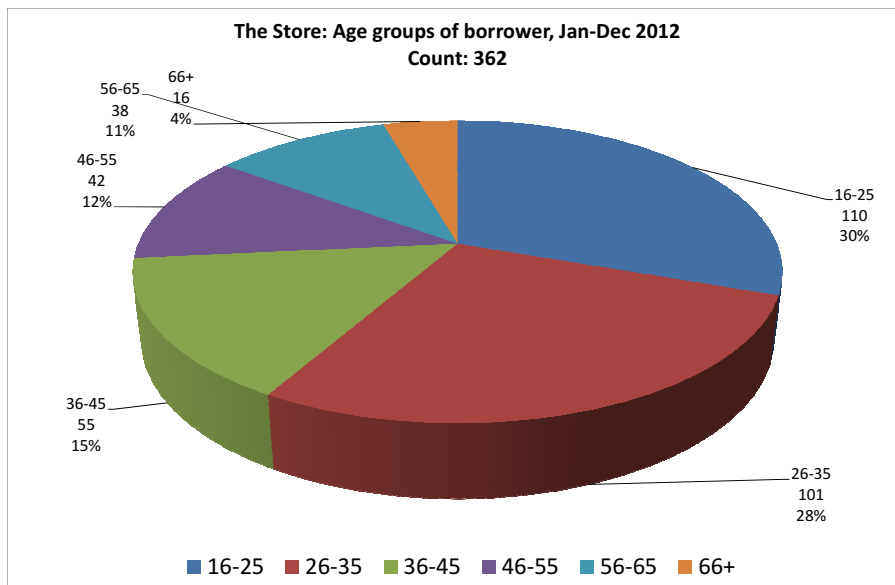
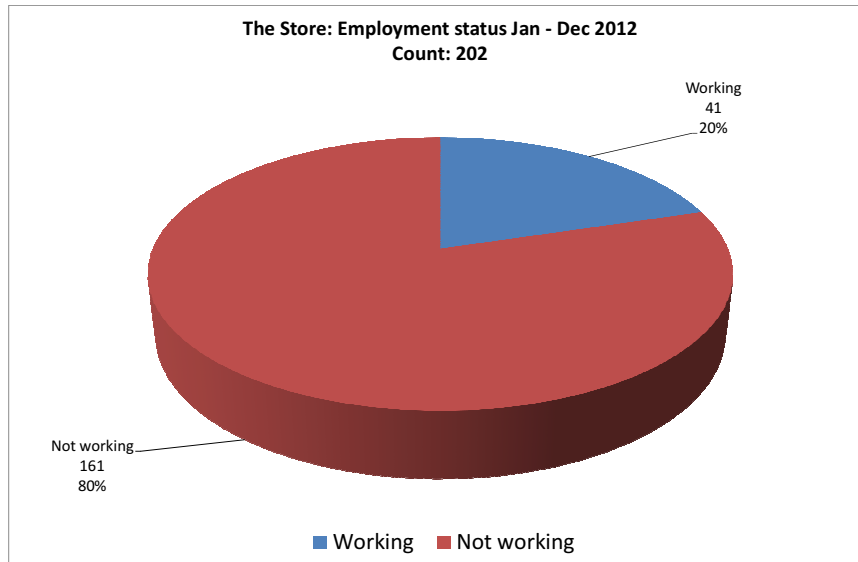


Chart 19: Store customer employment status (2012)



5.7 Footfall and location

The Store draws a footfall of around 50 shoppers per week. In addition, there are customers who receive the high quality catalogue, produced four times a year and distributed via the housing association. The number of approved loans represents around 30% of all loan applications.

The location is not ideal but represents pragmatism over idealism. It is at the end of a long primary shopping street in Stanley; it does not attract significant passing trade and the window display was the subject of minor criticism in our focus group.

The layout of *The Store* where goods are visible was considered adequate by focus group customers, but they all believed the quality of goods was better than the presentation. The PBCB staff are located behind their desks at the far end of *The Store*, visible from the window and considered a little intimidating “*They all look up when you walk in*” and there is an expectation that customers will be the recipients of pressure sales. The reality is that although staff are present to answer customer queries, no pressure sales are used, and we believe that there is an unintended consequence of locating staff so visibly in the shopfront of putting off some potential browsers.

5.8 Marketing and Prices

The route to market is through the shopfront, website and catalogue delivered to social housing tenants. Originally, the plan was to deliver these twice per year, but this has been increased to four times per year. The product range consists of around 40 items (a similar number to *Buy As You View*) with a range of furniture, white goods and electrical items. The range could be described as deep and narrow. The quality of the goods was a significant factor for focus group participants.

The catalogue images, paper quality, layout, brands and style of marketing are highly professional, offering aspirational products in a way that will be familiar to the customer. Both catalogues are shown (below).



Price comparisons with *BrightHouse* and *Buy As You View* were carried out and products priced at levels just below that offered by the current weekly payment stores with a reduced number of weekly payments (104 instead of 156). These products are new and the price includes delivery and, for electrical goods, one year on-site warranty. A typical APR is 24.19% with a range from 7.6% to 36.7% is shown below.

	No. Weeks	Weekly Payment	Total Paid	Cashback CU a/c	Net Paid	
Bunk Bed						
BrightHouse	156	£3.19	£497.64	£0.00	£497.64	
Pay as You View	156	£3.22	£502.32	£0.00	£502.32	
The Store	104	£2.98	£309.92	£26.00	£283.92	
Saving 43%						
2 Seater Leather Sofa						
BrightHouse	156	£6.39	£996.84	£0.00	£996.84	
Pay as You View	156	£6.96	£1,085.76	£0.00	£1,085.76	
The Store	104	£5.59	£581.36	£26.00	£555.36	
Saving 44%						
Cooker Beko D533W						
BrightHouse	156	£3.76	£586.56	£0.00	£586.56	
Pay as You View			Model not available			
The Store	104	£3.75	£390.00	£26.00	£364.00	
Saving 38%						
Sharp 40" LCD TV LC40LE600E						
BrightHouse			Model not available			
Pay as You View	156	£10.71	£1,670.76	£0.00	£1,670.76	
The Store	104	£9.50	£988.00	£26.00	£962.00	
Saving 42%						
Washing Machine Beko WM5100W						
BrightHouse	156	£3.24	£505.44	£0.00	£505.44	
Pay as You View	156	£3.21	£500.76	£0.00	£500.76	
The Store	104	£3.20	£332.80	£26.00	£306.80	
Saving 39%						
Fridgefreezer Beko BEK653/648						
BrightHouse	156	£3.70	£577.20	£0.00	£577.20	
Pay as You View	156	£5.34	£833.04	£0.00	£833.04	
The Store	104	£3.69	£383.76	£26.00	£357.76	
Saving 38%						

Making like for like comparisons is difficult as *BrightHouse* offers goods on typically 156 weeks term, and *The Store* on 104 weeks. The goods are cheaper from *The Store*, interest applied is lower, there is no cross selling of damage liability cover (DLC) or optional service cover (OSC) (although home contents insurance is offered to customers without cover) and without knowing the margin on wholesale-to-retail goods that *BrightHouse* apply it is likely that the social enterprise application of margin to cover costs rather than generate profits for shareholders would infer a lower margin within *The Store* too.

We have compared, as closely as possible a mix of like-for-like goods. The illustration (below) shows the difference in the total cost of credit (TCC), after cashback is removed from *The Store*'s weekly payment. We have compared this to the TCC of similar goods in the current *BrightHouse* catalogue.

BrightHouse's price is shown with and without DLC (Damage Liability Cover) and OSC (Optional Service Cover) both of which are taken in 90% of cases. The Store's price is shown on the left of all illustrations²²:

Chart 20: Selected price comparisons between The Store and BrightHouse



²² Samsung 43" Series 4 Plasma TV Net Price at *The Store* £542 versus Samsung 40" Smart 3D LED TV at *BrightHouse* Price £1287 (without DLC & OSC) and £2276 (with DLC & OSC). Hotpoint Washing machine 6kg 1400 spin speed A+ in black Net price at *The Store* £476 versus Hotpoint 7kg washer 1150 spin speed in white at *BrightHouse* £505 (without DLC & OSC) and £895 (with DLC & OSC). Metal bunk beds (without mattress) Net Price at *The Store* £247 versus Beverley Bunk beds (without mattress) at *BrightHouse* £253 (without DLC & OSC) and £446 (with DLC & OSC). Nevada 3 seater sofa Net price at *The Store* £575 versus Olivia 3 seater leather settee at *BrightHouse* £1346 (without DLC & OSC) and £1936 (with DLC & OSC). All quotes from current catalogues.

The figure of 40% cheaper than *BrightHouse*, whilst probably right, is impossible to confirm without knowing the gross margin on wholesale-to-retail that *BrightHouse* or others charge. In our view, *The Store* should not focus on being 40% cheaper on a retail price to retail price basis since it is the affordability of the weekly payments which is most important to the customer and not the ticket price. Increasing the margin on wholesale-to-retail to comfortably cover costs, within an assumed potential 15% write off, and lower sales volumes should provide both headroom for sustainability and remaining fairly priced. Our view is that focussing on the weekly cost and cashback with associated quality brand products will attract business.

5.9 Key Performance Indicators

The Business Plan indicates that success of the project would be judged against a number of KPIs:

Chart 21: Store KPIs

	Y1	Y2	Y3	Y4	Y5
No. New loans per year	650	880	920	960	960
Actual No. loans per year	373				
Value of new loans (£)	306566	415043	433909	452774	452774
Actual value of new loans (£)	164000				
Value of bad debt (£)	6290	26732	40786	43164	45012
Actual value of bad debt (£)	19851 ²³				
Customer saving v BrightHouse (%)	40%	40%	40%	40%	40%
Actual customer saving v BrightHouse (%)	N/A				
Customers who increase savings in CU (%)	30%	40%	45%	50%	55%
Actual customers who increase savings in CU (%)	20%				
Customers subsequently taking CU loan (%)	25%	35%	40%	45%	50%
Actual customers subsequently taking CU loan (%)	10%				
Admin costs per loan (£)	64.62	41.83	44.44	43.09	49.48
Actual Admin costs per loan (£)	112.60				
Customer satisfaction (%)	80%	85%	90%	90%	95%

Of these KPIs in Year 1, the three principal KPIs covering number of loans, volume of lending and bad debts were all missed. The loan numbers and volumes were around 57% and 53% of the projected figures, and the bad debt was higher than projected although the seasonal increase is a factor here, and, as we point out later, the net figure owed to the Store is higher than the figure the Store is liable for with its suppliers.

²³ As noted earlier the true bad debt value is substantially less as the figure shown includes the wholesale to retail margin on the loan, a mark-up that is not, in effect, lost to The Store

However we are firmly of the view that these do not mean that *The Store* has been unsuccessful. Nor do we believe that these indicate that *The Store* cannot achieve a narrowing of actual to projected figures across these three KPIs.

5.10 Margin on goods mark-up and interest:

The Store's income comes from the repayment of loans. It receives earned income above the retail price applied to the goods, and a mark-up income, the gross margin between the wholesale cost paid for the goods and the retail cost paid by the customers. The customer is unaware of the gross margin but aware of the interest rate. Customers have, by entering into the credit agreement, accepted the retail price.

100% repayment of the Hire Purchase (HP) contract would mean full capital repayment of the set retail price, which is above the wholesale price by 22%. Additionally, 100% HP repayments will include the portion of weekly repayments that cover the earned interest income. The combination of both amounts to a surplus / profit that is sufficient to cover the cost of sales and write off.

The Store has applied a margin on the cost of the goods from the price it pays (wholesale) to the price the customer pays (retail). We have agreed not to publish this figure. In addition to this margin *The Store* has applied an interest rate charge of typically 24.19% APR. The charges per £100 remain considerably less than those paid to commercial, for profit suppliers of similar goods and cash (see below).

The margin and interest rate are realistic within the non-standard market. PFG, the leading UK home credit company charges £82 per £100 issued with a default rate that is generally thought to be 10%. Moneyline charges on a spectrum of £21 to £41 per £100 issued and write off 10% of capital issued.

The Store may face unfair criticism on the cost per £100 were it to become common knowledge; yet, as we have shown in the opening chapter a write off rate of 15% would erode the surplus and risk the sustainability of the entire operation on current sales projections. Charging less (unless the sales volumes and/or bad debt are altered up and down respectively) will mean *The Store* cannot be sustainable.

6.0 Customer feedback:

6.1 Focus group

We undertook a focus group with eight customers. They ranged in age from under 24 to over 70 years old. Six females and two males participated. None were in full time employment; half were retired. Only one was a house owner, the remainder, social renters. Two were previous users of *BrightHouse*, one had bought goods from *Buy-As-You-View* and two had loans in the past from PFG. All were banked, the majority had home insurance and the weekly household income was, apart from one, under £250.

Each had purchased goods from *The Store* within the past year.

A consensus emerged on their broad opinion of the product range, marketing and advertising, layout, cost and price. Overwhelmingly, people were satisfied with their experience, the quality of the goods, the cash price, the weekly cost, sales and aftercare. There was a view that *The Store* provided a quality service. The quality of the goods was highly valued, and the retail price offered on these goods was considered as fair, especially when compared to the realistic alternatives.

It was perhaps no surprise that the product range was limited and a majority of customers believed that *The Store* would benefit from widening its selection without compromising quality. The brand names were valued, people indicated that they would be less inclined to purchase goods that they didn't recognize so, *Dyson*, *Hotpoint Aylesbury*, *Indesit*, *Beko*, and *Sony* were all considered high quality items that would last and provide value for money.

The presentation of goods in the catalogue was recognized as attractive and similar to other catalogues that customers were familiar with. The layout of *The Store* was not so highly regarded. People referred to the ever changing window display at *BrightHouse* and thought that *The Store*'s window was dull by comparison.

The layout internally was also criticized. The location of PBCB staff at the rear of the shop was off putting. People believed, wrongly, that they were salespeople who would "pounce" if you came into browse. "They all look up from their desks when you walk in" "it's off-putting; I just want to browse" The reality is no pressure sales are conducted but the perception of a pressure sales environment could be easily altered.

The location at the end of Front St was considered poor. There is limited passing trade, with a local landmark "the Clifford Road crossing" being identified as the point beyond

which you were unlikely to go unless you had a pressing reason.

Again, there is a balance between the rental cost paid by PBCB against a more prominent shop location but it is a concern that *BrightHouse* in Consett was described as “*warm and friendly*” and its display “*changed around*” regularly, meaning there were additional reasons to go in when passing. In comparison the view on *The Store*’s presentation was that “*it doesn’t encourage you to come in*”

Customers identified excellent customer service and named individuals from whom they had received excellent service. Aftercare and flexibility were also identified as high quality traits. Several customers referred to minor glitches with goods that were quickly resolved and compared these with previous experiences with other retailers.

As with many non-standard customers, only one focus group participant knew the price (the APR) on their loan, despite all receiving their loan paperwork at the point of sale. Everyone was aware of the cost of their goods weekly, and it was the weekly cost that mattered to them “*I can afford £4 for a fridge freezer every week*”. Almost all customers professed to not knowing how much they still had left to pay “*They should give you a book to let you know how much is left on the loan.*”

Notwithstanding these general observations, which are mostly related to range of products, location and marketing, one other observation worth noting was the positioning of the goods at the social housing sector. There was genuine confusion on whether goods were solely for social housing tenants given the known association with Derwentside Homes “*I’ve told my neighbour about it (The Store) but he’s an owner and he says it’s not for owners*”. People arrived at this view because the catalogue was sent to social housing tenants only. “*They should advertise more in the Consett and Stanley advertiser – make it clear it’s for everyone*” was a view that generated support.

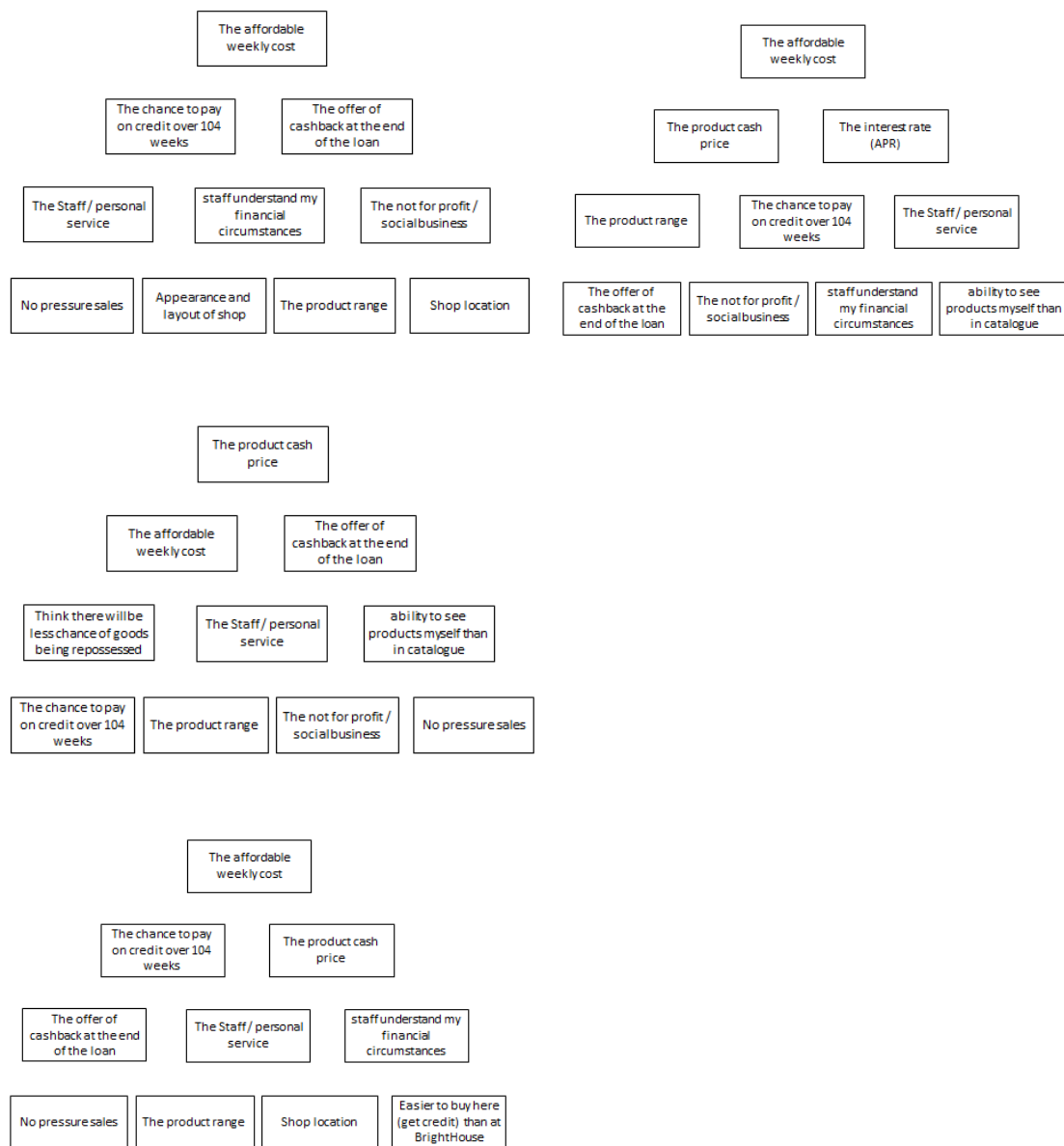
The cashback at the end of the loan caused a little confusion. People were pleased to hear that the cashback was cash, not a credit note toward future purchases which some, erroneously thought to be the case. Many of these observations are perceptions. *The Store* staff are explicit with customers about loan price, cashback, and tenure irrelevance. But customers do not always hear the message being conveyed.

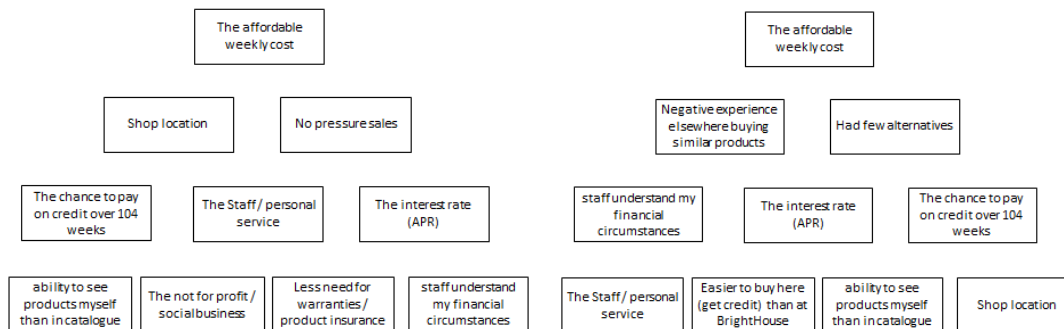
The observations around marketing, product range, location and customer tenure did not disguise the overall high esteem in which *The Store* was held. The weekly cost, the staff and service, the understanding of their circumstances and the ability to see products themselves rather than in a catalogue were all significant advantages, but it was the weekly cost that trumped all other aspects.

Participants were asked to individually order the most important aspects of *The Store* in a grid. 20 statements were issued and instructions given on placing the statements in a pyramid shape order of importance, using ten statements and discarding ten others.

The results show some broad similarities, the items toward the top of the pyramid being the most important three aspects of *The Store* for the individual:

Chart 22: Feedback from focus group pyramid exercise





The focus group responses reinforce the desirable aspects of weekly cost. When pressed, all participants acknowledged that their goods would still represent good value to them, and be within their budget at 25p, 50p, 75p or even £1.00 more per week. The price comparison was with *BrightHouse* and all thought the goods were keenly priced.

The principal lessons from the focus group were around shaping the marketing to ensure that the products were focused on non-standard borrowers from all tenures. The focus on weekly price and cashback were highly valued and the ability to view goods in the shop came over strongly. The layout and window display can be improved and the relocation of credit union staff can be achieved to remove the perception of pressure sales. The maintenance of both quality branded items and understanding and welcoming staff who are aware of customers’ circumstances are all valuable.

6.2 Case Study

One of the focus group participants, Nicola agreed to participate in a further face to face interview. Nicola is 36 years old, a lone parent with a five year old son living in a Derwentside Homes three bedroom house. She was eight months pregnant and anticipating the birth of a daughter. Her weekly income after Housing Benefit was around £150 consisting of £71 Income Support, £55 Child Tax Credit and £20 Child Benefit. She relied on the support of her mother who lived within a few miles. “*she’s my best friend, I go round there every Sunday*”.

Nicola has a poor credit history; she explained it was as a result of a failed relationship where she and her partner had borrowed money for their joint home when both had been working at the time. The loans were taken out in her name, not her partner’s, and she was now using a debt management company to repay her debts at £20 per month. “*At the current rate it’ll take 26 years!*”

After the relationship failed Nicola moved into a Derwentside Homes property and

initially, was still working, although it was becoming more difficult without a partner. She had no furniture to furnish her rented home. Nicola recounted trying a major furniture supplier, *“They told me I had failed a credit check, it was humiliating. I then went to BrightHouse for a cooker a TV and a sofa. They offered me the three items at about £50 per week (for 156 weeks) and it seemed manageable. It seemed more manageable when they told me I could have reconditioned TV and sofa, and a new cooker, for £35.17. They included optional service cover and warranties, it was presented to me as “you need this.””*

Nicola paid £35.17 for around 78 weeks, (£2,743). *“I found it more and more difficult but I needed a telly, then, I wasn’t working and my income dropped, it got to the point where I was living on about £12 a week, and I was going without to make sure my son was fed”.*

Nicola described how she first found out about *The Store*:

“I rarely go beyond Stanley, I don’t use public transport, too expensive. I was passing the Store and walked in for a nosy. I spoke to David and he was brilliant. Around the same time a friend of my mum’s gave me their old cooker, so I returned the BrightHouse one. That saved me about £9”.

“David asked me about my debts and the arrangements, I was up front with him, he said we could still do something and I ended up getting a better TV and a sofa for £18.83 a week, over 104 weeks. I am angry at what I was paying. I feel loads better about this. They (The Store) have been brilliant, it’s a massive difference in how much I’ll repay. The weekly difference goes on my son. If we are at the market I can now allow him a go on the carousel or a packet of crisps, I can afford his shoes. They’ve been a lifeline for me, really takes the pressure off”.

Nicola described the experience of late payment charges at *BrightHouse* *“£3 per item, if you missed a week, with The Store, when I changed from JSA to Income Support the money didn’t come (to my bank account) when they said it would. I called David and he said “Ok, keep us informed”; that’s brilliant, I’ll go in and pay double next week, but there’s no late charges”*

Over the 104 weeks Nicola will pay £1,932 for her TV and sofa. On a like for like basis she would have paid over £4,000 for the reconditioned TV and sofa at *BrightHouse*.

Nicola has also initiated insurance cover for her possessions. *“I got home insurance at Barclays, the whole house is covered, not just the goods I bought”.*

7.0 Conclusions and recommendations:

The demand for good quality affordable goods in the rent-to-own non-standard market is significant. The continued success of *BrightHouse* and its expansion is indicative of a retailer who knows its marketplace and customers.

The non-standard credit market in the North East of England will continue to offer rent-to-own retailers, whether for-profit or not-for-profit, sales opportunities.

The Store has mirrored many of the aspects that are popular with the *BrightHouse* proposition, namely:

- the deep and narrow goods selection;
- the recognised brand names;
- the product range;
- the high quality catalogue and website;
- the weekly payments.

The Store set itself over-ambitious targets in year 1. Not meeting the targets does not mean that *The Store* has failed, far from it. We believe that with some recalibration around margin, marketing, promotion and arrears management that *The Store* displays those characteristics that lead us to conclude there is scope for expansion and replication in other parts of the North East and UK.

We believe that the lessons of the first year, if acted upon, will allow *The Store* to develop a template for expansion. We believe the following aspects need to be addressed:

1. Sales volumes must be increased to a minimum of £300,000 per outlet.
2. To achieve greater sales volumes a marketing campaign involving brochures, website and newspapers needs to emphasise the affordable weekly cost, the cashback offer, the brand names and the availability of the goods to all tenures. However any marketing campaign will come at a cost and this will need to be factored into the model.
3. The window display needs to be altered fortnightly to maintain customer interest.
4. The PBCB staff layout needs to be altered in order to prevent an impression that they are *The Store* sales team.

5. The margin on wholesale-to-retail goods should be at the same level for all products; currently some have a lower markup per £100 than others.
6. Write off (as a percentage of capital issued) needs to be held under 10% (currently the write off over 13 weeks is higher than 10% on one measure Against the loan value) but technically lower than the 10% (if the measurement includes the real loss to The Store after the wholesale price of goods is included).
7. Direct Debit needs to be established as the preferred means of payment.
8. Collection of arrears by card reader either over the phone or on the doorstep should be developed.
9. The administration cost per loan payment to PBCB needs to rise to compensate for lower (than anticipated) sales to £100 per sale.
10. Annual operational running costs need to be identified for additional branches covering salaries and running costs.
11. If, after six months, the arrears are above 15% and / or the sales are below the £300,000 target then margin on wholesale-to-retail should be increased (a higher margin will still produce a cash price that will be considered a value proposition for customers).

We believe that *The Store* has made significant progress in its first year of operation. It will need to secure sufficient loan capital to expand its service, and it will need to identify locations across the North East, initially, where other outlets can be established. The social rented sector will, we think, be interested in entering into a dialogue on the potential benefits of establishing similar outlets in other towns.