

# Appendix V: Calculation of detriment

## Introduction

1. Customer detriment calculations are intended to provide an indication, in quantitative terms, of the magnitude of the pricing harms arising from the features of the market we have identified as giving rise to AECs.
2. In estimating customer detriment, we use average economic profit figures for those firms for which we have carried out profitability analysis. Our analysis should not be taken to suggest that every customer suffers a detriment of, or 'overpays' precisely this amount, nor that every firm is responsible for causing detriment to customers. These figures are averages. As our profitability analysis relates only to a sub-set of the market, so do our detriment estimates. We set out in more detail in Section 8 the extent to which we consider that these estimates can be considered to be representative of the broader funeral director and crematoria markets as a whole.

## Funeral directors

3. We have considered the nature and potential scale of the detriment to customers arising from the AECs we have found in the funeral directors market.
4. There were 616,014 deaths registered in the UK in 2018,<sup>1</sup> approximately 517,000<sup>2</sup> (84%) of which involved a funeral paid for at the time of bereavement, rather than through redemption of a pre-paid plan.
5. In trying to assess the scale of the detriment to customers we have focused on the extent to which outcomes, resulting from the AECs we have found, are worse than those we would expect in a well-functioning market.
6. Our estimates of detriment are based on our calculations of the economic profits achieved by funeral director firms and the pricing information we have gathered. Parties raised three key issues with regards to our calculation of detriment for the funeral director markets, each of which we consider in turn:
  - (a) The use of economic profits as a measure of detriment;

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<sup>1</sup> ONS, (22 November 2019) [Vital statistics in the UK: births deaths and marriages](#).

<sup>2</sup> This figure has been calculated by subtracting the number of funeral plans drawn down in 2018 (ie 98,800), as recorded by the [Funeral Planning Authority](#), from the total number of UK deaths registered. It includes Public Health Funerals.

- (b) the impact of quality differentials on the calculation of detriment; and
- (c) the historic nature of our analysis.

7. Firstly, some parties objected to the use of economic profits to measure detriment.<sup>3</sup> Funeral Partners argued that it cannot be assumed that all economic profits can be considered consumer detriment based on the fact that at particular times profitability may exceed the cost of capital due to cyclical factors, transitory price or other marketing initiatives, innovation or efficiency.<sup>4</sup> With regards to economic profits as an indicator of detriment, we consider that detriment arises from the difference between price and efficient cost, meaning that all economic profits are thereby equal to detriment. Indeed, to the extent that our analysis has used firms' actual costs rather than their efficient costs, it is likely to understate total detriment.
8. Further, some parties suggested that a consideration of quality differentials is essential to the consideration of detriment.<sup>5</sup> We note that to the extent any quality differentials are reflected in the cost-base of firms, this will be reflected in the detriment figure based on the calculation of economic profits.
9. Finally, Co-op suggested that in calculating detriment, the analysis should be 'forward-looking and reflect the current and future expected level of AEC in the market'.<sup>6</sup> We consider that historic actual performance is a strong evidence base on which to measure the detriment that firms are contributing to the market. We therefore base our analysis on the data obtained from the firms in the Historic Period and consider potential trends in these results below.

### ***Calculation of detriment based on economic profits***

#### *Average detriment*

10. In considering the detriment of the Large firms based on economic profits our analysis found that ten of the Large firms earned economic profits in all years from 2014 to 2018. We then netted off the economic losses earned by the three loss-making Large firms to give average (net) annual economic profits of

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<sup>3</sup> In this appendix we address the points raised with regards to the use of economic profits as an appropriate metric to consider detriment. Points raised by parties with regards to the adjustments to financial information feeding the calculation of economic profits are considered in detail in Appendix S. Similarly, we consider the points raised with regards to the calculation of the weighted average cost of capital used in the calculation of economic profits in Appendix R.

<sup>4</sup> [Funeral Partners response to Provisional Decision Report](#), page 10.

<sup>5</sup> [Funeral Partners response to Provisional Decision Report](#), page 1; [Co-op response to Provisional Decision Report](#), para 7.5(b)

<sup>6</sup> [Co-op response to Provisional Decision Report](#), para 7.3.

£96.6 million over the period. On a per funeral basis, this equates to economic profits of £429 per funeral.

11. We note that our detriment figures are the product of our profitability analysis and therefore reflect the assumptions and judgements that we have used in that analysis. As such, we consider these estimates to be indicative of the level of detriment suffered by customers rather than a precise quantification. We discuss various reasons why our estimates may be understated in paragraph 18 below.

### *Detriment over time*

12. In addition to considering the average detriment across the period, we also present the results on an annual basis across the period.

**Table 1: Detriment (economic profits) of the Largest firms from 2014 to 2018<sup>7</sup>**

	2014	2015	2016	2017	2018	Weighted average
Total detriment (£m)	91.6	115.8	111.1	100.4	63.9	96.6
Per funeral (£)	434	509	485	441	277	429

Source: CMA analysis

13. The results per Table 1 demonstrate that there has been a significant decline in economic profits (and therefore measured detriment) in 2018. Based on the profitability analysis per Appendix S, this has been driven largely by a decline in the profitability of [X] and [X] in 2018.
14. We do not have data from all 13 firms with regards to results in 2019, however we were able to obtain data from [X] and [X]. The results from these two firms demonstrate an average detriment of £[0-50] per funeral in 2019, however we note that this is largely the result of the net effect of [X] earning economic losses of £[(200)-(250)] while [X] continues to earn significant economic profits of £[350-400].
15. The decline in detriment is a result of declining economic profitability which we consider in more detail in Section 7 and Appendix S. We observe that the reduction in economic profits (ie measured detriment) earned by the firms is the combined effect of reduced pricing but also significant increases in costs. We note that the two Largest firms have provided us with detailed evidence that they are seeking to improve their efficiency via turn-around /

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<sup>7</sup> In [Co-op's response to the PDR](#) (para 7,4) Co-op noted that it could not exclude the possibility that the CMA used only at-need funeral volumes in the calculation of the detriment, and that since the profitability analysis underlying the detriment calculation includes pre-need funerals, they should be accounted for in the estimation of the detriment. We note that in performing our analysis we have used consistent volumes across the profitability and detriment analysis based on the financial templates provided by the parties.

transformation strategies, suggesting that these costs have been too high in recent years.<sup>8</sup>

16. As a result, we find that measured detriment was still significant as of 2018 and that, while it has been decreasing in recent years, the actual benefit to customers has been smaller than the measured decline in the detriment (as costs are likely to have been too high due to inefficiencies and have been increasing over time). Furthermore, it is not evident that the lower detriment figures observed in 2018 (and 2019 for [redacted] and [redacted]) will be maintained in the longer run as it is not clear that lower detriment has been driven by an improvement in the functioning of the market.
17. Dignity suggested that the average detriment figure based on the data from 2014 to 2018 is skewed upwards by higher figures in 2014 to 2016 and that consideration of the results from 2017 to 2019 would result in a lower overall average detriment.<sup>9</sup> This is true. However, the average level of detriment in later years is still significant, supporting our AEC finding and, as explained above, it is not clear to us that the lower level of detriment observed towards the end of the period will necessarily be sustained in the future.

#### *Market-wide detriment*

18. A number of parties queried the scalability of these detriment figures across the market. In particular, Dignity noted that 10 of the 13 Largest funeral directors earned economic profits, submitting that this does not suggest a substantial share of the market has been found to earn excess profits.<sup>10</sup> Europe Economics, on behalf of NAFD, disagreed with the netting off of loss-making firm results with those of profit-making firms, suggesting that this fails to acknowledge the implication of there being Large loss-making firms in the sector.
19. First, in presenting our average figures, we have calculated total detriment net of any losses incurred by those of the Large funeral director firms that were not making economic profits, hence our figures fully reflect the profitability of

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<sup>8</sup> For example, Co-op is currently undertaking a significant reorganisation of its business via the closing of around 20% of its funeral home network, accelerating its digital transformation and improving its workforce scheduling. We consider it likely that both the inefficiencies that Co-op has identified in its existing operations, together with the costs of implementing its turnaround strategy have depressed its profits (by increasing its costs) [redacted]. We observe that Co-op is currently forecasting that it will increase its profits significantly by 2024 as a result of this plan, without increasing its prices.

<sup>9</sup> [Dignity response to Provisional Decision Report](#), Annex 1: Critical observations on the CMA's profitability analyses and customer detriment figures, para 2.6

<sup>10</sup> [Dignity response to Provisional Decision Report](#), Annex 1: Critical observations on the CMA's profitability analyses and customer detriment figures, para 2.21

these firms, which comprise just over 40% of the market.<sup>11</sup> We consider this to be a substantial share of the market. We do not agree with Europe Economic's submission. We have clearly stated how many of the Large Funeral Directors have made economic profits, how many have made returns in line with the cost of capital, and how many have made economic losses. However, we note that of the three firms which were not profit-making, two were making returns in line with the cost of capital and only one was making economic losses. Moreover, all three of these firms were relatively small, such that even if we only consider profit-making firms, our finding of high returns covers 40% of the market.<sup>12</sup>

20. Further, our profitability analysis indicates that some of Smaller firms are likely to be earning economic profits similar to those of The Large firms, based on a comparison of EBITDARS. Thus, a proportion of customers of the remaining 58% of the market are likely to have been overpaying for each funeral to a similar extent to those of The Large firms (although we accept that we cannot be sure as to how large that proportion is).
21. Our detriment calculations are is likely to underestimate the actual total detriment to customers as:
  - (a) It does not take into account the potential inefficiencies that we have identified. Our calculations largely use the actual costs of funeral director firms and do not adjust for potential inefficiencies, meaning that detriment figures may well be higher, potentially significantly so, as a result of an inefficient cost base. In addition to the evidence set out in Appendix S, we note that the 13 Large funeral directors demonstrated a very broad range of costs per funeral, with the lowest cost firm in the group managing to provide a funeral for over £1,500 less than the highest cost firm;
  - (b) it does not seek to measure the detriment arising from the issues we have identified in relation to back of house quality; and
  - (c) it does not seek to measure the detriment arising from the issues we have identified in relation to the distortion of choices where recommendations or referrals are influenced by financial considerations rather than representing the best choice for the customer. Nevertheless, given the potential for vulnerable people to be channelled towards a given funeral director whom they may not otherwise have chosen or to towards a type

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<sup>11</sup> Based on 2018 share of branches.

<sup>12</sup> Based on 2018 share of branches.

of funeral which may not fully meet their needs, we consider the detriment would be material.<sup>13</sup>

22. Accordingly, we estimate the total consumer detriment is at least £400 per funeral on average over the past 5 years. However, this is likely to be a conservative figure for the reasons set out in the paragraph above. Further, this does not mean that all funeral directors are over-charging by £400 per funeral, or that they have done so in every year or are doing so today. Our calculation of an average of £400 per funeral over the period is based on the average economic profits earned by the Large firms across the 2014 to 2018 period. In fact, the results demonstrate that in some cases funeral directors are earning economic profits significantly higher than the £400 average detriment figure, while others are making lower profits or, in some cases, economic losses. As such, we emphasise that the detriment figure presented is an average across the sector and that, based on the economic profits earned, some funeral directors will be contributing less to this detriment, while others contributing significantly more.
23. We set out in Section 7 that funeral director professional fees for a standard funeral have increased at a rate above general inflation since at least 2006 until 2016, albeit this has been checked more recently. Had funeral director prices increased in line with inflation since 2006, the average price within this dataset in 2019 would have been £456 and £608 lower depending on the measure of inflation used. This comparison<sup>14</sup> gives an indication of the amount that customers could have saved per funeral on average in 2019 if prices had increased in line with inflation since 2006.

## Crematoria

24. We have considered the nature and potential scale of the detriment to customers arising from the AECs we have found in the crematoria markets.
25. In 2018, around 480,000 cremations were conducted in the UK.<sup>15</sup> We estimate around 90% of these to be standard fee cremations, with the remaining services being either reduced fee, unattended, or other services.<sup>16</sup>

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<sup>13</sup> In [Co-op's response to the Provisional Decision Report](#) (para. 7.5(c)), Co-op told us that the financial benefits of any potential harm via the distortion of choices would, if it existed, be captured in funeral directors' profits and therefore also captured in the detriment estimate and that it is unclear to us why the CMA believes they are not accounted for. We note that the point raised at paragraph 18(c) relates to customers not obtaining the product or service that they would otherwise have wanted.

<sup>14</sup> This is not meant to be to a competitive benchmark, as the 2006 figure does not necessarily reflect competitive conditions in a well-functioning market.

<sup>15</sup> Based on Cremation Society data for 2018.

<sup>16</sup> Based on our analysis of volumes provided by Dignity, Westerleigh, Memoria and London Cremation Company in Section 2.

We estimate that standard fee, reduced fee, unattended cremation services, and optional additional extras generated a combined total revenue of around £350 million in 2018.<sup>17</sup>

26. Our estimates of detriment are based on our calculations of the economic profits achieved by crematoria operators.

### **Calculation of detriment based on economic profits**

27. Our profitability analysis finds that the local authority crematoria operators in our sample have earned economic profits of approximately £5.5 million per year across the 2014 to 2018 period. This level of profits suggests that customers of local authority crematoria have been overpaying by approximately £170 per cremation on average over the period.

**Table 2: Detriment (economic profits) of Local Authority Crematoria from 2014 to 2018: Case One**

	2014	2015	2016	2017	2018	Average
Total economic profits (£m)	4.4	4.6	6.3	6.1	5.8	5.5
Per cremation (£)	138	144	202	184	176	169

Source: CMA analysis

28. As at Table 2, economic profits earned by local authority crematoria operators rose by 30% from 2014 to 2018.
29. Based on our profitability analysis, over the same 2014 to 2018 period, we estimate that the large private crematoria operators<sup>18</sup> have earned average economic profits per year of £23 million. This level of profits suggests that customers of private crematoria have been overpaying by around £210 per cremation on average over the period.

**Table 3: Detriment (economic profits) of Large Crematoria from 2014 to 2018: Case One**

	2014	2015	2016	2017	2018	Average
Total economic profits (£m)	15.0	23.5	24.3	26.3	25.8	23.0
Per cremation (£)	170	234	228	225	205	213

Source: CMA analysis

30. Economic profits earned by large crematoria operators increased significantly over the period from £15.0m in 2014 to £25.8m in 2018, an increase of 72%. This increase in economic profits resulted from a broad-based increase in

<sup>17</sup> We have estimated this figure by estimating the volume of standard fee services at each crematorium and multiplying by the standard fee at each crematorium for 2018. We have also estimated the volume of reduced fee and unattended standard fee services and multiplied by an average reduced and unattended fee (based on data from 272 crematoria). Finally, we have used data from Dignity, Westerleigh, and Memoria relating to their sales of additional optional extras in 2018 and extrapolated this across other providers. We consider this figure to be an underestimate of the total market size, as it does not account for revenue generated from other services such as contract cremations and memorials.

<sup>18</sup> These comprise Dignity, Westerleigh, Memoria and LCC.

profitability across three of the four private operators [redacted] [Firm A], [redacted] [Firm B] and [redacted] [Firm C]) across the period.

### **Parties' views**

31. We received a number of submissions from parties regarding our calculation of customer detriment for crematoria operators.
32. Dignity told us that 'the CMA estimated a Sensitivity scenario in the crematoria profitability analysis [...] the CMA does not report this lower detriment'.<sup>19</sup>
33. Memoria told us that 'it is critical for the CMA's final analysis of detriment to identify which crematoria are driving any detriment, and the reasons why those specific crematoria are able to earn excess profits. Without such an analysis, the CMA will simply not be able to design suitable remedies to limit the size of any detriment, without bringing material adverse consequences for consumers'.<sup>20</sup>

Memoria also told us that 'it is likely that many of the crematoria driving the finding of economic profits are not particularly high priced in absolute terms' and that 'Sites with high volumes [...] and old sites [...] may well appear to be highly profitable even at modest prices'.<sup>21</sup>

34. Westerleigh told us that our estimate of customer detriment 'has no regard to qualitative factors'.<sup>22</sup>

### **Our approach**

35. In addition to the detriment estimates presented above, which have been calculated under the Case One land valuation, we have also calculated the economic profits for large and local authority crematoria under the following sensitivities (see Table 5 below):
  - (a) Under land valuation Case Two for both local authorities and large Crematoria operators;
  - (b) Under Case One for large crematoria and including long leasehold capitalisation; and

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<sup>19</sup> [Dignity response to PDR](#), page 5, paragraph 1.8

<sup>20</sup> [Memoria response to PDR](#), page 31, paragraph 4.2

<sup>21</sup> [Memoria response to PDR](#), page 31, paragraph 4.2

<sup>22</sup> [Westerleigh response to PDR](#), page 2, paragraph 6



(c) Under Case Two for large crematoria and including long leasehold capitalisation i.e. all sensitivities combined.<sup>23</sup>

36. Regarding Memoria's submission, we recognise that this matter might need careful consideration should a price cap be imposed on the industry. However, the CMA has decided not to impose a price cap following the current market investigation. As a result, this is not a matter we have considered further. However, we observe that, in the context of assessing whether firms may have market power which they can exploit to earn returns in excess of the cost of capital, the existence of different operating models in terms of the combination of price levels and volume of cremations undertaken, is not relevant. In a well-functioning market, returns for all business models should be pushed down towards the competitive level.
37. Finally, we considered Westerleigh's point regarding qualitative factors. We note that our analysis takes into account firms' actual costs and hence any differences in costs that arise as the result of some firms providing higher/lower quality products and/or services. We do not agree that any further allowance should be made for qualitative factors in this type of analysis.

**Table 4: Detriment (economic profits, £m) of sensitivities**

	2014	2015	2016	2017	2018	Average
Local Authorities: Land valuation Case Two	1.6	1.7	3.6	3.3	3.0	2.6
Large crematoria; Land valuation Case Two	8.7	17.2	18.0	19.7	19.2	16.6
Large crematoria: Land valuation Case One incl. long leaseholds	14.2	22.8	23.5	25.3	25.0	22.2
Large crematoria: Land valuation Case Two incl. long leaseholds	5.2	13.8	14.3	15.0	14.5	12.5

Source: CMA analysis

**Table 5: Detriment (economic profits per cremation, £) of sensitivities**

	2014	2015	2016	2017	2018	Average
Local Authorities: Land valuation Case Two	50	55	115	99	90	82
Large crematoria; Land valuation Case Two	98	171	168	169	152	154
Large crematoria: Land valuation Case One incl. long leaseholds	160	227	220	216	198	206
Large crematoria: Land valuation Case Two incl. long leaseholds	59	137	134	128	115	116

Source: CMA analysis

<sup>23</sup> Since no local authority crematoria operators in our sample lease their land, there is no need to calculate economic profits under this sensitivity.

38. Under land valuation Case Two, local authority crematoria earned economic profits of £1.6m in 2014 which increased to £3.0m in 2018. There was a high of £3.6m in 2016. This implies an average detriment of around £80 per cremation over the period.
39. Therefore, overall we estimate that customers of local authority crematoria suffered detriment of between £80 and £170 per cremation, with an upward trend over the period.
40. Under the three sensitivities presented at Table 4, large crematoria earned economic profits of between £12.5m and £22.2m on average across the Historic Period. This implies a corresponding detriment figure of between approximately £115 and £210 on average over the period.
41. Therefore, overall we estimate that customers of large crematoria suffered detriment of between £115 and £210 per cremation. As highlighted in our profitability analysis, two of the large crematoria operators opened a significant number of new crematoria over the relevant period and we expect that their profitability – and measured detriment – will increase in the future as those sites reach maturity.
42. In 2008 the average standard cremation fee was £434. If it had increased in line with inflation the average fee would have been £543 or £569 in 2018 depending on the measure of inflation used. In 2018 the average standard cremation fee was £775 (ie over £200 more than the inflation adjusted fee). This comparison<sup>24</sup> gives an indication of the amount that customers could have saved per cremation, on average, in 2018 if standard cremation fees had increased in line with inflation.

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<sup>24</sup> This is not meant to be to a competitive benchmark, as the 2008 figure does not necessarily reflect competitive conditions in a well-functioning market.