

6 Views of the main parties

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6.1. We received a joint submission from SCI, Plantsbrook's parent company, and written answers given to specific questions addressed to SCI through its solicitors. These were supplemented by two hearings with SCI.

SCI's acquisition of Plantsbrook

6.2. SCI stated that it had, for many years, been evaluating the possibility of a merger or alliance with a major UK funeral director, as described in Chapter 3. In 1987 SCI had met representatives of each of the two predecessor companies of Plantsbrook-Hodgson and Kenyon. Contacts with Kenyon had not been pursued after Mr Howard Hodgson, the then Chairman of Hodgson, invited SCI to invest in the company for the purpose of financing an acquisition it then had in mind; in exchange, SCI would acquire approximately 20 per cent of Hodgson. In the event, it had been Kenyon that made the acquisition and the deal between Hodgson and SCI did not proceed further. In January 1988 SCI and Hodgson resumed talks relating to possible co-operation in the sale in the UK of pre-need funerals, and a capital injection by SCI and shareholding in Hodgson. Discussions ended, in July 1989, when Hodgson announced its intention to merge with Kenyon.

6.3. Preliminary discussion concerning Plantsbrook had taken place with Lyonnaise des Eaux (which controlled 46.3 per cent of Plantsbrook through its subsidiary, Pompes Funèbres Générales) in May 1994, but was discontinued when SCI launched its ultimately successful bid for GSG; its offer was declared unconditional on 24 August 1994. In the same period-between May and September 1994-SCI had built up a stake of 8.4 per cent in Plantsbrook, while maintaining informal contact with Lyonnaise des Eaux, which was initially unwilling to sell the Plantsbrook stake separately from its other funeral businesses in France: however, it unexpectedly agreed to do so on 1 September 1994 after being informed that SCI was prepared to increase its stake to just under 15 per cent in a public tender. An agreement was signed on 2 September 1994 whereby SCI acquired control of Plantsbrook. The same day, pursuant to Rule 9 of the City Takeover Code, SCI made a bid for the remaining shares in Plantsbrook.

Financial implications of the acquisition

6.4. SCI told us that it had offered 175p for each ordinary share (the price at which it purchased the shares from Pompes Funèbres Générales), and 115p for each convertible share. Its bankers, J P Morgan and Schroders, had advised that the premium of 5.7 per cent over the market price of 165p prevailing on 1 September was reasonable. Plantsbrook's price had been as low as 82p per share on 19 May 1994 (when SCI first acquired a stake), but had been depressed by poor results and the expectation of the company being locked in with Pompes Funèbres Générales as controlling shareholder. SCI had been advised that the price for Plantsbrook reflected both the structure of the company's ownership and the potential cost savings achievable by SCI, for example from the rationalization of two head offices, and the revenue gains from a wider mix of products and services. There were no real price increases factored into SCI's calculations or those of its adviser.

6.5. SCI also told us that the cost of the acquisition was further mitigated by a favourable US tax structure. The overall after-tax cost of funding had been reduced through the use of a tax-efficient funding mechanism which SCI proposed to introduce.

Prices

6.6. SCI said that the merger presented opportunities to boost revenues by widening the product range, enhancing the quality of services, and increasing consumer satisfaction in what had been, in general, a sluggish and inefficient industry. Higher profits could not and would not be achieved by raising prices. We noted that over the last five years funeral income had risen by about 30 per cent in GSG and 20 per cent in Plantsbrook, but SCI told us that this average did not take into account the varying costs of providing funeral services according to locality and to changes in mix of products and services. SCI told us that it had not adopted the objective to increase funeral prices as a matter of course, and was content for this commercial decision to be reported openly, as indeed it had been communicated to the trade. The product range would be widened both ways, with the introduction of simple services at lower prices and the launch of higher-quality coffins and a wider range of merchandise. The benefit of the merger to the consumer would be in terms of better value for money through improved service and wider choice of merchandise.

6.7. SCI submitted that, contrary to what it described as popular myth, price competition was present between funeral directors. There was significant evidence that customers of funeral services had become more price-sensitive in recent years. GSG had not increased its prices from 1992 to 1994. In the Lewisham area GSG branches had lost market share when the Co-op had reduced prices; and GSG had responded by investing heavily in staff training, upgrading premises, and improving management, ie by generally enhancing quality and perceived value for money. SCI provided Table 6.1, which, according to SCI, showed price reductions at various Plantsbrook branches during 1994. We asked SCI to explain the large differences in the prices for what were intended to be identical types of funeral charged, for instance, by the Southall branch. SCI stated that the frequency of discounts in Southall was very high by comparison with other branches because of the special needs of various groups (for example, for religious reasons the bereaved might wish themselves to wash the bodies, or provide their own bearers). The frequency and extent of discounts was explained, SCI stated, by competitive reactions in price, or, less importantly, the decisions by individual funeral directors to accept lower payments from the poor, from employees or from certain special groups, eg policemen killed on duty.

6.8. SCI also told us that, in its view, for some customers price was the determining factor, and many funeral directors directed their marketing effort to that segment of customers. For others, price was one factor, along with other considerations, eg location, facilities, staff, choice of service or coffin selection. Most new entrants entered the market by offering a demonstrably low price or more attractive service options and, once established, began to trade on the basis of price and service.

TABLE 6.1 Discounts at sample branches

Branch	Frequency of discount	Standard price £	Lowest price paid £
Southall	27	995	[
Wembley	15	995	
Kensington	13	1,045	
Wood Green	10	899	
Barking	10	749	
Battersea	7	965	*
Haverstock Hill	6	995	
Edmonton	5	899	
Kensington	3	995	
Enfield	2	899	
Holloway	1	699]

Source: SCI.

6.9. In response to our invitation to confirm that, following SCI's acquisition of GSG, prices charged at one GSG branch at Kingston upon Thames (Farebrother) had been raised to the higher level prevailing at the other GSG Kingston branch (Paine), SCI described the history of price changes at Farebrother as follows:

When GSG acquired T H Sanders & Sons [in neighbouring Roehampton] ... I was able to rationalize the business and then use the excess property at Farebrothers to ... house the business of T H Sanders. It was much easier from an administrative point of view for me to have the same price range from that Farebrothers' office as the rest of T H Sanders' business, which was cheaper than Paines ... but one of the things that was always in hand, we were going to move the business of T H Sanders into Paines and therefore to utilize the facilities of Brighton House, Kingston (the location of Paines) to service the whole of that area. Then [we] reversed the earlier decision because it was easier administratively to have them both operating on price card 1.¹

6.10. SCI said that it was important for consumers to be able to obtain price information by telephone and at the funeral home, and to receive written estimates of all services and merchandise quoted. These were requirements of the NAFD Code of Practice but were not always enforced (although SCI, and before it GSG, had adopted them); SCI accepted that this was an aspect of price transparency that had been somewhat poorly observed in parts of the industry. SCI intended to continue to support the NAFD in enforcing these pricing rules. SCI had implemented and long favoured a policy of 'itemization' (see paragraph 6.38) which contributed to greater price transparency and consumer satisfaction. This enabled SCI employees to explain the various services that were being provided and the cost of each service. Such 'unbundling', in SCI's view, gave better sense of value, and a more realistic appreciation of the component parts of a funeral. It would enable the consumer to make an informed choice and purchase only those items or services desired.

6.11. We put to SCI a price comparison we had received from Mortlake Crematorium Board, indicating that SCI's prices were higher than those of its local competitors (see paragraph 5.59). It accepted this as evidence of price competition, but emphasized to us that simple comparisons of SCI's funeral prices with those of its competitors were not conclusive, not least because the quality of service and options available from different sources were not identified. SCI explained that it, as well as its competitors, 'mystery shopped' other firms, asking for quotes in order to remain competitive. However, such quotes had to be treated with caution. There was no standard, industry-wide, notion of what comprised a 'basic' service-it meant different things to different funeral directors; further, an initial telephone quote was likely to be changed once the customer discussed with the funeral director concerned the detail of what was included in the initial telephone enquiry. SCI also said that its own mystery shopping surveys demonstrated that quotes were for a broad range of products and services which were difficult to compare.

6.12. SCI said that GSG and Plantsbrook had had different pricing policies. In GSG, the policy had been to standardize the pricing of all branches into a range of about eight or nine price lists. A corporate decision had been taken that all branches trading under the same name, eg Fredk W Paine, should have the same price.

*Figures omitted. See note on page iv.

¹ie the same price card.

Prices were adjusted according to the views of local management and depended on competition in the area and the local market. In respect of Plantsbrook, the policy was different. Hodgson's corporate policy, particularly in the latter 1980s, had been to raise prices in the hope of recouping acquisition costs. This had been a failure; it had resulted in loss of market share and profits. The new Plantsbrook management had decided to give local managers considerable autonomy to cut prices to meet local competition. Prices in some areas had now been reduced in order to regain market share (illustrations put forward by SCI are set out in Table 6.2). In addition, SCI told us that prices in the long run had to reflect property and labour costs, which varied according to area. A survey commissioned by CH from Third Age International showed that prices charged by funeral directors in different parts of the country could vary by up to 30 per cent.

TABLE 6.2 Nominal changes in price at sample branches, 1992 to 1994

Branch	Price index		
	1992	1993	1994
Wembley	100	110.70	102.95
Edmonton	100	100.51	100.35
Barking	100	100.00	99.40
Wood Green	100	96.67	95.65
Buckhurst Hill	100	106.53	91.84

Source: SCI.

6.13. SCI stated that it had no intention of standardizing prices of GSG and Plantsbrook branches. Branches would continue to quote different prices. SCI's evidence at one of the hearings was that:

... our business is very competitive on a local or regional basis: different overheads, different intentions, different types of funeral, different types of operator. We ... believe-all of us in management believe-that we must remain price competitive on a local basis, which means different things to different branches in different areas, in different cities, in different areas of the cities. It depends on who the competitor is. Within a reasonably good commercial parameter, it is our intention to give our management ... the authority and responsibility to price competitively in their market.

SCI also said:

... we charge what we believe to be the correct price for the service we provide in a location based on our costs and the general market. However, we would not wish to get out of step with the general level of our competitors' prices. We make sure that on balance we are in step.

6.14. SCI maintained that, even in areas where it might have relatively higher market shares such as Sidcup and Bromley, it would not make commercial sense to adjust prices upwards. This was because there was effective competition from a large number of Co-op and independent funeral directors, and SCI would simply lose market share:

... the intensity of competition is such that there is no possibility at all of raising prices beyond those which exist at the moment. In other words, what determined the prices of GSG before the merger was not simply the existence of Plantsbrook in very few locations. They had to determine their prices by reference to the independents and the Co-op. The mere fact that Plantsbrook and GSG are now under the same ownership has not really changed the competitive position at all.

6.15. SCI went on to tell us that there was '... not an area within the areas under consideration, or indeed anywhere else in the United Kingdom, where this merger would lead to the ability of this company to raise prices without losing share dramatically'.

6.16. SCI gave a number of examples of what it described as the effect of price competition on market shares, and of the way in which Plantsbrook had had to adjust its prices to stop erosion of market share. SCI told us that:

- Titford Funeral Services in Clacton, Essex, reported that the effect of price undercutting by two new businesses, which opened in 1989 and 1991, was a [†] per cent reduction in the number of funerals in 1990 and a further [†] per cent reduction in 1991.
- Plantsbrook's Wigley branch in Battersea lost [†] per cent of its business between 1987 (when Hodgson acquired the branch) and 1994. The Wigley family, who had sold the business, recommenced a business in direct competition, and numbers of funerals carried out immediately fell. When the Wigley family advertised substantially lower prices in the local press, Plantsbrook's numbers fell again.
- Plantsbrook's Bromley branch experienced a sharp reduction in the number of funerals carried out because of a relocation in November 1989 to premises in a one-way street with no parking. Its first reaction was to raise prices, but this led to a massive loss of business (42 per cent) in 1990. Prices were then reduced by 23 per cent and this brought about a slow recovery in 1993. The data set out in Table 6.3 were supplied by SCI in order to illustrate the course of events.

TABLE 6.3 Price history of movements in funerals and basic funeral prices at Plantsbrook's Bromley branch, 1989 to 1994

	1989 (Hodgson)	1990	1991	1992	1993	1994
Number of funerals	162	94	84	58	74	65
Prices (£)*	523	556	428	420	475	495

Source: SCI.

*For NAFD/OFT basic funerals only, excluding disbursements.

- In Sidcup, Plantsbrook's branch experienced a [†] per cent reduction in the number of funerals between 1989 and 1994, with numbers stabilizing after the introduction of the NAFD/OFT basic funeral in 1991.

SCI also told us that there was no obvious inverse relationship between GSG branches gaining or losing custom and Plantsbrook branches gaining or losing customers. Gains and losses were spread across all competitors.

Competition in local markets

6.17. SCI emphasized that it was crucial to define the relevant geographical market properly. In SCI's view the relevant geographical market should be defined as an area:

... worth monopolising because a single supplier would be able to sustain an increase in prices over time. To the extent that one undertaking can increase prices and not suffer loss or share from competitors from outside a locality, the relevant market is defined. If, on the other hand, any attempt to increase prices results in competitors from outside the immediate locality entering that area, this means that customers regard the service supplied by the undertaking outside the immediate locality as an acceptable substitute. The area would not therefore be 'worth monopolising' and the relevant market is properly defined to include at least the source of competing supply.

SCI submitted that on this criterion there were no localities in either the reference area or the determined area which would be worth monopolizing because in all these areas customers would continue to enjoy a wide choice of funeral directors, and customers would readily regard a service in one locality as perfectly substitutable by a funeral service supplied from another locality. SCI branches continued to be subject to effective competition, and customer choice was retained. In SCI's view, it was important that customers still had a choice of funeral director appropriate to their needs in each geographical market. Because of the overlapping areas in which all funeral directors competed, there were no localities where SCI could become a market leader, or price setter.

6.18. SCI said that it had informed the OFT before the reference was made to the MMC that 'within London, competitive areas are localized within a radius as small as one mile or even less than one mile (one quarter mile in some cases); the areas are, in any event, circumscribed by natural boundaries, such as the River Thames or motorways, for example'. SCI told us that this statement should not be taken out of the context of its discussions with the OFT. However, having done more work on local markets, it had now changed its view. The extent of the market depended on factors such as distribution of outlets, density of population and communications. Proximity, although influential, was not the overriding factor and was less important than the expectation of quality. It was the pressure to maintain quality which, in SCI's view, ensured effective competition.

6.19. SCI pointed to the difficulty in identifying each relevant geographical market, and hence market shares, given that there could be no precise delineation of the area to which customers might feel themselves obliged to confine their custom. SCI's evidence from the customer surveys it regularly conducted was that proximity to the nearest funeral director was not the primary determinant in the choice of funeral director. The main factor influencing customer choice was the willingness of customers to return to the funeral director where they had experienced satisfactory service in the past and the willingness of others to recommend a particular funeral director. As part of GSG's continuing customer survey, mentioned above, 40 per cent of those responding replied that they selected one funeral establishment over another because they had used it before; 28 per cent stated that they chose a funeral director on the basis of a recommendation; 11 per cent had had direct experience attending a funeral organized by the firm ultimately selected; 25 per cent referred to the locality as the reason for their choice of funeral director; but only 8 per cent chose the nearest funeral director.

6.20. SCI said that the relevant geographical market had to be distinguished from a local funeral director's 'catchment area', which could be ascertained from the individual funeral director's experience of the provenance of the majority of his customers. SCI had surveyed the location of ten SCI branches and the location of each of the deceased handled by the branch and found that in built-up areas of London some 70 per cent of the deceased came from within one mile and up to 90 per cent within two miles of the funeral directors' branches.

6.21. SCI told us that it was not possible to generate reliable data on local market shares because the extent of the relevant geographical market for each branch was unknown: it was clear that there was a very material overlap between virtually all funeral directors' catchment areas and there was no good reason, in theory or in practice, why customers should feel themselves obliged to confine their custom to a narrowly-defined geographical area, if hypothetically and speculatively, prices were to increase as a result of the merger. SCI also explained that it did not expect local funeral directors' branches to have knowledge of their market shares. A good funeral director would have 'knowledge', in the sense of 'a feel for', the number of funerals he conducted compared with his competitors. His knowledge, however, was merely anecdotal. It was not 'knowledge' in the sense of the numerical certainty required to discharge our burden of proof to the required standard. SCI also told us that an attempt by GSG to break down local trading areas into wards to obtain market shares from OPCS ward data had been abandoned: the data had been found not to be a reliable measure of the total local market reasonably available to each funeral director. For instance, they did not take into account hospital deaths (OPCS reallocated deaths to the deceased's home address). This meant that, for example, the number of funerals capable of being handled by funeral directors located near to important hospitals, ie their total market, would be significantly underestimated. Accordingly, in SCI's view, there was no reliable means of calculating market shares in the relevant geographical markets, properly defined, even if such markets could be identified, given the overlap between localities.

6.22. SCI said that it only used OPCS data to calculate trends for business planning purposes (ie to see whether SCI was carrying out a greater or smaller proportion of funerals), and not to calculate market shares. Data were only assembled at the much wider registration district level and compared with the number of funerals carried out at specific cost centres, as shown in Table 6.4. The aim was not, however, to calculate market shares in the relevant geographical market. SCI provided no market share data for that purpose, but offered the figures in Table 6.4 as, SCI believed, the closest that could be obtained as appropriate market share estimates for the areas in question. In SCI's view the trading areas for the three cost centres tended to be concentrated around the Registrar for Deaths who, although not allowed to recommend a particular funeral director, kept a list of funeral directors in the district. Given the nature of competition in the industry and the low barriers to entry, the merger would have no adverse consequences in these areas or in the relevant geographical areas.

TABLE 6.4 Market shares using SCI records, 1993

	London					
	Outer south-west/Surrey*		Inner south-east/south-west†		Outer south-east/Kent‡	
		%		%		%
Total deaths registered	13.151		12.879		8.067	
GSG	3.436	26.1	2.363	18.3	2.523	31.3
Number of branches	22		20		13	
Plantsbrook	555	4.2	399	3.1	345	4.3
Number of branches	6		4		4	
Combined funerals	3,991		2,762		2,868	
Combined funerals market shares		30.3		21.4		35.6

Source: SCI, OPCS.

*Based at Kingston.

†Based at Lewisham.

‡Based at Orpington.

6.23. SCI commissioned an independent study by Lexecon Ltd, a firm of economic consultants, on the relationship between funeral prices and local concentration. This study started by taking average prices of the Derby and Warwick funerals offered by GSG and Plantsbrook respectively at 30 London locations; SCI subsequently told us that each of them accounted for about 48 per cent of funerals sold at these branches. The study then plotted price levels against the ratio of SCI branches over the total number of funeral branches within specified radii. Lexecon said that the graphical representation showed no relationship between price and concentration, even within a radius of three miles. SCI commented that it would have been normal to see some positive relationship between price levels and concentrations at this level but none had been found. A similar graphical analysis was undertaken for all funerals sold by the branches covered, with, according to Lexecon, similar results.

6.24. Lexecon then proceeded to analyse every transaction in the 30 branches to assess whether there was any econometric relationship between price and concentration, the number of competitor outlets, and other variables, including business costs, at selected radii up to three miles. Lexecon concluded, up to a 95 per cent level of significance, that no relationship was present between price and concentration. The study was repeated, with similar conclusions, for locations outside London. Lexecon/SCI commented that the fact that the local catchment areas of outlets overlapped with each other implied that there was a 'continuous chain of substitution' between the outlets. On the basis that customers were not 'captive' to any one locality but could and did go beyond their immediate area for funeral services, competition acted as an effective constraint on the merged group from increasing prices.

6.25. SCI argued that the Lexecon work provided important evidence that although the merger, as with all mergers, would inevitably increase 'concentration', it would not enable the enlarged group to raise prices.

6.26. The Lexecon analysis also examined the relationship between rates of price increase for selected London localities and the degree of concentration: Lexecon said that it had found no such relationship; indeed, there were many examples of price reductions in areas of high concentration. The study further analysed the frequency of discounts offered and concluded that there was no relationship between frequency and concentration. Lexecon said that it would have been expected that greater concentration would have been associated with a lower frequency of discount offered to customers: this was not the case. The study concluded that even with 100 per cent concentration in a local area within a three-mile radius there was no evidence of a positive relationship between funeral prices and concentration.

Rates of return

6.27. SCI asked its bankers, J P Morgan, to respond to a paper put to SCI by the MMC regarding the cost of capital and the overall returns earned by GSG and Plantsbrook. J P Morgan reported that if GSG and Plantsbrook had operated in an uncompetitive market-place, it would have expected the total return to equity investors to have exceeded significantly the total return for the market as a whole. J P Morgan prepared comparative figures as set out in Table 6.5.

TABLE 6.5 Rates of return

	<i>per cent</i>	
	<i>1989 to 1994 Plantsbrook</i>	<i>1986 to 1994 GSG</i>
Compound actual annual total return to investors	(6.3)	18.0
Average expected market cost of equity	11.5	11.8
Compound actual annual total return on FT-All Share Index	9.0	11.8

Source: SCI.

6.28. In J P Morgan's view these figures indicated (for the periods chosen) that Plantsbrook delivered significantly lower returns than the market as a whole and GSG earned a higher return than the overall equity market, but taking into account the company's relative size, no more than those customarily expected for smaller companies (the FT Smaller Companies Index, for example, implied a return of 42 per cent in 1993 compared with an overall market return of 28 per cent). Since 1981, the Hoare-Govett Smaller Companies Index had shown a compound actual annual total return of 18.6 per cent against 10.2 per cent for the UK market as a whole.

6.29. J P Morgan also commented on a methodology we had used to value annually Plantsbrook and GSG's assets on a replacement cost basis, and to calculate an annual return on this value. J P Morgan presumed that this was based on the premise that the historic book value of the companies' assets, adjusted for replacement cost, was equivalent to the market value of those assets. In J P Morgan's view we had overlooked the fact that both Plantsbrook and GSG were, for substantial periods, quoted companies whose businesses had a genuine market value reflected in their respective share prices. Additionally, J P Morgan said that our paper indicated little understanding of the business development of both Plantsbrook and GSG: both companies had expanded significantly by acquisition on a continuous basis. In J P Morgan's view the capital used to fund these acquisitions should have been fully taken into account: goodwill should have been included in the calculations. J P Morgan said that the UK was one of the few developed economies where goodwill is customarily written off on acquisition, although current developments in UK accounting were moving towards amortization of goodwill in common with the USA, France and elsewhere. However, regardless of the accounting treatment of goodwill, a return was still required from capital invested in goodwill.

6.30. The return on capital (including capital invested in goodwill) based on market value, as calculated by J P Morgan in response to our paper, is set out in Tables 6.6 and 6.7.

TABLE 6.6 GSG: return on capital employed (on the basis of market value of debt and equity), 1989 to 1993

	<i>£ million</i>				
	<i>Years ended 31 December</i>				
	<i>1989*</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>
Operating profit*	3.96	(0.55)	3.09	3.90	9.51
Market value of net debt	11.92	12.95	11.29	10.78	10.91
Market value of equity	21.10	23.40	29.08	35.58	53.58
Market value of preference shares	5.80	5.20	6.60	7.80	11.60
	<i>per cent</i>				
Return on capital employed	10.20	(1.32)	6.58	7.20	12.50
Average return on capital employed	7.03				

Source: SCI.

*Operating profit has been adjusted to include changes in, *inter alia*, the market value of properties.

TABLE 6.7 Plantsbrook: return on capital employed (on the basis of market value of debt and equity), 1989 to 1993

	<i>£ million</i>				
	<i>Year ended 31 December</i>				
	<i>1989*</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>
Operating profit†	2.82	6.45	7.23	8.30	14.85
Market value of net debt	23.31	32.93	29.72	11.26	7.03
Market value of equity	59.21	50.57	18.01	49.02	92.98
Market value of preference shares	23.89	19.55	16.74	24.18	15.22
	<i>per cent</i>				
Return on capital employed	2.65	6.26	11.21	9.83	12.89
Average return on capital employed	8.57				

Source: SCI.

*Operating profit for the period from 28 September to 31 December 1989.

†Operating profit has been adjusted to include changes in, *inter alia*, the market value of properties.

6.31. In J P Morgan's view, the most significant measure of return to an investor or a company generally relates to the market value of a company's capital, not the book value, adjusted or unadjusted for replacement cost. Whilst there may be arguments for looking at current or replacement cost figures for calculating returns in a highly capital-intensive utility, which did not make significant acquisitions, J P Morgan believed this approach could be seriously misleading, particularly in the case of companies which expanded by acquisition or which were not intrinsically capital intensive, eg the funeral business which was essentially a service industry.

6.32. J P Morgan also pointed out that the margins achieved by GSG and Plantsbrook were not uncommon amongst service and people businesses, nor even utilities. This was supported by a comparison for 1993 between the ratios of earnings before interest and tax divided by turnover for GSG, Plantsbrook, Rentokil, Blenheim and Thames Water.

Economies of scale

6.33. In SCI's view, the acquisition of Plantsbrook gave it an opportunity to provide better, higher-quality and more efficient services, partially through economies of scale. Some economies would be achieved through the 'cluster' principle described in Chapter 4. After the merger SCI had extended clusters to include additional branches, although there were limits to the size of clusters depending on the locality—for example, all the vehicles and embalming facilities at a cluster would have to be sufficient to service all the branches' funerals; and because all funerals were administered from the cluster (which sent out staff and vehicles), clusters had to be within a reasonable geographic area. In very sparsely populated areas, such as SCI's branch in Kilmarnock in Scotland, a single branch could have its own vehicle fleet and embalming service and constitute its own 'cluster'.

6.34. In addition, economies of scale would arise from the very significant 'one-off' savings resulting from the merger in the form of centralization of administration. The acquisition of Plantsbrook had the effect of SCI having duplicate office facilities, personnel and computer departments, and two sets of senior management. The rationalization process had brought savings of 230 staff and 60 vehicles, representing about £6 million. No branches had been closed as a result of the merger.

Barriers to entry to funeral directing

6.35. SCI told us that the merger would not affect the low barriers to entry into the market. Some or all of a funeral director's services could be rented, for example by small operators carrying out a few funerals from their own homes. Very little initial capital was required. SCI pointed to the large number of new entrants within the London area and suggested, in the course of site visits, that it was easy to convert secondary retail premises to funeral director usage. There were no special planning or hygiene requirements. SCI also stated that new entrants had succeeded in winning funerals away from SCI and other longer-established funeral directors. Former employees of funeral directors, including those of GSG and Plantsbrook, and people with some experience of the funeral business were a particularly important form of entrant—they could capitalize upon their local goodwill, reputation and contacts. SCI supplied examples of new competitors who, it said, had successfully set up in opposition to it.

6.36. As to GSG's evidence to the CWS/House of Fraser inquiry, SCI stated that this related to entirely different circumstances. There were obvious difficulties in getting established, as in any business, and acquiring goodwill. In SCI's view, however, the difficulties were less than was formerly the case and probably no different from any other service business. Advertising was now more common as there was less reluctance to discuss prices. In addition, many ex-vendors had found that they could establish themselves with ease (eg Wigley's: see paragraph 6.16). In the words of SCI's Chief Executive in the UK:

Let me tell you how I would view it if I were a potential entrant. Assume that I am a church organist, schoolteacher, or shop-owner, or coach, or orderly in a hospital, and I am situated in an area of London or a small town. I am 40 or 45 years of age. I have grown up in that area and know most of the people in the locality. I have a good reputation. I want to get into the funeral business. I will keep my job, whatever it may be, and put a sign saying 'Funeral home' on my house. I will say to my wife, 'You stay here.' I will get a mobile phone, and when I get a call from somebody who knows that I am now in business I will call the local removal man. I will get him to deliver the body to the local trade embalmer and have the body embalmed and brought to the ground floor of my house. The family will come over. I will then call the hearse rental and say, 'Look, I may not be able to pay you for a month but I am a new customer. As soon as the family pays me I will pay you. Carry me for a while.' I call the coffin manufacturer and say, 'Look, I am a new customer. Will you carry me a little while?' They say, 'Sure', because if they do not they know that I will call the other guy. I can be in business and have no investment. That is what happens. The guy goes to the trade and asks to be carried for 30 days. He says, 'I am starting up. I will put my business with you full time.' He still has his job: and he does not have to quit it until he gets four or five funerals a week.

Quality of service and consumer choice

6.37. SCI believed the UK market offered significant opportunities for giving UK consumers an improved funeral service based upon higher professional standards, greater choice and value for money. Its experience and expertise in funeral services in the USA, Canada and Australia would enable it to bring extra quality, added value and consumer choice (including a less costly service option) to the UK market. Surveys had been developed which would be sent to customers requesting an evaluation of all aspects of funerals and merchandise provided, including facilities and personnel services. The purpose of the surveys was to evaluate the service and identify areas for possible improvement, shortfalls and any particularly exemplary service provided by individual employees. SCI emphasized to us that it was conscious of the traditional nature of the market and did not plan to seek to alter UK practices to any 'American' way (although it believed this was a convenient stick for UK competitors and others with which to beat SCI). The SCI UK subsidiary would be acting with a significant degree of autonomy from its US parent, following the practice adopted with other foreign acquisitions. SCI would continue to seek business opportunities, including acquisitions where appropriate, on a European basis, and in the UK; it had delegated two full-time executives to identify possible acquisitions of funeral directing businesses in the UK.

6.38. SCI told us that it was already taking measures to improve the choice of goods and services on offer to customers. These included an expanded range of coffins, among them less expensive and higher-quality units. Test marketing of this range had begun and initial results indicated consumer acceptance. SCI said that it was exploring methods to assist consumers in making better-informed purchase decisions, including the use of audio-visual aids, the display of model units, sample materials and finishes, and more informative product descriptions. For example, since in general UK funeral homes were smaller than in the USA, where it was possible for the consumer to view the different types of coffin prior to purchase, the display of miniaturized samples would be tested and it was hoped that customers would find it a significant improvement over choosing from a brochure, where the discernment of quality and value was difficult. The extension to Plantsbrook branches of SCI's (and GSG's before it) long-standing policy of 'itemization' would allow the selection and billing of individual services from a range. SCI believed this practice would further assist informed consumer choice, by giving the consumer more detailed information regarding prices of items purchased, an opportunity to buy only those items or services desired, and a clearer understanding of the terms of purchase (ie exactly what was being bought).

6.39. SCI assured us that high-pressure salesmanship was inappropriate and unsustainable in the funeral business, and no commission for selling more expensive coffins would be offered. The current GSG and Plantsbrook incentive schemes would remain for the time being, but they would be replaced ultimately by a higher basic salary and an incentive scheme based on critical objectives which included increasing the flow of business through the branch, collecting accounts, implementing the new coffins and merchandise programme, customer satisfaction and control of operating costs. SCI told us that it had now set its former Plantsbrook managers a target of a minimum 6 per cent improvement over the previous 12 months. The objective was to achieve improvement in overall net contribution through efficiency gains, such as by improved control of staff salaries or increased turnover. There was no requirement to increase prices if the target could be met by other means.

6.40. SCI agreed that it had included in its UK budget for 1995 increased revenue of £[*] arising from a 'merchandising adjustment': this reflected a higher-quality and more varied range of coffins, as well as a wider selection of ancillary merchandise, that would be available.

6.41. SCI believed standards of health and hygiene in UK funeral directing were poor relative to those in the USA and elsewhere. It intended to improve these standards in its own operations in the UK and ensure that safe and hygienically sound practices were followed by employees in the workplace.

6.42. SCI told us that it also planned to develop a range of memorialization options, which would be marketed through funeral branches or crematoria on a prearranged basis. Such options would include monumental masonry, niches, memorials, tablets, urns etc which could be sold, delivered and installed on family or individual plots, at crematoria or cemeteries, 'before need'. In this and all other aspects of the business, however, SCI would be sensitive to local custom and traditions. It remained to be seen whether the market would respond.

*Figure omitted. See note on page iv.

6.43. SCI said that an indication of the importance of local goodwill attaching to a business name and reputation was the invariable practice of maintaining the local business name following an acquisition. For example, this was the practice adopted at the outset by Hodgson in its very rapid expansion programme. Indeed, the attempt by Hodgson to depart from this practice and to trade under a national corporate logo and standardized livery had proved unsuccessful. Customers wanted their service to be local, and preferably family-run (though not necessarily family-owned). The failure of Hodgson to grasp this truth had resulted in significant loss of market share, for which Hodgson had paid substantial sums. By contrast, the strategy adopted by GSG in its acquisitions since 1972, and the strategy adopted by SCI in its purchases of GSG and Plantsbrook, was to maintain and build upon the local reputation and tradition of each trading business acquired and not to present the enlarged group to customers as a national company. One of SCI's trading subsidiaries, which used to be a wholly-owned trading subsidiary of GSG, and which now owned and ran all SCI's funeral branches, was called Family Funeral Directors (FFD). SCI said that its use of the term 'Family Funeral Directors' (on invoices, for example) was not misleading as this was the relevant corporate name. Moreover SCI provided funerals for families: its local staff had generally been acquired with the branch taken over, and was usually a family which was as much a part of the local community as any independent. In any event SCI did not trade under the FFD name but under the names of local branches.

6.44. SCI also told us that if a customer approached different SCI branches, or different independently-owned branches, trading under different names, he or she might well get different quotations. SCI's own policy was to remove rigidity in prices. SCI had never encountered the situation of someone feeling aggrieved as a result of getting what he or she believed was a quote from a separate company (when the outlets were in fact in common ownership). SCI recognized the importance of people's expectations as a consumer protection topic, but questioned whether or not the problem had materialized as fact.

6.45. SCI emphasized that if we were minded to make recommendations relating to the names under which funeral branches traded, it wished to be treated the same as other funeral enterprises or other businesses which retained the trading names of premises they had acquired. Otherwise, there would not be a level playing field.

6.46. SCI also said that the enlarged company would not be in an advantageous position to obtain coroners' contracts at the expense of independents. It said that a few of these contracts were gained as a result of tendering and most were on a rota basis. The locations where SCI had successfully tendered were relatively few. The contract it had in Kingston, for example, had not resulted in any difference in funeral volumes. Any decision to bid for a coroner's contract would reflect the commercial judgment made by the individual branch manager.

Codes of practice

6.47. SCI told us that it was well used to operating in a strictly regulated environment, which produced significant advantages for consumers, including the 'itemization' of prices referred to above and the visible display of price lists, both of which were already implemented by GSG. SCI confirmed that the new merged company was a member of the NAFD, and thus bound by the NAFD Code of Practice (GSG had been a member, but Plantsbrook, which had withdrawn its membership temporarily, had nevertheless abided by the Code).

6.48. The NAFD Code of Practice for Funeral Service had come into operation in 1979. Whilst the OFT continued to monitor the industry generally, the main responsibility for supervising the behaviour of those participating in it lay with the NAFD. The Code, which had been revised several times since 1979, set out a number of principles relating to the provision of customer services, eg it required the funeral director to 'provide clients with full and fair information about services, to have readily-available price lists covering the BASIC FUNERAL and other types of coffins, caskets and services provided': it also laid down a disputes and conciliation procedure in the event of customer complaint or dissatisfaction. SCI (and GSG before it) fully respected the Code, eg by its policy of itemization, and of having a price folder available in the branch and a price list to take away. In SCI's view customers were thus presented with adequate information.

Prepaid funerals

6.49. SCI said that its main competition in the prepaid funerals market came from schemes-funeral expenses plans-marketed by insurance companies; if these schemes were taken into account, it had only 5 per cent of the prearranged segment of the market. There was a distinct difference between insurance policies and prepaid funeral schemes in terms of the final product (ie a sum of money as opposed to a funeral service), although the money invested in an insurance plan was then available to purchase a funeral. That difference would not necessarily be apparent or material, to customers, largely because of the way in which the insurance schemes were marketed.

6.50. SCI told us that just over 50 per cent of CH customers were allocated to an independent funeral director. It submitted copies of letters of assurance it had sent to these independents, confirming that Plantsbrook funeral directors would not replace them in CH schemes as a result of the merger. Moreover, SCI would thereby be honouring its commitment to the families who had purchased such schemes, that the funeral homes with which they had contracted would carry out the service. SCI told us that it valued the relationship with the independents, and said that even in cities and towns where GSG and Plantsbrook branches competed with independents, it would still allocate CH business to the independents, unless the family specifically selected an SCI branch.

6.51. SCI explained that demand for prepaid schemes came from the customer, who now had a larger choice of the various schemes on offer. The sale of prepaid schemes also secured some future business for funeral directors. However, SCI would not be introducing telemarketing or cold-calling as part of its marketing strategy.

6.52. SCI said that the UK was significantly behind other parts of Europe in its adoption of prepaid funerals. In Holland, for example, 85 per cent of the population had a prepaid plan. The development of its prepaid business in the first place responded to public demand. It was also a means of building future market share in funeral directing services.

Crematoria

6.53. SCI told us that its main objective in the crematoria business was the introduction and sale of memorialization products in perpetuity. The merger would have no effect on its ownership and operation of crematoria. Plantsbrook had owned no crematoria. SCI's crematoria had all adopted a set scale of fees and did not discriminate against any funeral director. It offered no volume-related discounts or special terms and would continue this policy. As an experienced operator of crematoria, SCI considered it of paramount importance that its crematoria offered totally uniform and impartial services to all funeral directors, with no preference in favour of SCI funeral directors; GSG had offered no preference in favour of GSG funeral directors in the past.

6.54. SCI also said that it did not expect to see any change in the former Plantsbrook's funeral directors' use of crematoria. The choice of crematorium was a matter for the family and not the funeral director and, between them, the selection would be made on the basis of family preference. SCI insisted that it could not and would not put pressure upon families to use an SCI crematorium where it was not the family's preference. Even when the funeral director was asked for his recommendation, he would not be obliged by any SCI policy to put forward an SCI crematorium. SCI said that in any event there would be an alternative choice of crematorium in only three areas; in the ten other areas where it operated crematoria, there was not even any possibility of pressure being applied. SCI also produced evidence which, it said, showed that since the merger with Plantsbrook, SCI's crematoria had not benefited from any increase in referrals from SCI-owned funeral directors: if anything, the contrary was true. It also emphasized the importance of independent funeral directors to its crematoria business; any diversion would risk the alienation of the independents and consequent loss of funerals. SCI said that it would nevertheless be prepared to give an undertaking that it would provide every customer with a list of all the crematoria in the relevant area. It would be ready to indicate which crematoria it owned, and acknowledge that the funeral director and crematorium were under common ownership. It would also be prepared to give an undertaking that it would not operate a two-tier pricing system. In fact it had never contemplated introducing such a system anywhere in the world.

6.55. SCI told us that its crematoria were managed separately and reported independently of funeral directors to the Managing Director of SCI (UK). All accounting relationships between SCI funeral directors and SCI crematoria were conducted at arm's length.

6.56. SCI said that, although there were no special incentives for its own funeral directors to divert funerals to SCI crematoria, it did expect its crematoria managers to visit independent funeral directors to encourage business. It added that its crematoria managers called on all independent funeral directors in the catchment area served to ensure that funeral directors were made aware of the characteristics, products and services offered by each crematorium, so that they might better advise families in their choice of crematorium, if requested.

6.57. SCI was aware of the fears of competing crematoria, as relayed by us, but said that such fears were groundless. In its view, the 'evidence' provided by third parties had not stood up to examination. However, if we were concerned that SCI crematoria at some point in the future would show preference in favour of SCI funeral directors, SCI reminded us that powers existed under the Competition Act 1980, as amended, to investigate such a situation. SCI said that while it was appropriate that such serious allegations should be examined in depth, it was inappropriate for us to evaluate the merger on the basis of loose speculation about future conduct which was unlikely ever to materialize.

6.58. SCI explained that its crematorium prices varied across the country, and that this merely reflected local conditions. Bodmin, for instance, was a very recent crematorium; it had to operate on low volumes. SCI said that its prices were 'reasonably competitive' as against those of other private crematoria and, in most cases, local authority crematoria. It told us that all private crematoria charged more than local authority crematoria because, unlike the latter, they were not able to operate at a loss or enjoy cross-subsidy. Moreover, SCI had undertaken to bring its crematoria up to the standard mandated under the Environmental Protection Act 1990 and, to that end, had introduced a temporary surcharge to finance the improvements.

6.59. SCI believed there were significant opportunities for the development of crematoria, and in addition to the Downs crematorium in Brighton it was expecting to make further acquisitions or to construct new crematoria. It took the view that some crematoria would change hands because of the requirements of the Environmental Protection Act 1990: local authorities might not be able to afford the heavy financial burden of compliance without increasing prices and losing market share. SCI confirmed that it had submitted a tender for the management of the Putney Vale Cemetery and Crematorium for the next six years. It also told us that part of the management contract stipulated that the contractor could not levy charges higher than the maximum charge determined by the Council for the cremation of a Wandsworth resident.

H H LIESNER (*Chairman*)

I S BARTER

J EVANS

A L KINGSHOTT

J K ROE

A J NIEDUSZYNSKI (*Secretary*)

28 April 1995