FUNERAL MARKET INVESTIGATION

WORKING PAPER ON PROFITABILITY ANALYSIS

CO-OP RESPONSE

1.1 This note sets out Co-op's response to UK Competition and Markets Authority's ('CMA's') profitability analysis working paper published on 20 February 2020.[1] While the CMA has withdrawn its deadline for submission of comments on its latest batch of working papers, it has asked Co-op if it is in a position to provide comments. We have previously shared that we are willing to do this, however, the comments are being finalised by the Legal team without significant involvement by our Funeralcare business colleagues, who are currently focussed on adapting to the significantly changing environment resulting from the coronavirus pandemic and ensuring we continue to support families at this very difficult time. We, therefore, may have additional comments we want to add at a later date.

1.2 This response was largely drafted prior to the COVID-19 pandemic and does not therefore fully take account of its implications for our customers, our business and the sector as a whole.

1.3 However, our early experience shows that in the short term, the impact of the outbreak includes:

a. operational disruption;

b. a change in the way customers interact with the business (we are seeing a significant shift from face-to-face contact) to use of telephone and online;

c. significant increased costs, in particular as a result of needing to both pay colleagues who are self-isolating or sick as well as colleagues to perform the tasks those out of the business would have performed, but also other costs such as to add mortuary capacity in key urban areas and to supply sufficient PPE equipment to protect our staff;

d. a shift in the mix of funerals towards slimmed-down propositions or options without ceremony due to the need to comply with the Government's social distancing guidance. This is significantly impacting on the financial performance of the business and we are needing to adapt our offering so we can support families to say goodbye to their loved ones in the best way they can. We have shared with you the proposition changes we made on 3 April and we continue to monitor the situation and will adapt as appropriate;

e. deaths being brought forward (resulting in a decreasing number of funerals after the outbreak);

f. the significant emotional and psychological impacts on funeral directors who are giving dignity to the deceased, supporting the family of the deceased whilst having to explain the restrictions imposed by the emergency rules. Furthermore, all our colleagues are dealing with the worry of the personal risk they are taking by being away from their homes and the consequent increase in risk which their families will be exposed to; and

[1] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February.

g. without increased government support[2] losses being incurred by funeral providers as the mix changes. This is likely to impact on the financial viability of funeral providers if the situation continues for some months.

1.4 While some of these impacts may be temporary, we believe that others will speed up or lead to permanent changes we were already seeing in the market as funeral directors exit the market and consumers become more familiar with unattended funerals. For example, we believe the increased take-up of unattended funerals will become a permanent feature of the market, putting sustained pressure on the profitability of funeral directors.

1.5 We will keep the CMA updated on our experiences and the impact on our business. As you would anticipate we are revisiting our group forecasts in the light of the coronavirus pandemic and assuming the pandemic continues in the UK for 6 months, whilst these are necessarily being reviewed regularly and are therefore indicative, we are currently estimating that this would have a negative profit impact on our Funeralcare business [✂].

2. INTRODUCTION

2.1 In its profitability analysis working paper, the CMA reports the results of the analyses of the profitability for 13 largest funeral directors ('large' providers), which, according to the CMA, cover 42% of all branches or 37% of funeral volumes in the market.[3] The CMA also reports the results of the reduced-scale analyses of the profitability of the rest of the market based on a sample of 32 independent funeral directors ('small' providers).

2.2 CMA's main findings are as follows.[4]

- Out of 13 largest funeral directors, ten have earned return on capital employed ('ROCE') above the weighted average cost of capital ('WACC').
- Small providers earn profits equal to or greater than those of the larger firms.
- There is no evidence of the downward pressure on profits in the last couple of years.

2.3 We do not agree that the CMA's analysis and conclusions are robust.

2.4 First, we do not consider that the ROCE of the large providers is as much above WACC as the CMA considers. In section 2 of this response, we highlight a number of adjustments that the CMA should make to its ROCE analysis. Moreover, as explained in our response to the cost of capital working paper, we believe that the WACC should be adjusted upwards. If these changes are implemented, the CMA will find that Co-op's profitability converges to the WACC by 2018, and is likely to find that the profitability of the largest companies follows the same pattern.

2.5 Second, we have serious concerns in relation to the coverage of the profitability analysis and in particular, the sample of independent providers that the CMA uses to draw conclusions about the rest of the market. Although the CMA has acknowledged the corresponding responses to the profitability approach paper provided by Co-op and other parties, we do not consider that the way the CMA has addressed them is sufficient.

---

[2] Current Government packages available do not materially help the sector. [✂].

[3] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 29 and footnote 4.

[4] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, paras 174, 214, 230.

2.6 Finally, we completely disagree with CMA's overarching conclusion that there is no evidence of declining profitability in the market.[5] We remain concerned about the CMA's methodologies and its interpretation of the results.

2.7 Overall, CMA working papers setting out its evidence base so far (consumer survey, firm-level analysis, take-up of simple, price dispersion analysis, profitability analysis) show a disconcerting picture emerging. On the one hand, the evidence strongly indicates that intrusive remedies, such as price controls or local authority tendering, would be wholly disproportionate to the current and expected future level of competition in this market. On the other, despite the level of robustness and overall quality of the CMA's analysis being poor, the CMA appears minded to draw misguided conclusions on the extent of consumer detriment in this market, by directly attributing any gaps, distortions and ambiguities in the analysis towards consumer harm. As the CMA is still consulting on a wide range of remedies, some of which are extremely intrusive, we are seriously concerned that the CMA is on course to greatly overstate the magnitude of the AEC (if any) in this market, and that it risks applying damaging and disproportionate remedies as a result.

3. THE ROCE OF THE LARGE PROVIDERS IS NOT AS HIGH AS THE CMA CONSIDERS

3.1 To assess the profitability of the 13 largest funeral directors, the CMA has estimated their ROCE. We find the overall approach to ROCE assessment reasonable. However, there are a number of specific adjustments to ROCE, with which we do not agree. In particular, below we provide our comments on the treatment of the following:

1. cash adjustment;
2. building revaluation;
3. depreciation of property;
4. valuation of brand/trade names;
5. operating leases.

Cash adjustment

3.2 The CMA considers that cash 'represents a means of funding the capital employed of the business rather than being an operational balance' and hence excludes all cash from the capital employed.[6] We do not consider this treatment of cash appropriate.

3.3 First, such treatment of cash is not aligned with the CMA's decisions in previous investigations. For example, in the Local Bus Market Investigation, the CMA considered that the companies need a minimum level of cash balances for efficient operation to 'deal with unpredictable cash-flow fluctuations' and included the minimum level of cash in the capital employed based on companies' operating profits.[7] The same concept applies to any sector, including the funeral services: there are such uncertainties as the fluctuation of the death rates, volumes uncertainty due to competition, average revenues uncertainty due to the variety of customers' preferences. The COVID-19 outbreak is an extreme example of an unpredictable event that leads to cash flow fluctuations.

[5] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', para. 242.

[6] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 112.

[7] Competition Commission (2011), 'Local buses services market investigation. Appendix 10.1. Bus industry profitability', 20 December, p. A10(1)-6, para. 30.

3.4 From a conceptual perspective, part of the cash is held by the company to ensure the day-to-day operation of the business. It is normally referred to as the 'required cash'. The required cash enables the company to smooth out the gap between receiving money from sales and paying invoices for purchases. In this way, the required cash is similar to the balance of inventory. Therefore, the required cash is, in effect, employed by the company to generate the operating income and hence should be included in the capital employed calculation.

3.5 Instead of excluding cash balances from the capital employed, we consider it more appropriate to determine the 'required cash' level. For example, we propose to use Dignity's or other listed funeral directors' cash balance level to approximate the required level of cash for operations.[8] Listed companies would only hold an essential, i.e. efficient, level of cash due to the pressure from equity investors. In particular, if a listed company holds cash that does not generate operating income and hence returns for investors, the investors will put pressure on the company to distribute the excess cash as dividends or reinvest it somewhere else. To compare the level of cash across companies, we suggest measuring it as a proportion to revenue or operating profit.

Buildings revaluation

3.6 The CMA highlights that 'the historic costs … [for] assets [that] were purchased a long time ago … will differ considerably from current replacement costs', and thus re-values properties owned by funeral directors.[9] It also acknowledges the practical challenges for revaluing properties based on market prices and therefore, adopts the approach proposed by Co-op to estimate the depreciated replacement cost ('DRC') of properties based on the book values and certain price indices.[10]

3.7 In particular, the CMA considers that the indexation of historical costs against the housing price index ('HPI') tends to overvalue the properties owned by funeral directors, and instead it proposes to apply consumer price index ('CPI') as an alternative.[11] The CMA also limits the revaluation to 'the principal property assets' (i.e. main buildings) and values all fixtures and fittings assets (or other capitalised building items) at their net book value ('NBV').[12] CMA's justification for such treatment is that the non-principal building items 'have relatively short Useful Economic Lives ('UELs')' and their NBVs are *not* materially different from the 'replacement cost in current condition'.[13]

3.8 We agree with CMA's indexation approach and share the concern that HPI can potentially overvalue the DRC of the buildings owned by Co-op. Indeed, in our previous submission, we included both HPI and CPI in the revaluation exercise. However, we do not agree that the fixtures and fittings should not be revalued.

3.9 [✂].

3.10 [✂].

3.11 [✂].

---

[8] This should exclude cash held for non-operating purposes, such as paying out dividends.

[9] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 113.

[10] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 114–118.

[11] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 118–119.

[12] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 121.

[13] Ibid.

Figure 1 *[✂]*

Depreciation of property

3.12 As the CMA re-values the property assets owned by funeral directors, it makes the corresponding adjustment to earnings before interest and tax (EBIT). Specifically, the CMA's treatment to property depreciation is similar to the financial accounting treatment of investment properties, i.e. revaluation gains (due to indexation) or losses (due to depreciation) are recognised directly in the income statement.[14] As a result, the CMA adds back all property depreciation, as recorded in the original income statement, to EBIT and then includes 'holding gains or losses'. To avoid the potential distortion to the historical profitability trend, the CMA averages the gains or losses resulting from the revaluation across the 2014–18 period and adjusts EBIT by the 'smoothened' 'holding gains or losses'.[15]

3.13 We agree with CMA's treatment for the depreciation of property and recognise its merit of ensuring internal consistency between EBIT and capital employed. However, based on the disclosed information, it is unclear to us how the CMA calculates the holding gains or losses for the first year of the 2014–18 period, i.e. 2014. In our understanding, it should be calculated as the difference between the ***revalued*** *ending balance* and the ***revalued*** *beginning balance* of property assets in 2014. This is because the adjustment should be applied to all years, including years prior to 2014, to ensure the consistency of financial data across time. If the holding gains or losses for 2014 are calculated as the difference between the ***revalued*** *ending balance* and the ***historical*** *beginning balance*, there is likely to be a substantially overstated holding gains recognised in 2014, leading to artificially high profits in 2014.

Brand/trade names

3.14 The CMA adopts the cost-based approach to estimate the value of brand/trade names and 'capitalise[s] only those costs that are additional to those incurred from running the business'.[16] In particular, the CMA considers the branch-level marketing spend over the first three years of the branch operations qualified for the capitalisation.[17] In terms of the useful economic life, the CMA assumes the infinite useful life for the capitalised marketing costs, i.e. no depreciation.[18] As a result, the CMA uplifts the capital employed of the funeral directors based on the number of branches while adding back the marketing costs to EBIT based on the number of branches opened in the past three years.[19]

3.15 We agree with CMA's approach to valuing the brand/trade names at the branch level. However, Co-op does not limit its marketing efforts at the branch level but instead invests in Co-op Funeralcare brand across different branches and a wider Co-op brand across different segments. Co-op trades on customers' trust to the group brand, which has been built over the years. The costs of building this brand are additional to those necessary to run the business—this is evidenced by the fact that individual branches can operate without the overarching nation-wide brand. Therefore, the marketing costs at the company and group level incurred over the years should be capitalised in addition capitalising the branch marketing.

---

[14] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 132–134.

[15] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 134.

[16] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 97.

[17] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 101.

[18] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 102.

[19] CMA (2020), 'Funeral Market Investigation–Funeral Directors: Profitability Analysis', 20 February, para. 103.

3.16 Figure 2 shows the composition of Co-op's marketing costs incurred at the company level during the 2014–18 period, as per the data shared with the CMA in response to the corresponding RFI. The marketing costs of the branches opened during the past three years, which the CMA qualifies for capitalisation, represent only a small fraction of Co-op's overall marketing costs. The largest part of the amount is comprised of the costs incurred at the company level. This illustrates that the CMA omits a significant portion of the brand / reputation assets in its analysis.

3.17 We also note that two adjustments need to be made to this data requested by and submitted to the CMA to make it suitable for capitalisation: first, a fraction of these costs needs to be allocated to a pre-need part of Co-op's business; second, and more importantly, marketing incurred at the group level and allocated to Co-op Funeralcare should be taken into account.

Figure 2 *[✂]*

3.18 Furthermore, Co-op invests in acquiring new members and maintaining the membership base. Given that around a third of Co-op's customers are members, the membership base is a valuable asset for Co-op. Therefore, the CMA should capitalise the corresponding costs to estimate the value of this asset. This approach should apply to all other cooperatives.

Operating leases

3.19 Based on the disclosed information, it is not clear whether the CMA has capitalised the operating leases. The property assets under operating leases should be considered as part of the capital employed, as they are used for providing funeral services.

3.20 In relation to the change in IFRS 16, which requires companies to show the assets on operating leases on their balance sheet, the CMA notes that it 'should not have a material impact on … [its] estimates of economic profits'.[20] We consider it important that the CMA ensures consistency in its methodology towards capitalising operating leases between the periods before and after the change in the standard.

4. THE SAMPLE OF INDEPENDENT PROVIDERS MAY PROVIDE A BIASED VIEW ON THE PROFITABILITY IN THE MARKET

4.1 With respect to the market coverage of the profitability analysis, we consider that the CMA has not adequately addressed the concerns raised by Co-op and other parties in the respective responses to the profitability approach paper. We believe that these concerns continue to undermine the robustness of the CMA's profitability analysis and its interpretation of results.

4.2 In relation to the large providers, although the CMA has expanded its sample from three to 13 and increased the market share covered from 29% to 37% funerals,[21] this expanded market coverage is still significantly lower than the coverage in previous market investigations. As highlighted in Oxera paper submitted to the CMA in response to its profitability approach working paper, in the previous market investigations, it was possible to treat financial information on the largest operators as representative of a 'substantial part of the market', as they have accounted for at least 60% of the market.[22] Since the largest operators cover only

[21] CMA (2019), 'Funerals Market Investigation: Approach to profitability and financial analysis', 24 July, para. 25; and CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', footnote 4.

[22] Oxera (2019), 'Funerals market investigation: approach to profitability analysis', 9 August, Table 2.1.

37% of the market, the robustness of the CMA's conclusions depends on the quality of evidence for the independent providers.

4.3 In relation to the small independent providers, the CMA continues to consider that its sample of 100 small funeral director branches provides a good representation of c. 5,000 branches owned by smaller providers.[23] The CMA only presented the profitability results for 32 out of the 100 branches surveyed, while excluding (some of) the others as outliers or due to poor data quality. We have three concerns about this approach.

4.4 **Confirmation bias**. The excluded outliers had 'ARF [Average Revenue per Funeral] figures which appear too low (i.e. below £2,000) to credibly include disbursements'.[24] We are concerned that excluding branches based on low ARF figures may have created confirmation bias in CMA's independent provider sample: the CMA has placed too little weight on data points that contradict its previously existing beliefs regarding the appropriate level of ARF. We understand that some independent providers price low-cost funeral services with disbursements below £2,000.[25] Therefore, it is possible for an independent provider to have an ARF below £2,000 inclusive of disbursements if a large volume of low-cost funerals were sold. We note that this confirmation bias could be significant if a large proportion of the 68 omitted branches (100 surveyed minus 32 presented) are excluded for having low ARF. Therefore, we consider it important that the CMA discloses the exact reasons why the sample has reduced from 100 to 32 independent providers.

4.5 **Correlation between the quality of data and profitability**. It is possible that more profitable funeral directors provide higher quality financial data. For example, a study analysed data from the World Bank's Enterprise Surveys and found evidence that increased financial reporting credibility reduces private firms' external financing constraints, which could have led to higher growth and profitability.[26] Similarly, other international evidence suggests that high-quality financial information improves the small and medium enterprises' (SMEs') access to capital, which in turn enhances their performances, including profitability.[27]

4.6 **Survivorship bias**. The CMA did not account for survivorship bias in choosing its small provider sample. It appears that 31 out of the 32 small branches that the CMA analysed reported ARF in 2018 and therefore, were open. The CMA did not consider the small branches that closed down before 2018. Indeed, it would not be possible for the CMA to survey the providers that have stopped operating. The CMA mentions that it has not seen evidence of firms exiting due to financial pressures.[28] However, we note that the CMA would not be able to find any evidence of this, given that it is not possible to survey any firms that have stopped operating. If the CMA were able to include the firms that exited the market before 2018, even

---

[23] CMA (2019), 'Funerals Market Investigation: Approach to profitability and financial analysis', 24 July, para. 86.

[24] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', para. 182.

[25] For example, an independent provider started offering low-cost funeral service inclusive of disbursements (such as a minister and doctors' fees) for £1,595 in 2016. See Sandwell Metropolitan Borough Council (2016), 'Launch of new low cost funeral service for £1,595', 5 October, http://www.sandwell.gov.uk/news/article/3916/launch_of_new_low_cost_funeral_service_for_1595, accessed on 3 March 2020.

[26] Hope, Thomas and Vyas (2011), 'Financial credibility, ownership, and financing constraints in private firms', Journal of International Business Studies, 42, 935–957, p. 17.

[27] Sarapaivanich and Kotey (2006), 'The Effect of financial Information Quality on Ability to Access Eternal Funds and Performance of SMEs in Thailand', Journal of Enterprising Culture, Vol. 14, No.3 (September 2006), 219–239, p.17.

[28] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', Appendix A: Obtaining information from funeral director firms, para. 37, p. 56.

if the reason is unclear, it would make the sample more representative of the market. In addition, the CMA should monitor firms that exit the market as a result of the COVID-19 outbreak and include these in the sample.

4.7 The CMA's working paper on the profitability of crematoria shows that the CMA itself prefers a better coverage of the market. In particular, the CMA collected data from 22 small crematoria, which represent 11% of the small crematoria in the market (compared with 32 out of c. 5,000 branches owned by small funeral directors). More importantly, even though the CMA had a superior coverage of the market in its analysis of crematoria to the analysis of funeral directors, in the case of crematoria, the CMA 'supplemented […] [its] analysis by also reviewing and analysing the data prepared by the […] Chartered Institue of Public Finance & Accountancy ('CIPFA') on the financial performance of local authority crematoria'.[29] This indicates that the CMA was looking for additional evidence to cross-check the results of its assessment based on the sample of 22 small crematoria. We understand that no such cross-check was performed for funeral directors although the coverage of the analysis is inferior.

4.8 For the reasons set out above, we believe that the 32 small providers may be more profitable than other small providers in the UK, and therefore, CMA's results may be upward biased.

5. THE CMA MISINTERPRETS THE EVIDENCE ON THE PROFITABILITY TRENDS

5.1 CMA's current position of profitability across the market is significantly impacted by the earlier years of the assessed period when the market has been changing significantly. Therefore, with respect to the timeframe of the profitability analysis, we welcome the CMA's intention to incorporate the 2019 actual financials and future forecasts in its analysis.[30]

5.2 As shown in Figure 3, Co-op's profitability continues to decline sharply in 2019. [✂].

Figure 3 *[✂]*

5.3 In our previous submissions to the CMA, we have explained that the increased competition affected Co-op's pricing strategies and product offerings. For example, we noted that the increased competitor activity in Scotland in 2017 led to a significant marketing campaign for 25 Co-op funeral homes in Glasgow City. It also was a factor in our decision to reduce the Simple funeral price in Scotland from £1,995 to £1,675 in August 2017. Similarly, prior to the introduction of Cremation Without Ceremony ('CWC') in May 2018, we observed a significant level of competitor activity both at the local and national level, which was affecting our market share and overall performance.[31] Over the years, Co-op's market share has decreased significantly from a peak of [✂]% in 2012 to [✂]% in 2018.[32] In 2019, declining trends in average revenues and the market share have continued.[33]

a. Co-op's at-need volumes, excluding redemptions, have gone down in 2019 by c. [✂]%, resulting in a further loss of market share.

---

[29] CMA (2020), 'Funeral Market Investigation – Crematoria: Profitability Analysis', paras 20–24.

[30] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', para. 31.

[31] Co-op (2019), Schedule 1 to Annex B to 'Response to CMA's Request for Information dated 10 May 2019', 21 June, para. 55.2 and 55.3; and Co-op (2019), 'Submission by the Co-Operative Group: Response to the CMA's Statement of Issues', 9 May, para. 5.19.

[32] Co-op's response to the CMA's working paper on 'Company-level price and market share analysis', para 2.10.

[33] Co-op (2020), 'Funeral market investigation. Working paper Pricing levels and trends. Co-op's response', paras 3.8–3.10.

b. The ARF of standard and simple funerals has fallen by [✂]% in nominal terms ([✂]% in real terms, based on RPI) in 2019.

5.4 Dignity's EBIT margin reached its lowest level since 2014 in 2019 (see Figure 4). The operating profit has decreased by 9% caused by the drop in the number of deaths, market share, and the average income, and inability to compensate the losses by the cut in its cost base. [34]

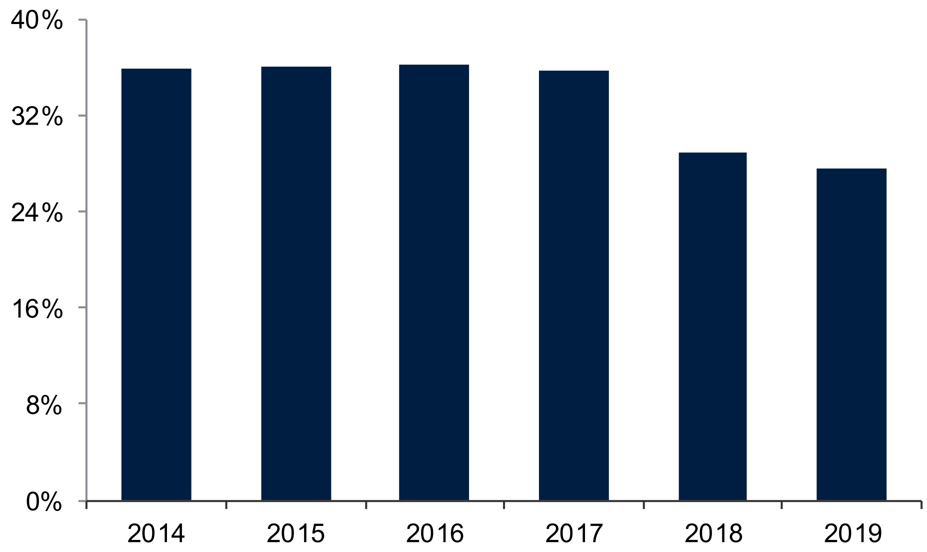
a. The number of conducted funerals has decreased from 72,300 in 2018 to 69,400 in 2019.

b. The market share in the locations contributing to the whole of 2018 and 2019 has decreased from 11.8% to 11.6%.

c. The average revenue per Full service funerals and Simple and limited service funerals has decreased by 4.2% and 12.9% respectively.

5.5 These statistics suggest that Dignity is experiencing competitive pressure from the rest of the market.

Figure 4 Dignity's unadjusted EBIT margin for funeral services between 2014 and 2019



Source: Oxera analysis based on Dignity's annual reports and preliminary results for the 52 week period ended 27 December 2019.

5.6 If the CMA explores 2019 and 2020 financials of other firms, it may find similar trends as those for Co-op and Dignity.

5.7 As for the CMA's analysis of the 2014–18 period, we have concerns about the interpretation of the trends in the financial information collected. Contrary to the CMA's overarching conclusions that there is no evidence of declining profitability in the market, the CMA's analysis showed that ten out of thirteen large providers have seen an overall decline in ROCE from 2014 to 2018, with the average ROCE for these firms also declining.[35] Data for 2019 and 2020 will provide additional insight into how this trend develops.

5.8 We previously mentioned that the drivers of Co-op's profitability decline are closely related to the increased competition. In particular, Oxera saw Co-op's profitability affected by:[36]

[34] Dignity plc (2020), 'Preliminary results for the 52 week period ended 27 December 2019', 11 March, pp. 11–12.

[35] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', para. 200 and Chart 1.

[36] Oxera (2019), 'Funerals market investigation: approach to profitability analysis', 9 August, p. 2.

a. the downward pressure on ARF via an increase in the proportions of Simple funerals and Cremation(s) Without Ceremony (CWC) sold; and

b. declining volumes and market share.

5.9 To investigate these drivers, the CMA has assessed the ARF trends and the number of funerals per branch.

5.10 In relation to the ARF trends, the CMA asserts that the downward pressure on ARF experienced by Co-op and Dignity does not appear to be a generalised market trend, on the basis that other large provider saw 'year-on-year increases in ARF to a greater or lesser extent'.[37]

5.11 While we do not have reasons to disagree with the CMA's observation that most large providers saw increased ARF, we believe that the CMA has not put this observation into perspective. Based on the CMA's own statistics, Co-op and Dignity had a combined market share of 27% as of 2017, while the third-largest provider Funeral Partners had a market share of just under 2%.[38] This way, Co-op and Dignity represent 73% of the volumes covered by the thirteen large providers.[39] Therefore, the CMA should correctly weight the ARF of the large providers by their market share when calculating the average ARF. We understand that the CMA has not done so in its analysis, instead placing equal weights on the ARF of each large provider to calculate the average ARF.[40] Such methodological flaw created a distorted picture of the general market trend.

5.12 Furthermore, the CMA's analysis focused only on nominal revenue growth. Our analysis shows that adjusting for RPI inflation, the median average total revenue per funeral ('ATR', equivalent to ARF with disbursements) for large providers fell by 2% annually between 2016 and 2018. We also found that 10 out of 13 large providers saw their ATR stagnating or decreasing in real terms over the 2016–18 period.[41] These trends show that the large providers are experiencing increasing pricing pressures in recent years.

5.13 Finally, the CMA has included disbursements when calculating the average ARF of both the independent and the large provider samples. Since disbursements are external pass-through costs to most funeral service provider and are out of their control, the average ARF inclusive of disbursements is not representative of these providers' actual pricing power and in fact, overstates the growth in prices. For example, Co-op's average ARF (inclusive of disbursements) growth was c.[✂]% between 2014 and 2018.[42] Excluding disbursements, this growth would be reduced to just c.[✂]%. Similarly, the CMA's profitability analysis estimated that the independent providers' average ARF (inclusive of disbursements) growth

---

[37] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', para. 225.

[38] CMA (2019), 'Funeral Market Study: Final report and decision on a market investigation reference', para. 2.31.

[39] Market share of Co-op and Dignity (27%) ÷ market share of the thirteen largest providers included in the CMA's analysis (37%).

[40] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', Chart 8.

[41] Co-op (2020), 'Funeral Market Investigation – Working Paper on Pricing Levels and Trends – Co-op response', 19 March, para. 3.16 and Table. 4.

[42] Co-op's ARF (inclusive of disbursements) [✂] respectively. See Co-op's response to the CMA's RFI dated 10 May, Annex A1.1.1 to 'the Response to CMA's Request for Information dated 10 May 2019', tab 'Profit and Loss Account', Row 12, 55 and 56.

was c. 2% between 2014 and 2018.[43] Deducting the burial/cremation weighted average disbursement fees implied by the CMA's price trend analysis, this growth would be reduced to c. 0.4%.[44] These examples show that CMA has overstated the average ARF growth over time by including disbursements in the analysis.

5.14 In relation to the volume of funerals, the CMA observes that 'all of the [large] firms who have seen a fall in the number of funerals per home have also seen large increases in cost-plus'.[45] While the CMA attributes the fall in the volume of funerals to the large providers' operational inefficiency, it disregards the possibility of increased competition in the market. The increase in cost-plus indicates that many large providers (including Co-op) may have committed investments in the hope of retaining their existing market shares in the increasingly competitive market. For example, in 2016, Co-op began to commit significant investments into its existing funeral homes, which were essential for delivering the scale and quality of service required to maintain and enhance its competitive offering.[46] Therefore, the relatively low levels of investment and costs in the prior year, which translated into higher reported profitability in the earlier part of the 2014–18 period, are not representative of the lower underlying steady-state level of economic profitability.

5.15 Co-op's competition-induced cost growth is not an anomaly. As evidenced by the CMA's own analysis, on average, larger providers saw slower growth in ARF (c. 3%)[47] relative to the growth in cost-plus (c. 4%)[48] between 2014 and 2018. This implies that the larger providers absorbed some of the cost increases, which resulted in the decline of their profitability. As such, the worsening market conditions and increased competitions should, at least partly, account for the generalised market trend of declining volumes and increasing costs.

---

[43] Based on the CMA's profitability analysis, the average ARF of independent providers (including disbursements) was £3,261 in 2014 and £3,535 in 2018. This implies an average growth of around 2% during the period. See CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis'. Table 14.

[44] Based on the CMA's price trend analysis, the percentage of cremations was 74.8% in 2014 and 78.2% in 2018. Applying these percentages to the Cremation disbursement fees and Burial disbursement fees recorded in the SunLife data, we estimate the weighted average disbursement fees for the 'independents and others' category (as defined by SunLife) to be £1,154 in 2014 and £1,391 in 2018. While we understand that the 'independent and others' category in the SunLife data may include independent providers different from those surveyed by the CMA, we consider this data informative for illustration purposes. See CMA (2020), 'Funeral Market Investigation – Funeral directors pricing levels and trends', Table 3, 9 and 10.

[45] CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', para. 238.

[46] Co-op (2019), Schedule 1 to Annex B to 'Response to CMA's Request for Information dated 10 May 2019', 10 June, para. 9.8.

[47] Based on the CMA's price trend analysis, the average estimated cost of a funeral (including disbursements) was £3,346 in 2014 and £3,771 in 2018. This implies an average weighted growth of around 3% during the period. As explained in para. 4.7, we believe it is more appropriate to use the supply-weighted ARF from the SunLife sample and not the average ARF from the large provider sample. We would encourage the CMA to provide supply-weighted ARF for the large provider sample. See CMA (2020), 'Funeral Market Investigation – Funeral directors pricing levels and trends', Table 3.

[48] Based on the CMA's profitability analysis, the average cost-plus of larger providers was around £3,400 in 2014 and around £4,000 in 2018. This implies an average weighted growth of around 4% during the period. See CMA (2020), 'Funeral Market Investigation – Funeral Directors: Profitability Analysis', Chart 10.