
Price regulation of UK at-need funerals

Prepared for the Competition and
Markets Authority

4 November 2019

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1 Executive summary

- 1.1 In April 2019, the Competition and Markets Authority (CMA) published an Issues Statement in relation to its ongoing investigation into the UK at-need funerals market. In this document the CMA proposed price regulation as a potential remedy to the issues it has provisionally identified in this market.¹
- 1.2 On behalf of the Co-operative Group (Co-op), Oxera, with input from Peter Culham,² has reviewed the suitability of price regulation in this market, with particular reference to the options set out by the CMA in the Issues Statement.
- 1.3 This report highlights significant concerns about the suitability of price regulation in the case of the UK at-need funerals market.
- 1.4 In its guidelines for conducting market investigations ('the CMA guidance'), the CMA acknowledges that measures to control outcomes, including price remedies, introduce risks and can lead to adverse unintended consequences.³ As such, the CMA concludes that these remedies should not generally be used unless other, more effective, remedies are not feasible or appropriate.⁴
- 1.5 In the Issues Statement, the CMA identifies a number of concerns in relation to this market.⁵ These relate predominantly to demand-side issues that we consider best described by the CMA's category 'Information shortfalls and behavioural biases'.⁶ The CMA guidance explains that such issues are best addressed through informational remedies and market-opening measures (as opposed to price regulation).⁷
- 1.6 In addition, this market exhibits a number of characteristics that make it a less suitable candidate for price regulation than most other price-regulated sectors. These include:

- **Market structure and dynamics:**

¹ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues'.

² Oxera Associate Peter Culham, who is an experienced regulatory and competition economist and former Chief Economist at Ofcom.

³ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action', April, para. 88.

⁴ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action', April, para. 89.

⁵ We note that an assessment of the issues in the UK at-need funerals market is outside the scope of this report. We only refer to the potential issues as set out in the CMA's Issues Statement.

⁶ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 68.

⁷ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies', April, p. 83, Table 1.

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- a large number of players;
 - diverse business models;
 - small share of the largest companies' supply;
 - dynamic market.
 - **Product offering:**
 - heterogeneity of products;
 - non-measurable and non-observable aspects of quality.

These market characteristics make price regulation in general complex, costly and risky (in terms of the potential to inadvertently distort the market).

- 1.7 While each specific form of price regulation identified by the CMA attempts to address these issues individually to a lesser or greater extent, none are capable of adequately addressing all of these characteristics.
- 1.8 We conclude that, in the context of the UK at-need funerals market, every price remedy option set out by the CMA has limitations and would create a significant risk of unintended consequences.
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2 Introduction

2A Context

- 2.1 In April 2019, the Competition and Markets Authority (CMA) published an Issues Statement in relation to its ongoing investigation into the UK at-need funerals market. In this document the CMA proposed price regulation as a potential remedy to the issues it has provisionally identified in this market.⁸
- 2.2 On behalf of the Co-operative Group (Co-op), Oxera has reviewed the suitability of price regulation in this market, with particular reference to the options set out by the CMA in the Issues Statement.
- 2.3 Oxera has a long history of supporting regulators, companies, investors and other policymakers in relation to regulatory issues, across a wide range of sectors, beyond traditional utilities. In preparing this report, we have drawn on our extensive experience in assessing the suitability of different forms of regulatory intervention, which have made us a leading authority and trusted adviser in this space. In our work, we seek to design effective and proportionate regulation and policy to enable well-functioning markets.
- 2.4 In addition to Oxera staff and partners, this report has received valuable input from Oxera Associate Peter Culham, who is an experienced regulatory and competition economist and former Chief Economist at Ofcom.

2B Report structure

- 2.5 In section 3, we outline the main principles of the CMA's remedies design framework and summarise the issues that the CMA has raised in relation to the UK at-need funerals market. We then assess what these two sources indicate about the most suitable form of regulatory intervention. Finally, we set out the price remedies that the CMA is considering in relation to the UK at-need funerals market (as presented in the Issues Statement).
- 2.6 In section 4, with reference to the CMA framework, we explain where price regulation works best, and our view on whether the various forms of price regulation being considered by the CMA are likely to provide effective remedies to the potential issues in this specific market. Our assessment is driven by a number of characteristics of this market, which we describe in this section.

⁸ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues'.

2.7 In section 5, we outline our conclusions.

3 Application of the CMA's remedies framework

3A The CMA's remedies framework

- 3.1 The CMA's most recent framework for designing market remedies is the 'Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action', published by the Competition Commission in 2013 (the CMA guidance).⁹
- 3.2 As a general approach, the document suggests using remedies that address the underlying causes of any adverse effects on competition (AECs) in the first instance. Only if it is not possible to identify effective ways to address those causes should measures to directly control outcomes (e.g. price remedies) be considered.¹⁰

3B Potential issues in the market identified by the CMA

- 3.3 The CMA's Issues Statement identifies a number of potential issues in the UK at-need funerals market.¹¹ The CMA groups the issues into the following categories:¹²
- a) the difficulties many people have in engaging with the funerals purchasing process;
 - b) firm behaviours in the supply of funeral director services;
 - c) market structure and barriers to entry in the supply of crematoria services.
- 3.4 Issues under group (a) are focused on consumer engagement. The CMA notes that issues under group (b) are also associated with consumers' difficulties in engaging with the funerals purchasing process, as well as firms' behaviour in relation to the provision of price information and the sales process.¹³ Therefore, leaving group (c) aside, as it is focused on crematoria, these issues are primarily associated with consumer engagement, i.e. the demand side of the market.

⁹ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action', April.

¹⁰ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action', April, para. 89.

¹¹ We note that the assessment of the issues in the UK at-need funerals market is outside the scope of this report. In this report, we only refer to the potential issues indicated in the CMA's Issues Statement.

¹² CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 68.

¹³ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 83.

3C Application of the CMA's remedies guidance to this market

- 3.5 Using terminology from the CMA guidance, we consider the potential issues highlighted by the CMA to be 'information shortfalls and behavioural biases', for which the CMA's suggested remedy approach is a combination of market-opening measures and informational remedies.¹⁴
- 3.6 This suggests that remedies targeted at improving transparency, sales practices and quality should be prioritised in this instance.
- 3.7 Consistent with this approach, in its market study for the care-homes market, where the main issues identified by the CMA were similar to those identified in the Issues Statement for the UK at-need funerals market (i.e. customers' ability to make good decisions in moments of extreme vulnerability), the CMA recommended remedies that focused on:¹⁵
- helping people make good decisions about their care options;
 - protecting residents and their consumer rights;
 - making the complaints system work well for care-home residents, their representatives and families.
- 3.8 In the Issues Statement for the UK at-need funerals market, the CMA does consider remedies related to information/transparency and quality regulation;¹⁶ however, in addition to these, the CMA considers the following price/charging remedies:¹⁷
- cost orientation condition;
 - profit margin/rate of return allowance;
 - safeguard cap on essential services;
 - safeguard cap on a specific package.
- 3.9 On the basis of the CMA guidance, price regulation does not appear to be an obvious remedy to the potential issues identified by the CMA in this market.

¹⁴ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies', April, p. 83, Table 1.

¹⁵ CMA (2017), 'Care homes market study: summary of final report', 30 November.

¹⁶ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 111.

¹⁷ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 127.

4 Price regulation as a remedy

4A Where is price regulation suitable?

- 4.1 The CMA guidance notes that measures designed to directly control outcomes, including price regulation, are often used in regulated sectors, in particular where effective competition may not be feasible.¹⁸
- 4.2 This is the case in many utility sectors, such as energy and water networks, where market players are typically natural monopolies supplying essential goods or services. To avoid abuse of their market power and subsequent consumer harm, regulators set price limits based on estimated competitive levels (while also protecting the financeability and sustainability of the firm).
- 4.3 These markets have a number of common characteristics that make price regulation a suitable regulatory intervention. These characteristics include:
- lack of competition in the market (i.e. dominance of a single firm);
 - homogeneity of goods or services;
 - observable and measurable quality.
- 4.4 Since there is typically little or no competition in those markets (as many are natural monopolies),¹⁹ there is a low risk that price regulation will introduce distortions to competition. Indeed, in many cases, price regulation is carefully targeted at ‘bottlenecks’, while elsewhere in the value chain the regulator seeks to promote competition. Regulators of potentially competitive markets have to be much more cautious in terms of proportionality of their measures as the risk of distorting competition could be significant.²⁰
- 4.5 In addition, the overall administrative costs of price regulation should be considered. When there are only a few market players, the benefits of regulation tend to outweigh the costs. However, the costs may increase with the number of market players.
- 4.6 The homogeneity of goods and services provided by firms in these markets makes it easier for regulators to identify appropriate price levels for price

¹⁸ Competition Commission (2013), ‘CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action’, April, para. 88.

¹⁹ Lipczynski, J., Wilson, J. and Goddard, J. (2005), *Industrial Organization. Competition, Strategy, Policy*, Financial Times/Prentice Hall, Chapter 18.2, p. 660.

²⁰ In its final report for the energy market investigation, the CMA recognised the potential negative impacts of the price cap, including the possibility of reduced competition and the risk of a supplier exiting the market. See CMA (2016), ‘Energy market investigation: Final report’, 24 June, pp. 1037–1050.

controls. Therefore, a regulator can efficiently and effectively enforce a single or small number of pricing mechanisms, meaning that the costs of implementing price regulation are less likely to outweigh its benefits.

4.7 Finally, in addition to setting prices, most regulators also now require companies to maintain a specified set of quality standards.²¹ These are designed to prevent cost minimisation at the expense of quality of service, i.e. companies reducing costs and therefore increasing profits, given a specific price limit, by lowering the quality of the goods or services. Observable and measurable quality is therefore crucial for effective price or revenue cap regulation.

4.8 Where these characteristics of the market are not present, designing and enforcing price regulation with minimal distortive effects necessarily becomes more complex, costly and risky.

4.9 In the following section, we highlight some potential challenges in implementing price regulation in the UK funerals market, be it in a relatively simple form (e.g. price caps on a specific product or components) or more involved (cost orientation or profit margin regulation). Overcoming these challenges necessarily comes at a cost, which partly relates to the risk of regulatory error and unintended consequences (e.g. damage to existing competition in the market). Given these challenges, we consider price regulation to be a last resort—used only where other interventions have been fully tried and proven ineffective.

4B Price regulation challenges in this market

4.10 In this sub-section we discuss the risks and challenges associated with introducing price regulation in the UK at-need funerals market in relation to the following aspects:

- the market structure;
- heterogeneity of the funerals product;
- non-observable and non-measurable quality;
- the dynamic nature of the market.

²¹ See, for example, Ofwat's guaranteed standards scheme (GSS), which sets the minimum standards of service required from England & Wales' water and sewerage companies. Specific penalties are set in case companies fail to meet these standards. Ofwat (2017), 'The guaranteed standards scheme (GSS): summary of standards and conditions'.

- 4.11 Each of the price/charging remedies proposed in the CMA's Issues Statement attempt to address some of these challenges. However, as we show in the following sub-section, there is no option that would address them all.
- 4.12 The arguments we make in this paper are not specific to any particular type of funeral product. Therefore, when we discuss price regulation of funeral products, we do not make any assumptions about what the definition of that product might be. A 'funeral' can take many forms, from an unattended cremation to a multi-day funeral ceremony.

4B.1 Market structure and dynamics

Market structure

- 4.13 The fundamental difference between the UK at-need funerals market and other markets that are typically price-regulated, is that companies in those markets have a very strong position in their respective markets, while this is not the case in the UK funerals market.
- 4.14 In contrast, the issues in the UK at-need funerals market, according to the CMA, include a lack of transparency in relation to quality and sales process, the vulnerability of customers at the point of need and the resultant reduced customer engagement. As a result, price regulation that focuses on correcting supply-side market failures is unlikely to be the best way of addressing the potential demand-side problems that the CMA has identified in this market.
- 4.15 Moreover, market characteristics such as the large number of players and the heterogeneity of business models create additional challenges to structuring an appropriate regime and introduce a significant risk of regulatory error and competitive distortions.
- 4.16 According to the CMA, there are over 1,300 funeral directors in the UK, operating between 5,000 and 7,000 branches between them.²² The three largest funeral directors have a combined share of less than 30%.²³ This is not comparable to the majority of price-regulated sectors, where one or a few large companies dominate the market.²⁴

²² CMA (2019), 'Funerals market study – Final report and decision on a market investigation reference', para. 2.30.

²³ CMA (2019), 'Funerals market study – Final report and decision on a market investigation reference', para. 2.31.

²⁴ We note that in the Issues Statement the CMA used the Northern Ireland community pharmacies market as a comparator sector in which price regulation is applied. As set out in Co-op's response to that statement, we do not consider this sector to be a good comparator—the process referred to was for establishing a

- 4.17 This fragmentation of the UK funerals market brings into question the suitability and feasibility of price regulation. Monitoring and enforcing some of the more complex forms of regulation (e.g. a cost orientation condition) would require collecting and analysing data from over 1,000 funeral directors and involving thousands of branches. Such a process would be burdensome for market players and, therefore, may be disproportionate for some of them, and potentially prohibitively expensive for the regulator.
- 4.18 Some of the options presented by the CMA (e.g. cost orientation, profit margin allowance) would require the regulator to issue detailed guidance on cost allocation and standardised policies for determining regulated profit—compliance with which may be challenging to monitor effectively. Seemingly simpler price regulation (e.g. nationwide price caps on one or more products or components) may bring with it risks of market distortion, given the diversity of operators in terms of size, business model and, hence, cost structure.
- 4.19 Given the small share of the largest players, we do not consider that regulating only large players would be effective at controlling prices faced by consumers. In addition, putting a framework of regulation around some players and not others risks sending a signal to consumers that the regulated players are a safer/better option than the non-regulated firms. This, in turn, risks limiting the competitive pressure from these small and medium-sized competitors, which make up 70% of the market, and from new entrants.
- 4.20 Similarly, relying on companies' self-assessment, as proposed by the CMA in one of its options, may reduce the effectiveness of the regime.
- 4.21 The UK funerals sector is also characterised by its heterogeneity. There are national operators (Co-op, Dignity and Funeral Partners, each operating under a different business model), medium-sized independent operators that have a significant regional presence (such as CPJ Field and A.W. Lymn, each operating 20–30 funeral homes), as well as a significant number of family-owned small independent operators.²⁵
- 4.22 The scale, and therefore the business models and cost structures, varies significantly among market players. For example, unlike many independent

budget for a publicly funded sector rather than for a regular price control review. See CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 126; and Co-op (2019), 'Submission by the Co-operative Group. Response to the CMA's Statement of Issues', 9 May, para. 6.44.

²⁵ CMA (2019), 'Funerals market study – Final report and decision on a market investigation reference', para. 2.36.

funeral directors, Co-op operates its own care centres as the hub for multiple branches. The level of infrastructure, such as refrigeration facilities and mortuaries, also varies across different funeral directors. This level of diversity is not typical for regulated markets where price regulation is usually applied. This makes it challenging for a regulator to have a single or few pricing mechanisms for all players in the market. On the other hand, differentiating between market players in terms of the regulatory requirements or price-setting parameters has a higher potential to distort competition and necessarily increases the level of complexity of the regime.

- 4.23 The differences between small and large players are typically recognised in other, more traditionally regulated, sectors;²⁶ however, business models and cost structures in these sectors are generally much more homogeneous than across funeral directors in the UK market.
- 4.24 In terms of the number of market players, many district heating markets across Europe are somewhat similar to the UK funerals market,²⁷ although we note that it is the natural monopoly characteristic of operators in the district heating market that typically could make it more suitable for regulatory measures than the UK funerals market.²⁸ Where the number of players in district heating markets is large, regulators tend to simplify the regulatory regimes, which, in some cases, the case study evidence suggests might have been problematic. For example, the details of some regimes have taken a long time to agree on (up to ten years in one case) or the impact was undesirable in terms of increased prices or the limited number of private companies entering the sector. Box 4.1 presents some international examples of price regulation in district heating markets.

²⁶ For example, UK price regulations for the water and electricity transmission sectors make certain adjustments to the regulatory cost of capital of smaller players, acknowledging the different business risks among players of different sizes. See Ofwat (2009), 'Future water and sewerage charges 2010–15: Final determinations'; Ofgem (2012), 'RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd', 7 February; and Utility Regulator (2016), 'Price Control for Northern Ireland's Gas Distribution Networks GD17', 15 September.

²⁷ District heating refers to a heating system where heat is generated in a centralised location and distributed to the end-users via a district heat network.

²⁸ A monopoly arises once the source of heating has been chosen, given the difficulties that may exist in switching to other forms of heating beyond this point. Prior to that, there is competition between heating sources. Also see CMA (2018), 'Heat Networks market study: summary of final report', 23 July.

Box 4.1 European price regulations in the district heating market

In the Dutch district heating market, there are a dozen large-scale networks and thousands of small networks. **It took almost ten years for the regulatory reform to take place.** The price cap is benchmarked against the gas price (since gas is a popular heating alternative to district heating), i.e. the price is not linked to the costs of individual district heat networks. This simplicity makes it feasible to run price regulation for this large number of networks. However, this results in a mismatch between the actual costs and the price cap for suppliers not powered by gas, which may create **financial difficulties for these suppliers** when the gas price is low. Moreover, despite the improvement in pricing transparency, **customers have seen price increases in many cases** where suppliers uplifted their prices to close to the cap.

In Denmark, there are more than 400 district heating schemes, which are mainly cooperatives or municipality-owned. The price for district heating is regulated on a cost-plus basis. According to the CMA, it **discouraged private operators from entering the district heating market.** Presumably, the allowed profit margin was not set high enough to be attractive for private operators.

In Sweden, there has been no price regulation since 1996, with more than 500 district heating schemes operated by over 200 companies. In 1996, **the regulator implemented demand-side measures focusing on price transparency.** The deregulation has attracted private investment into the market, which was previously dominated by municipality-owned operators. Although this initially caused a price increase, according to the study by Climate Change (an independent research centre), Sweden's district heating prices are generally lower than in countries with price regulation.

In the UK, there are more than 14,000 heat networks, of which 2,000 are district heating. Despite the CMA recommending a light-touch form of price regulation (so-called 'principle-based' approach) to protect customers from suppliers' ability to exercise their monopoly power, it **did not recommend direct intervention** due to the diversity in the sector. Instead, the CMA recommended that a regulator should intervene only in **limited cases** where networks are pricing too high. The CMA also recognised the **risk that a price cap might cause higher prices for customers.**

Source: Donnellan, S., Burns, F., Alabi, O. and Low, R. (2018), 'Lessons from European regulation and practice for Scottish district heating regulation', December; CMA (2018), 'Heat networks market study – Final report', 23 July; CMA (2018), 'Heat Networks market study: summary of final report', 23 July.

- 4.25 In its Issues Statement, the CMA mentions the pharmacies market in Northern Ireland as an example of regulating a fragmented market. Box 4.2 explains why this example is not sufficient to demonstrate that price regulation of fragmented markets can work well.

Box 4.2 Cost of Service Investigation (CoSI) for community pharmacies in Northern Ireland

In 2017, the Department of Health in Northern Ireland (DoH) undertook a CoSI for community pharmacies in Northern Ireland.

There were over 500 community pharmacies operating in Northern Ireland in 2011/12, the year for which the CoSI was carried out,¹ so the market had a significant number of players. However, UK funeral directors operate from over 5,000 funeral homes—i.e. 10 times the number of community pharmacies. Moreover, the CoSI analysis was not based on information from 100% of branches.

Notably, the Pharmaceutical Services Negotiating Committee flagged ‘the immense difficulty of obtaining accurate data on the costs borne by independent pharmacies’ in relation to CoSIs.²

Overall, the aim of the 2017 CoSI was to gather information for the purpose of allocating resources to a publicly funded sector. This is different from establishing a comprehensive regulatory framework for a market populated by private actors, where a regulator needs to be much more concerned about creating the right incentives and avoiding the risks of competition distortions.

Ultimately, the CoSI formed the basis for an industry-wide negotiation rather than informing the level of funding directly—this approach is unlikely to be applicable for price regulation in the UK funerals market.

Finally, in the case of this CoSI, the process took a particularly long time: the assessment of data from 2011/12 informed the allocation of funding for 2018/19 and 2019/20, as announced in 2018.

Sources: DoH (2018), ‘Additional funding announced for Community Pharmacy’, 16 November, available at <https://www.health-ni.gov.uk/news/additional-funding-announced-community-pharmacy>. ¹ PwC (2017), ‘Cost of Service Investigation for Community Pharmacy in Northern Ireland. Final report’, May, p. 6. ² Pharmaceutical Services Negotiating Committee, Cost of Service Inquiry, available at <https://psnc.org.uk/funding-and-statistics/pharmacy-funding/cost-of-service-inquiry/>.

- 4.26 As shown above, and illustrated by examples, it may not be proportionate to implement a complex price regulatory regime, and may be challenging to design a simple one that would fit all market players without distorting competition significantly.

Dynamic nature of the market

- 4.27 The dynamic nature of this market highlights another challenge of designing price regulation which remains suitable over time. This is recognised by the CMA in its guidelines for market investigations.²⁹

Defining appropriate parameters for the control measure—for example, the level of a price cap—may be complex and, in some cases impractical, and the measure may therefore be vulnerable to specification risks. This is especially likely where any of the following conditions apply:

...

- (iv) Supply arrangements and products are subject to significant ongoing change, which require the control measure to change to reflect new developments.

²⁹ Competition Commission (2013), ‘CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action’, April, para. 88 (a) (iv).

- 4.28 In many price-regulated sectors, the regulatory period of the initial introduction or subsequent price control update generally spans over multiple years based on an ex ante assessment of how the market would develop during the period. If the ex post market condition deviates from the ex ante assessment, price regulation may endanger the financial sustainability of the companies by reducing their flexibility to react to adverse market development or result in prices that are too high. This is particularly the case in markets experiencing rapid changes. For example, the UK postal service market experienced substantial changes before its deregulation in 2012, as explained in Box 4.3.

Box 4.3 Changes on the UK postal services market

The UK postal service market experienced substantial changes (mainly in volumes) before its deregulation in 2012. Since 2006, customers had been moving away from higher-value traditional products, such as First Class mail, to lower-value services such as bulk mail. In addition, the overall market volumes had fallen significantly as customers substituted traditional mail with digital tools, such as email.

Despite ongoing changing market conditions, Royal Mail was subject to the price control implemented in 2006. In 2006, it was assumed that the postal service market would remain stable. The inflexibility resulting from outdated price regulation undermined Royal Mail's financial sustainability and jeopardised the provision of universal postal service in the UK.

In the wake of Royal Mail's financial difficulties, a new regulatory regime for the postal service sector was introduced in 2012. The new regulation granted Royal Mail more flexibility with the aim of ensuring a financially sustainable universal postal service and encouraging efficiency improvements. In Ofcom's 2017 regulatory review, it found that deregulation had led to higher customer satisfaction, better financial sustainability of Royal Mail and improved efficiency.

Sources: Ofcom, (2012), 'Securing the Universal Postal Service – Decision on the new regulatory framework', March; Ofcom, (2017), 'Review of the regulation of Royal Mail', March.

- 4.29 Overall demand in the funerals market is much more stable than in the postal services sector. However, the market has been experiencing other significant changes in recent years, including significant market entry and the growing popularity of low-cost product offerings.³⁰ For example, 'Simple' funerals and Cremation Without Ceremony have emerged in the market and become popular among consumers.³¹
- 4.30 Although the total volume in the market is relatively fixed (as this is driven by the death rate), product mix and total volumes for individual funeral directors are variable.³² Given the high proportion of fixed costs in this market, the average costs can vary significantly with volumes.³³ This uncertainty increases

³⁰ Co-op (2019), 'Submission by the Co-operative Group. Response to the CMA's Statement of Issues', 9 May, para. 1.3.

³¹ The volumes of 'Simple' funerals and Cremations Without Ceremony increased from under 5,000 (5% of the total at-need funerals volume) to more than 18,000 (19% of the total at-need funerals volume) during the 2014–18 period. See Co-op's response to the CMA's RFI from 10 May 2019, Annex A, Schedule 1, Q1.

³² For example, in the last five years, from 2014 to 2018, year-on-year change in Dignity's at-need funerals volumes ranged from -4% to 12%, based on data from Dignity's annual reports.

³³ See Co-op's response to the CMA's RFI from 10 May 2019, Annex B, Schedule 1, Q10.

the risk of regulatory error, i.e. where actual market or firm developments deviate from ex ante assumptions. If ex post profit margin/rate of return regulation is applied, prices would need to be recalibrated more often and increasing the cost of regulation. As a result, price regulation may stifle further market change/innovation and threaten the financeability of some firms.

4B.2 Product offering

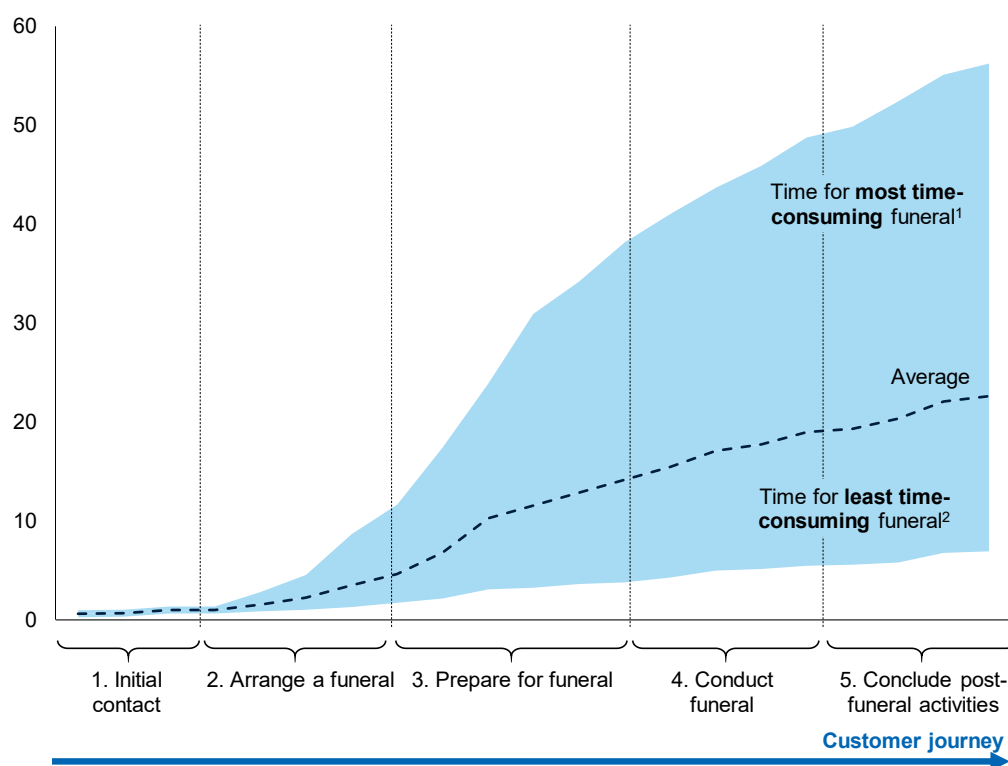
Heterogeneity of funeral products

- 4.31 As discussed in section 4A, price regulation is more likely to be effective and easier to implement in sectors where the goods or services are relatively standardised. A regulator would establish a single revenue cap for all regulated activities of a company or a price cap on a standard product or a package.
- 4.32 However, instead of offering standardised products, funeral directors provide personalised services which vary significantly from one customer to another. The products range from very simple options to highly tailored arrangements. For example, Co-op's Cremation Without Ceremony product includes no funeral service, the cremation is unattended, and there are no viewings of the deceased prior to cremation. In contrast, some funeral ceremonies span multiple days, require detailed personalisation, and involve a significant amount of input from the funeral director. Few funerals are the same, given the significant number of variables and scope for personalisation (e.g. coffin type, flowers, hearse, music for the ceremony).
- 4.33 The diversity in funeral requirements across the market is evidenced by YouGov research findings from 2017, which demonstrates that consumer preferences vary significantly.³⁴ Research by PA Consulting, on behalf of Co-op, further illustrates the wide range of customer requirements in terms of the time a funeral director spends on a funeral. Over the eight-week period of the study, Co-op funeral arrangement times ranged from 7 to 56 hours (see Figure 4.1).³⁵

³⁴ YouGov (2017), 'Funeral planning 2017', pp. 31 and 40.

³⁵ Co-op (2015), 'At Need Activity Analysis Final Report', October, slide 41. This report was submitted to the CMA as part of the Co-op response to the 10 May RFI. It is referenced at p. 17, para. 4.28. The report was attached as Annex B2.4.1.

Figure 4.1 Time required from Co-op staff to conduct a funeral by stage of a funeral (cumulative hours)



Note: ¹ Represents a hypothetical funeral that takes the longest possible time at every stage of the service. ² Represents a hypothetical funeral that takes the shortest possible time at every stage of the service.

Source: Oxera, based on PA Consulting's analysis conducted on behalf of Co-op. Co-op (2015), 'At Need Activity Analysis Final Report', October, slide 41.

- 4.34 Owing to the heterogeneity of funeral services, it is hard for a single, or few, price control mechanisms to cover the entire product offering, while setting a price for every possible product would be infeasible (due to the hundreds of possible permutations). The CMA appears to have recognised this constraint, as no price regulation option seeks to set a price cap on all products.
- 4.35 Nonetheless, the two CMA options that do involve setting a price cap (on either essential services or a standard package) present the challenge of appropriately defining the specification of those essential services or packages. This is particularly difficult when the specification must be suitable for the whole market, not one firm, as further discussed in sub-section 4C.
- 4.36 The CMA guidance specifically recognises the complexity introduced by increasing levels of product heterogeneity:³⁶

³⁶ Competition Commission (2013), 'CC3 (Revised)—Guidelines for market investigations: Their role, procedures, assessment and remedies, Annex B: Remedial action', April, para. 88 (a).

Defining appropriate parameters for the control measure—for example, the level of a price cap—may be complex and, in some cases impractical, and the measure may therefore be vulnerable to specification risks. This is especially likely where any of the following conditions apply:

- (i) Pricing in the relevant market is naturally volatile, for example because of variability in input costs.
- (ii) Products or services are differentiated rather than homogeneous; this may increase the complexity of any control in order to capture adequately the diversity of products offer.

...

4.37 In addition to the two price cap options, the CMA lists cost-orientation as an option. Due to the heterogeneity of products, implementing this approach would require a very complex cost allocation exercise, based on a set of cost allocation principles set out by the regulator for firms to follow.³⁷

4.38 Although regulators in many sectors require firms to allocate their costs, it may be disproportionately complex and costly for the UK at-need funerals market, specifically because consistency between firms, operating diverse business models and providing a different mix of products, needs to be ensured. In particular, the challenges of allocating costs consistently are as follows.

- For companies that sell pre-need plans or provide crematoria services, the cost allocation would need to separate out the at-need funeral services business. At this stage, the main challenge is the consistency of the accounting treatment of pre-need plans (including the allocation of common costs) between companies and over time.³⁸
- Common costs would need to be allocated by package or by funeral component. This would involve a lot of assumptions and approximations due to the high proportion of common costs that do not have any identifiable cost drivers.³⁹ Consistency between firms in this exercise may be difficult to achieve.

4.39 Overall, designing the price regulation of a heterogeneous product such as a funeral service is likely to be complex, i.e. time-consuming and costly.

³⁷ Cost allocation principles would need to be established if cost assessment needs to be undertaken at the level of individual companies and needs to be consistent between firms. If a single cap is established for all companies, without an explicit link to their individual costs, it may not be required to develop these principles. However, even in this case, the regulator will need to take a view on the appropriate level of the cap which will also require detailed information and consistent analysis of costs across the industry.

³⁸ Time consistency is particularly relevant where accounting treatment of redeemed plans depends on the principles followed at the point of sale of the plan.

³⁹ In its response to the CMA's RFI from 10 May 2019, Co-op has performed the cost allocation by product. The proportion of cost categories for which no cost drivers were identified (i.e. a combination of 'Other' and 'Common' costs) was c. 30% in 2018. See Co-op's submissions in response to the CMA's RFI from 10 May 2019, Annex A, Schedule 1, Question 5.

Non-measurable and non-observable quality

- 4.40 As explained in section 4A, price regulation should always be supplemented by the regulation of quality. This is because price regulation alone sets no incentives to maintain or improve quality. Instead, most often it creates incentives to reduce costs, which may lead to lower quality.
- 4.41 As an example, in the 2016 Business Connectivity Market Review, Ofcom found that Openreach's performance in the provision of Ethernet circuits had materially declined since 2011. In light of this finding, Ofcom concluded that the regulatory arrangements in force were not sufficient to ensure an appropriate level of BT standards of quality to support effective competition and to protect end-users. As a consequence, it was decided to introduce appropriate ex ante regulation that imposed a set of minimum performance standards.⁴⁰
- 4.42 It is important to monitor the quality in a market such as the funerals services market, where many parts of the service happen 'behind the curtain' and are therefore invisible to customers, such as care centre services.
- 4.43 What is critical, however, is that the quality of some aspects of the funeral service cannot be measured. The CMA provides many examples of the 'soft' quality that consumers are looking for in their funeral directors, including:
- achieve a 'meaningful farewell';⁴¹
 - supporting the bereaved emotionally and helping them to give meaning to the funeral;⁴²
 - ... professionalism, which was perceived in terms of the following aspects of their service:
 - smart dress and presentation of their premises;
 - responsiveness to funeral arrangers' needs;
 - flexibility in how and when services were provided (eg available outside normal working hours);
 - expertise in guiding respondents through the process; and
 - a calm and respectful manner.⁴³
- 4.44 Given that ex ante price regulation incentivises the sacrifice of quality of service and that a regulator may not be able to fully measure quality, there is a risk that introducing ex ante price regulation in this market might lead to a

⁴⁰ Ofcom (2016), 'Business Connectivity Market Review – Volume I', April, paras 1.41–1.43, 7.9 and 8.122.

⁴¹ CMA (2019), 'Funerals market study – Final report and decision on a market investigation reference', para. 3.30.

⁴² CMA (2019), 'Funerals market study – Final report and decision on a market investigation reference', para. 3.30.

⁴³ CMA (2019), 'Funerals market study – Final report and decision on a market investigation reference', para. 3.31.

deterioration in the quality offering of some firms. In the Issues Statement, the CMA considers profit margin or rate of return price regulation regimes, which do not introduce this adverse incentive. A cost orientation condition also explicitly allows companies to differentiate prices in line with the cost of quality. However, under these types of regulation, firms' efficiency incentives may be reduced in comparison to the current state of the market, which may lead to higher costs and, therefore, higher prices to consumers (along other risks listed in sub-section 4C).

4C Why don't the CMA's proposed price remedies adequately address the issues that it has raised?

4.45 Each of the price/charging remedies proposed in the CMA's Issues Statement overcome some of the challenges outlined above (see Table 4.1 for a summary).⁴⁴ The options presented by the CMA are:⁴⁵

- cost orientation condition;
- profit margin/rate of return allowance;
- safeguard cap on essential services;
- safeguard cap on a specific package.

4.46 However, as discussed throughout the previous sub-section and shown in Table 4.1, there is no option that would be appropriate given the market characteristics identified. At the same time, combining the options will only increase the level of complexity of the regime.

4.47 Take the heterogeneity of products as an example. A safeguard price cap has been used in the past for markets with heterogeneous products: Ofcom implemented one in the case of Royal Mail—Second Class stamps for letters and parcels up to 2kg—to ensure that affordable basic postal services would be available to vulnerable customers.⁴⁶

4.48 A 'simple funeral', as defined by the CMA, could be considered the most basic product in the funerals market.⁴⁷ Although this product tends to be more

⁴⁴ The proposed options include cost orientation condition, profit margin/rate of return allowance, safeguard cap on essential services, and safeguard cap on a specific package.

⁴⁵ CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 127.

⁴⁶ Ofcom, (2017), 'Review of the Regulation of Royal Mail', 1 March, p. 2.

⁴⁷ In the Issues Statement, the CMA defined a 'simple funeral' as 'a more limited, lower cost funeral that may: exclude provision of limousines; have no/limited choice of slot for the funeral director service; have no viewing options and/or include a basic coffin with no/limited opportunity to upgrade'. See CMA (2019), 'Funeral directors and crematoria services. Market investigation. Statement of issues', para. 27.

standardised than traditional funeral products, defining such a generic package for the entire market to provide is not straightforward and is more complicated than the examples we have identified, such as Second Class postage or prepayment meter services.

- 4.49 Specifically, if too many components are included, the price cap for the most basic package could still be unaffordable for financially constrained customers, and would therefore not protect the most vulnerable customers. Arguably, funeral directors would not be encouraged to provide an even lower-cost product, as the standard one would be considered a legitimate price floor.
- 4.50 If the most basic package includes too few components, it may not meet the needs of most customers. In this case, the regulator would have to rely on an assumption that a chain of substitution exists that means that the price of the safeguard product constrains the pricing of other products. If this assumption holds only to an extent, the remedy will be only partly effective.
- 4.51 Given the challenge of establishing the right balance in the product specification for a safeguard product, the benefit arising from the simplicity of this option may be offset by its low level of effectiveness.
- 4.52 Overall, we consider that the number of challenges associated with the characteristics of the UK funerals market, as described above, makes it very difficult to design and enforce a price regulation regime that would minimise the risk of regulatory errors and, hence, unintended consequences.
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Table 4.1 Limitations of the CMA’s proposed price remedy options

	Cost orientation condition	Profit margin/rate of return allowance	Safeguard cap on essential services or a specific package
Relative merits compared with other price regulation options	<ul style="list-style-type: none"> reflects underlying cost base variances between firms allows for the remuneration of higher costs associated with high quality 	<ul style="list-style-type: none"> self-assessment, as proposed by the CMA, minimises the cost of enforcement for a regulator reflects underlying cost base variances between firms allows for flexibility to firms’ outturn volumes and product mix allows for the remuneration of higher costs associated with high quality 	<ul style="list-style-type: none"> allows for standardisation of a capped product along with a chain of substitution
Risks and unintended consequences	<ul style="list-style-type: none"> difficult and costly for firms to allocate appropriately central/shared costs across products, update them regularly as the market evolves, and achieve consistency across the players (room for judgement that can be used to adjust relative prices) reduced effectiveness of the remedy where monitoring of each company is prohibitively expensive introduces an incentive to ‘gold-plate’ if allowed profit margin is above the competitive level risk of reducing the efficiency incentive does not minimise the regulatory burden for firms potentially restricts innovation due to limited scope for (short-term) abnormal returns costly to adapt profit margin to reflect individual business models/cost structure/geography 	<ul style="list-style-type: none"> risk of reducing the efficiency incentive potentially restricts innovation due to limited scope for (short-term) abnormal returns difficult to monitor compliance if based on self-reporting (given the number of firms) risk of market exit or deterred entry if the profit margin is below the competitive level costly to adapt the profit margin to reflect individual business models/cost structure/geography does not address the heterogeneity of the products concerned 	<ul style="list-style-type: none"> difficult to set an appropriate price or set of prices, given the diversity across the market (cost base, size, business model, product offering) may not affect the majority of consumers challenging to define essential services or specific packages (e.g. a coffin may be essential—but what specification should it be?) difficult and costly to allocate appropriately central/shared costs across products and update them regularly as the market evolves, and achieve consistency across the players (room for judgement that can be used to adjust relative prices) creates a risk that firms price at the cap, regardless of cost, as this is perceived to be ‘acceptable’ an incentive for firms to up-sell ‘non-essential’ services or an unregulated package, which may be problematic for consumers who are not well informed deterioration of the quality of the capped service

Source: Oxera.

5 Conclusions

- 5.1 In this report, we have discussed the appropriateness of price regulation for the UK at-need funerals market.
- 5.2 Given that the potential issues highlighted in the CMA's Issues Statement are primarily associated with the demand side of the market, we consider it most appropriate for the CMA to focus on remedies such as sales practices, information transparency, and quality. As acknowledged by the CMA in its guidance, price regulation is a measure of last resort and should not be used unless more effective remedies have been tried with some commitment and have been clearly shown to be ineffective.
- 5.3 Price regulation is most suitable in markets where competition is not feasible, and therefore cannot be distorted by the regulator's intervention, or where controls on some services ('bottleneck services') open up the possibility of competition in other parts of the value chain. However, the UK at-need funerals market is significantly different from these markets. In particular, it is characterised by:
- a large number of heterogeneous market players with a large number of small market players;
 - heterogeneous products;
 - non-observable and non-measurable quality;
 - the dynamic nature of the market.
- 5.4 These characteristics of the market make the design and enforcement of an appropriate price regulation regime challenging, and hence time-consuming, costly and risky. We conclude that every price remedy option from the CMA's proposed list has limitations and would create a significant risk of unintended consequences.
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