



Europe Economics

Impacts of COVID-19 on the Funeral Director Market – implications for the CMA investigation

A report for the National Association of
Funeral Directors

June 2020

Europe Economics
Chancery House
53-64 Chancery Lane
London WC2A 1QU

Tel: (+44) (0) 20 7831 4717
Fax: (+44) (0) 20 7831 4515

www.europe-economics.com



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1 Implications of the COVID-19 Pandemic for the Funeral Director Market and the CMA Investigation

1.1 Introduction

Europe Economics has been asked by the National Association of Funeral Directors to analyse implications of the COVID-19 pandemic for the CMA's market investigation. In this paper we cover:

- Impacts of the pandemic on firms' costs, revenues and price recovery.
- Impacts on consumers and the market more generally such as entry and competition.
- Features of the market which have been brought into sharper focus during the pandemic.
- Implications of the above for the CMA's market investigation and remedies.

Our paper focuses on the restrictions imposed throughout the UK as a result of the lockdown announced 23 March 2020. For the funerals sector this has meant funerals limited to immediate close family with no church services, arrangements made online or over the phone, and the application of social distancing across many areas of the business. These restrictions have led to a range of changes for firms and consumers.

Whilst some restrictions have been eased during June and may continue to be so over the coming months, our analysis remains relevant for a number of reasons. First, the impacts of the restrictions will have lasting effects on some funeral directors, for example forcing them to change business models, change their size or scope of practice, or exit the market. Second, the restrictions will have changed the way the market (including consumers) operates in many areas, which may be sustained over the near and long term. In addition, the impacts of the restrictions have highlighted aspects of the funeral director market which previously may not have been clearly observed, which will have implications for the analysis undertaken and remedies proposed by the CMA. And finally, the situation with the pandemic continues to evolve – at the time of writing many funeral directors are still operating in the same way as under full lockdown, and it is possible that subsequent lockdown periods may be imposed in the UK.

In preparing this paper we held focus groups with nine independent funeral directors (not including any large corporates) of different sizes across different regions of the UK. We note that this research, while limited in scope, provides useful insights into the ways in which the pandemic can impact businesses. There have been some positive developments during this time – in particular reports of simpler paperwork as driven by government regulations and increased electronic administration. However, there have been negative impacts for many such as falling revenues, increasing (or static) costs, regulatory arbitrage and concerns over cost recovery.

1.2 Impacts on funeral directors' costs, revenues, pricing and competition

1.2.1 Falling average revenues

The COVID-19 pandemic and associated restrictions have driven a number of changes in the revenues funeral directors are able to earn.

Social distancing requirements and restrictions on the numbers permitted to attend a funeral have led to more consumers purchasing simpler funerals. Examples include no or very scaled-down services either at the graveside or at the crematorium, no wakes (where the deceased remains at the family home for people to pay their respects), no viewings at the funeral home (e.g. where viewing chapels are too small to safely accommodate viewers within social distancing guidelines), fewer flowers and orders of service/other stationery purchased, fewer added extras such as elaborate caskets, and no limousine transport. There has also been an increase in the number of direct cremations (with no mourners at all). The price that funeral directors charge for the simpler funerals is typically much lower than for standard funerals. This includes the erosion of important margins that funeral directors are able to make on optional extras. Whilst these changes are not the same across the board – for example in some areas, families compensate for not hiring limousines by having more flowers or a more elaborate coffin – most of the funeral directors to whom we have spoken have reported a decline in the average revenues earned. In addition, the vast majority have not increased their prices for the funerals they do offer.

The ability of people to pay for funerals has also likely reduced given the widespread employment impacts of the lockdown which could drive a greater proportion of basic funerals being sought. This phenomenon is likely to persist beyond the lockdown period as the economy enters a probable recession.

Many funeral directors to whom we have spoken also report not charging for all the services they have offered during the pandemic, in their attempt to accommodate the wishes of families in the face of so many restrictions. Examples include recording or live-streaming services, spending time setting up donation or tribute pages on websites, or charging below-cost for a small number of orders of service.

Lower average revenues for funeral directors are not necessarily compensated by higher demand, for a number of reasons:

- The high death rates attributed to COVID-19 are not uniform across all regions of the UK. A number of the funeral directors to whom we have spoken have not experienced particularly higher demand for funerals but are nevertheless restricted in the revenues they can earn from the funerals they do arrange.
- Even in areas with significantly more deaths, this does not always translate into an equivalent demand for funerals. Many families are having direct cremations or very small funerals and postponing more elaborate services until the restrictions are lifted. Funeral directors will not necessarily be approached to arrange these services (e.g. other event organisers would be eligible).
- Increased competition from crematoria offering the increasingly common direct cremations may also erode the volume of funerals that firms are able to arrange. Increased activity by crematoria in this market also raises questions around a level playing field between crematoria and funeral directors.
- Funeral directors are not all able to expand capacity to meet a much higher demand, for example smaller firms with limited storage capacity, hearse availability and access to additional labour. There is even anecdotal evidence of funeral directors closing due to staff shortages and lack of PPE.

1.2.2 Increasing costs

Falling revenues are in some cases accompanied by higher costs, or at least costs remaining unchanged. Cost increases may stem from:

- *Temporary labour costs to replace employees who are unable to work.* A relatively high proportion of employees in the funeral director sector are elderly (including drivers and pall bearers), and thus more likely to be self-isolating or shielded and unable to work. This may require funeral directors to hire additional temporary staff whilst still paying the wages of the permanent staff. Even where staff are furloughed, funeral directors are often topping up salaries in addition to paying temporary staff.
- *Purchasing of PPE and other equipment.* Funeral directors have reported spending thousands of pounds on PPE and other protective equipment such as separation screens for limousines and Perspex covers for

coffins. They have also reported a dramatic increase in the cost of body bags – for example from £5 to £25 per bag. Other costs include equipping staff to work from home (laptops, physiotherapy risk assessments), and expenditure on IT services, online conferencing accounts and telephone bills (which in some cases have trebled).

- *Other precautions to protect staff and customers.* These include more time-consuming ways of working such as sending out drivers in multiple vehicles rather than have staff together in the same car. Funeral directors are also still incurring costs which they cannot directly charge for, for example limousines sitting idle whilst still incurring insurance and storage costs.
- *Increased wage bills.* Some funeral directors have reported that they and their staff are required to work longer hours to cope with the impacts of the pandemic, such as extra cleaning of funeral homes, increased time processing payrolls, and more out-of-hours work in areas where deaths in nursing homes have been particularly high (where the death occurs in hospital the deceased can be collected during normal working hours). In addition, the time taken to arrange funerals over the phone/email is often longer than when the family was visited directly by the funeral director. Significant amounts of time are spent going back and forth with a family before all decisions are taken, and in many cases funeral directors are additionally delivering hard copies of information brochures where families are not comfortable with these being sent electronically.
- *Investment in capacity to deal with spikes in demand.* Whilst many funeral directors have been able to cope with their existing capacity thus far, some have invested in increased capacity, for example converting garages into storage areas and buying / renting refrigerators. This has increased their fixed costs which may not be recovered during the pandemic, particularly if demand is not as high as expected.
- *Delays in conducting funerals.* Funeral directors are typically obliged to continue to store the deceased in the face of delays in holding the funeral – for example if the family takes a long time to make decisions, or wants to wait until the easing of restrictions. The majority of funeral directors to whom we spoke do not charge for this extra storage time, even if it puts pressure on their capacity and requires them to seek other storage options (for example, embalmers can sometimes store bodies for funeral directors, for a fee).
- *Refunding funeral plans.* Some funeral directors have had to refund customers for elements of funeral plans which they have been unable to provide, such as limousine travel, viewings or elaborate services. As described in this section, whilst in some cases not providing these aspects does represent a cost saving to the funeral director, in many cases they do not and the refunds are therefore direct out-of-pocket costs.

The increasing proportion of simpler funerals may lead to a reduction in some costs among some funeral directors, such as the time spent arranging and coordinating the funeral, or the time spent driving to and conducting the funeral. However, this is by no means the case across the board, with a number of funeral directors reporting to us that the time required to arrange a funeral remotely has in fact increased. Where business models already use casual staff, then the wage bill might be reduced if these staff are not needed. However, many funeral directors rely predominately on full-time staff. Further, many of the costs incurred by funeral directors are largely fixed in the short- and medium-term, such as hearse and limousine fleets, properties, software, mortuaries and refrigerators.

1.2.3 Cost recovery and pricing

The COVID-19 pandemic has highlighted a number of issues which are likely to affect firms' cost recovery and pricing. These point to features of the market which until now may not have been fully accounted for in the CMA's investigation, and which could have significant implications for the proposed remedies.

The supply of different types of funerals at different prices – for example basic and standard funerals – can be seen as an example of Ramsey pricing, or price differentiation. Price differentiation, for example recovering a greater proportion of common costs through one service compared to another, can improve overall market

efficiency by enabling firms to supply services at lower prices to under-served customers with lower willingness to pay, whilst still recovering common fixed costs. A greater proportion of the common costs are recovered from those customers to whom the service or product is most valuable (and thus who are willing to pay more).

In the case of funerals, many firms appear to be recovering a greater portion of shared fixed costs from standard and more elaborate funerals compared to simpler / basic funerals. Particularly in the case of an essential service such as a funeral, ensuring that there are low-price products on offer is an important feature of the industry.

With the significant increase in the proportion of simpler funerals being bought as a result of the pandemic, many firms may be struggling to cover their fixed costs without the revenues from the more expensive standard or luxury funerals. The firms to whom we have spoken report a fall in average revenues without a corresponding fall in costs. This suggests that many firms are engaging in price differentiation. One firm for example has had to increase the price of its simple funeral as it was unable to cover its costs given the fall in the sale of more elaborate funerals. The extent to which this is the case across the industry is as yet unknown, but it is a market feature which deserves full investigation by the CMA as it will have significant implications for any price regulation proposed.

There is also evidence of price differentiation in the supply chain. We have received reports of coffin suppliers no longer offering discounts and/or increasing the prices of their more basic coffins in the face of lower sales of more elaborate coffins.

The impact of the pandemic therefore could be that firms may need to reassess the balance of their pricing between basic funerals and standard / more elaborate ones, such that basic funerals recover a larger share of the common costs than they have previously done. Therefore, whilst average prices across *all* funerals could remain constant, prices of different types of funeral may need to change in order for firms to recover their costs and avoid operating at a loss. If firms are unable to increase their prices for certain funeral types, then this may lead to long-term losses and market exit. As an analogy, a cinema offering discounts for customers under eight years of age may be able to do so profitably as long as there are sufficient numbers of over-age customers; if all customers were below eight then that business model would no longer be viable.

In addition, where firms have incurred higher costs as a result of the pandemic as described above, they should be able to recover these if they were efficiently incurred. This raises a dilemma. Increasing prices during the pandemic could be difficult from a social responsibility perspective. However, it is debatable as to whether price increases should or could be passed onto future customers once the pandemic has passed. New firms may enter certain market sectors in the future and undercut those firms still paying off the higher costs incurred during the pandemic.

The number of deaths may well fall below existing averages in the years following the pandemic, as the pandemic would have claimed some lives now that would have ended in the following few years. This reduction in deaths may further impede firms' ability to recover costs in the future.

1.2.4 Competition and regulatory arbitrage

The move towards remote arrangement of funerals and greater online presence of funeral directors during the pandemic has been favourable to new entrants advertising and gaining customers online. Many of these focus on direct cremations – where the family cannot view the deceased or attend a service – and may have no or limited physical premises (such as capacity to store and prepare the deceased). The absence of overheads and the traditional services offered to families means that these firms can offer direct cremations at a very low price. Whilst this is a positive move for consumers who are happy with a remote service and the level of care offered, there is concern that some families are not aware of what is included – or not – in these offers. Anecdotal evidence suggests that some firms leave the deceased at hospital mortuaries until just

before the cremation, do not prepare the body to a fit state to be viewed (e.g. dressed, tidied), and use a standard vehicle to transport the deceased to the crematorium, sometimes along with others. These lower cost operators may not even be more efficient from a societal perspective if they abdicate the costs of storing the deceased to the hospital mortuaries.

The cost differences between such firms and funeral directors with proper facilities to store and prepare the deceased can be significant, even for the 'same' service such as a direct cremation, driven by overheads and staff time to prepare the deceased to a good standard (including staff training). This highlights a key feature of the sector, that it is difficult to specify a single 'product', as each funeral director can offer a different level of service for even the same type of funeral/cremation, in terms of what is included and also the quality of what is offered. It also highlights the potential value of quality regulation.

A further issue highlighted by the pandemic is the scope for regulatory arbitrage. A number of funeral directors have reported to us that they have spent more time and money complying with the government's guidance on social distancing than some competitors. Examples include not permitting viewings where it is not possible to adhere to social distancing guidelines, requiring staff to travel in separate vehicles, and abiding by the recommended numbers of mourners at a crematorium service. They report losing business to competitors who for example do allow viewings regardless of the risks to staff and the public, or permit larger crematorium services. This reinforces the risk of regulatory or quality arbitrage and an unlevel playing field, which could be exacerbated by the remedies currently proposed by the CMA.

1.3 Implications for price regulation

The abovementioned impacts of the COVID-19 pandemic on the funeral director market, along with the market features highlighted by the pandemic, have a range of implications for the CMA's investigation and proposed remedies. Understanding these impacts fully will be necessary for the CMA to assure itself that its remedies – in particular a benchmark cap on a standard funeral package or an average revenue cap – do not result in damaging unintended consequences.

Cost recovery

Cost increases resulting from the pandemic will place pressure on firms and, where these have been operating efficiently, will erode their ability to make normal profits and could lead to market exit if firms are unable to increase their prices across certain funeral types. The extent of cost recovery problems will depend on a range of factors, including the duration of such cost increases and future death rates (it is possible that death rates will fall below previous years' averages following the pandemic if the pandemic pre-empted deaths that would have occurred in the next few years). A regulatory cap on prices could exacerbate market exit among certain firms if it is not calibrated with regard to cost changes across the industry.

The evidence of Ramsey pricing in the sector further suggests that a rebalancing of prices between certain funeral types may be necessary to enable firms to recover all their common costs in the face of greater demand for simpler funerals. Price regulation that impedes this rebalancing – for example by overly restricting prices of a certain funeral types – may therefore drive firms out of the market if they are unable to pursue viable business models.

The pandemic has highlighted that prices for individual services or types of funeral are not always directly linked to marginal cost, for example simpler funerals recovering a smaller share of common costs than more elaborate funerals, and funeral directors not charging directly for costs such as increased storage time, or for various extras during the pandemic. Price regulation that focuses on prices equalling marginal costs could have undesirable consequences, such as increases in the prices of basic funerals as elaborated below, as funeral directors are forced to recover costs directly through pricing. This could include scenarios whereby vulnerable families are faced with increasing costs if they delay making decisions about the funeral.

A shift away from the marginal cost pricing principle is applicable in other industries. These include pharmaceuticals, where the costs of drugs that make it to market are designed to recoup research and development costs more broadly, and IT innovation in the pricing of individual software packages. There are also many examples of where Ramsey pricing can be welfare maximising. These considerations should contribute to the CMA's analysis of the market and any remedies.

Unintended consequences of price caps

In light of the above, the risk of unintended consequences of price regulation is high.

Setting price controls in the context of price differentiation risks unbalancing the current pricing equilibrium. Price caps that are based on the premise of cost reflectivity would not necessarily allow for Ramsey pricing and may result in a shift in the prices of different funeral types and impact the ability of certain consumers to purchase a funeral within their means. In addition, caps on a particular type of funeral – e.g. a 'standard' funeral – which do not take into account Ramsey pricing equilibria could prevent firms from recovering a greater proportion of their common costs from these standard funerals, leading to rising prices of simpler funerals across the industry as these become more cost reflective.

The impact of the pandemic on the sector will also have to be considered when calculating a benchmark cap or an average revenue cap. Given the disruption to the sector and changes in costs and pricing practices, current prices would not be a stable basis for a "reasonable" price for the caps, and setting a cap based on historical prices would not be suitable for a market which may have undergone permanent changes.

If price caps set by the CMA are so tight such that firms are unable to recover all their costs, this is likely to lead to market consolidation and – more likely – market exit. This could have differing impacts across towns and regions, with some areas potentially left with very limited choice.

Defining services to be regulated

The rapid move towards simpler funerals during the pandemic highlights one of the key difficulties in the CMA's current remedy of capping the price of a standard service. Defining a standard funeral and associated costs will be very challenging, particularly as what is most common may change over time. Should the standard funeral be modelled on pre- or post-COVID trends? What are consumers most likely to choose in the future? Could there be a dichotomy in the market with very basic funerals / direct cremations on the one hand and large elaborate funerals on the other?

The pandemic has also highlighted the very different services provided by funeral directors, even within similar funeral types. Even a direct cremation can have a very different level of service attached, as previously described. Specifying a benchmark or standard funeral type and associated price cap may not take into account the underlying levels and quality of service offered by different funeral directors and thus not compare like-for-like. Having a single price cap apply for the same funeral type could miss the fact that the underlying service and therefore cost might be very different between funeral directors, meaning some could earn excess profits whilst others are unable to cover their costs. This could lead to market exit and the reduction in consumer choice down to the very basic funerals offered by low-cost operators.

Changes in the wider market

The move towards the remote arrangement of funerals may bring about longer-term changes in consumer and firm behaviour. Some firms have reported to us that families now have more time to make decisions about the details of the funeral, for example where information brochures are sent ahead of the conversations with the funeral director. Families are able to look through all the options at their own speed and funeral directors have noted that sometimes more elaborate options are chosen (e.g. coffins, flowers, cortege routes) compared to when the arrangements were made over a couple of face-to-face meetings. The provision of more, informed, decision-making time may increase the ability of consumers to make good choices about the

funerals they want. The provision of electronic information ahead of meetings with the funeral directors may also better enable consumers to choose between firms, thus encouraging competition.

The move towards remote arrangements may well continue beyond the pandemic, with the media and firm advertising raising the profile of online/telephone arrangements, combined with the general trend towards online consumption across the economy. This may enable and encourage consumers to compare funeral directors online, and in turn may incentivise the industry to increase their online presence, including the provision of more information.

This context suggests that quality regulation could be a useful remedy – for example in the form of an industry-led or independent ratings system – such that consumers can clearly see what services are offered by different funeral directors and be better able to judge between firms along the price spectrum.

1.4 Summary

The COVID-19 pandemic continues to affect the costs faced by funeral directors and their ability to earn sufficient revenues to cover these. It has also revealed features of the industry such as Ramsey pricing and the absence of direct cost-reflectivity in many business models. This emphasises the fact that the CMA's price regulation remedies could have a significant impact on the ability of firms to recover costs, and could lead to unintended consequences such as higher prices for basic funeral services, market exit and a decline in the quality and range of services offered.

At the very least, the CMA should be cognisant of the difficulties inherent in setting an average revenue or standard benchmark price cap in the face of disrupted pricing practices and changing consumer preferences for funeral services.

Finally, the changes in the wider market such as remote funeral arrangement and highlighted evidence of varying service and quality levels between firms should be taken into account by the CMA when considering the effectiveness of other remedies, such as transparency initiatives and quality regulation.