

8 Other providers of extended warranties

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Introduction

8.1. Most EWs sold in the UK are sold by retailers at the POS. Insurance companies also use direct marketing methods to sell directly to consumers. However, there are a number of other sales channels available to customers of DEGs, which involve agents other than retailers.

8.2. These other providers of EWs also provide EWs both at the POS and through direct marketing.

8.3. EWs can be purchased from manufacturers, utility companies, banks and credit card issuers. It should be noted that a large proportion of EWs sold through these other channels are underwritten by insurance companies.

Manufacturers acting as agents for insurers

8.4. The majority of manufacturers do not own or operate an EW business. The in-the-box EW offered by manufacturers often gives the appearance that the EW is offered by the manufacturer but in fact is in most cases provided by a third party insurance company, for whom the manufacturer is merely acting as an agent. In some cases, the EW literature is co-branded with both the manufacturer and insurance company name. However, in all such cases the EW terms make clear that the contract is between the customer and the insurance company.

8.5. Some manufacturers offer both service-backed and insurance-backed EWs to their customers. Manufacturers such as Miele and Whirlpool offer a number of variations of EWs: parts and labour, parts only, labour only, free and renewal. The type of cover provided depends on the variant of EW purchased.

8.6. Manufacturers act as agents for insurers in one of two ways; the manufacturer sells customer data which is gathered from returned product registration cards to the insurer, or the manufacturer allows the insurer to place an EW offer card in the product packaging which is then completed by the customer and posted back to the insurer. In both cases, the EW sale transaction is between the insurer and the customer. The provision of customer information to insurance companies must comply with the Data Protection Act.

8.7. Insurance companies pay the manufacturer to gain access to customer details. D&G, the main operator in this activity, pays each manufacturer a fixed 'marketing fee'. The marketing fee is based on projected appliance sales and the rate of return of the guarantee/registration card (see paragraph 7.43(a)).

[*Details omitted. See note on page iv.*]

8.8. Table 8.1 shows the commissions paid to the largest manufacturing agents of D&G.

TABLE 8.1 **D&G: commission fees paid to manufacturers**

	£'000	
	Year ended 30 June 2001	2002
Electrolux		
Merloni Domestic Appliances		
General Domestic Appliances		
Hoover Candy group		
Dyson		
BSH Home Appliance		
Whirlpool (UK) Ltd		

Source: D&G.

8.9. Most manufacturers have stated that the rate of return of registration cards is very low, usually in the region of 20 per cent. Some manufacturers are more successful than others. Because of this low return rate they are unwilling to invest further in resources to operate an EW scheme themselves. They

generally consider their business to be the manufacture of DEGs and whilst they fully meet their obligations under the initial guarantee offered with all new appliances they typically do not regard it as part of their business to be involved on an ongoing basis in the repair and maintenance of older products.

8.10. Manufacturers are not involved in setting the price paid by customers for EWs. This decision is the insurers.

8.11. A few manufacturers offer free EWs with their appliances but have stated, however, that these do not have a significant impact on sales volumes. Customers often fail to register for their entitlement. Despite this, Miele now provides a free ten-year EW policy with certain categories of appliances. The labour portion of the free EW is underwritten by D&G whilst the remainder is service-backed.

Accounting for EWs

8.12. Most manufacturers are paid a commission for granting access to their customers. This income is recognized in their accounts on a cash basis.

Service and repair arrangements

8.13. The service and repairs arrangements for EWs sold via this distribution channel differ across manufacturer. Some manufacturers, such as Dyson have their own in-house engineers; others such as Electrolux use independent engineers appointed by the insurance company. Centrica has stated that its engineers are contracted to repair appliances on behalf of some manufacturers even when the appliance is still under the manufacturer's initial guarantee.

Manufacturers selling own EWs

8.14. A few manufacturers sell their own service-backed EWs to their customers rather than sell insurance-backed EWs on behalf of insurance companies. Most of the service-backed EWs are sold by computer manufacturers such as Dell, Time, Apple, and Hewlett-Packard. A number of other manufacturers as already noted sell a mix of their own service-backed EWs and insurance-backed EWs; examples are Sony, Miele and Whirlpool.

8.15. Most manufacturers that sell their own primarily service-backed EWs do, however, have elements of their schemes which are insured. The insured elements include accidental damage cover and frozen food loss.

Time Group Ltd

Background

8.16. The Time Group Ltd (Time) is the UK's largest high-street computer retailer and manufacturer. Time began as a mail order supplier of branded PC systems in 1987 and subsequently expanded into its own brand production with the establishment of its manufacturing plant in 1994. In January 2002, Time acquired certain assets and the brand name of Tiny Computers from the administrators of OT Computers Limited.

8.17. For the year ended June 2002, Time reported turnover of £[] million, of which [] per cent related to sales of EWs. Time told us its operating loss for the year ended June 2002 was due to unsuccessful store expansions into Holland, a major downturn in the UK consumer PC market, unsuccessful extension of product lines into the mobile phone category, and increased competition which adversely affected gross margins.

EW business

8.18. Time offers a three-, four-, or five-year service-backed EW entitled 'TimeCover'. Cover includes telephone technical support, EW repair, and bundled software and other promotional items. All repairs are carried out in-house. Time told us that approximately [X] per cent of the costs of its EWs were related to repairs and replacements, with the remaining [X] per cent comprising technical support costs.

EW profitability

8.19. Table 8.2 shows the EW profit and loss account for the four years to June 2002. Time told us that its EW business does not have its own profit and loss account so any allocation of costs to its EW business was considered to be arbitrary. Profit before tax and average capital employed have not been adjusted for the capitalization of operating leases due to insufficient information.

TABLE 8.2 Time: EW consolidated profit and loss, four years to 30 June 2002

	Years ended 30 June				£'000
	1999	2000	2001	2002	
Sales of EWs after VAT/IPT*					
Direct expenses					
Contribution from EWs					
Indirect expenses					
Profit before tax from EWs					
EW average capital employed					
Non-EW sales					
Non-EW profit before tax					
Non-EW average capital employed					
<i>Figures omitted. See note on page iv.</i>					
<i>Profitability analysis</i>					<i>per cent</i>
EWs					
EW contribution/EW sales (%)†					
EW return on turnover (%)‡					
EW ROCE (%)§					
Non-EWs					
Non-EW return on turnover (%)¶					
Non-EW ROCE (%)#					
<i>Figures omitted. See note on page iv.</i>					

Source: Time.

*Time originally submitted information stating its EW sales for 2002 were £[X] million. Further information which arrived late in the inquiry stated its EW sales were £[X] million.

†Contribution from EWs divided by sales of EWs after VAT.

‡Profit before tax from EWs divided by sales of EWs after VAT.

§Profit before tax from EWs divided by average capital employed.

¶Non-EW profit before tax divided by non-EW sales.

#Non-EW profit before tax divided by non-EW sales.

8.20. Time told us that it releases EW income to the profit and loss account immediately upon the sale. A provision is then made for the costs likely to be incurred in fulfilling its obligations. Indirect costs have been allocated on the basis of sales. Capital employed has been allocated to the EW business on the basis of direct costs. Operating leases have not been capitalized because the relevant information was not available.

Dell

Background

8.21. Dell Computer Corporation was founded in the USA in 1984. Dell manufactures computing appliances and sells direct to the consumer. Company turnover for the year ended January 2002 totalled £32 billion. Approximately two-thirds of Dell's revenue is generated through medium and large business and institutional customers.

EW business

8.22. In the year to January 2003, Dell sold [£] EWs for £[£] million excluding VAT. Dell sells its own service-backed EW scheme and also acts as an agent for LGI offering cover (CompleteCare) to customers for accidental damage (notebook computers only). EWs are sold predominantly at POS via telephone or online ordering.

8.23. All Dell EWs provide access to technical support via the Internet or telephone, and offer mechanical breakdown cover. However, notebook batteries only include a maximum one-year service cover, and monitors sold independently to the computer system have a maximum three-year replacement warranty. Dell offers the following EW products:

- (a) Collect, repair and return service.
- (b) Next business day on-site and international service programme for notebook computers.
- (c) Same business day 4-hour on-site response.
- (d) Same day 4-hour on-site response.

8.24. Notebook products can have Collect and Return or International Next Business Day on-site response. Desktop products can have Collect and Return or Next Business Day on-site response.

8.25. Dell does not renew existing warranties. All its EW products are available at POS or non-POS except CompleteCare which is only available at POS. Dell allows a 7- working-day penalty free cancellation period. Initial technical support diagnosis is provided by Dell but all repair work is provided by external third parties.

EW profitability

8.26. Table 8.3 shows the profit and loss account for its EW business. Dell told us that its EW business does not have its own profit and loss account so any allocation of costs to its EW business is considered to be arbitrary.

TABLE 8.3 **Dell: EW consolidated profit and loss, five years to January 2003**

	Years ended 31 January					£'000
	1999	2000	2001	2002	2003	
<i>Direct income</i>						
Sales of EWs after VAT/IPT						
<i>Direct costs*</i>						
Contribution before investment income						
Net interest income on funds invested						
Contribution from EWs						
Indirect expenses						
Profit before tax from EWs						
						<i>per cent</i>
<i>Profitability analysis</i>						
EW contribution/EW sales						
EW return on sales						

Source: Dell.

*Direct costs have been included on a standard cost basis because Dell told us that it cannot separate claims costs between its standard EW products and those that relate to upgrades.

8.27. Dell told us that it could not calculate a ROCE for its EW business because it does not split its worldwide capital employed between its different sub products.

8.28. Dell told us that with the exception of its CompleteCare policy, all EW sales revenues are deferred and released back to the income statement equally over the life of the EW.

Hewlett Packard

Background

8.29. Hewlett Packard was founded in 1939 in the USA. Compaq was formed in 1982 also in the USA. Hewlett Packard merged with Compaq Computer Corporation in May 2002, the new enlarged group being known as Hewlett Packard. The UK merger became legally effective on 1 February 2003.

8.30. Hewlett Packard is a global manufacturer of computing appliances and peripherals which are sold to both consumers and business.

EW business

8.31. In 2002, the global revenues of the Hewlett Packard group were US\$72.3 billion.

8.32. Hewlett Packard entered the EW market in 1993 with SupportPack and Compaq entered in 1997 with Carepaq. Hewlett Packard has stated that entry into the retail channel of the EW market was difficult since many retailers had their own branded EW and were therefore unwilling to offer Hewlett Packard branded EWs in direct competition to these.

8.33. Both Hewlett Packard and Compaq have historically sold their own branded service-backed EWs to their customers. Both companies chose to retain the risk of their policies on their own balance sheets rather than obtain insurance cover from third party insurers. These EWs have been sold either direct to the customer or via independent retailers known as Channel partners.

8.34. The Hewlett Packard group provides an array of EWs depending upon the customer's needs but all include free parts and labour. The following EW products are available:

- (a) three-year next business day service;
- (b) three-year two or five business day pick and return service;
- (c) one-, two- or three-year policies offering next business day advanced replacement service;
- (d) return to manufacturer and return within seven days to customer service; and
- (e) next business day replacement service.

8.35. The EWs may be purchased up to 120 days after the purchase of the DEG if bought from a reseller and within 180 days if purchased direct from Hewlett Packard.

8.36. Hewlett Packard has told us that it does not offer renewals on EWs and no penalty-free cancellation period is allowed.

8.37. Hewlett Packard estimates that 80 per cent of calls to the call centre are resolved over the telephone. All repair work is carried out by either Hewlett Packard engineers or authorised service providers. All authorized service providers are monitored for performance.

EW profitability

8.38. Table 8.4 shows a summary of the profitability of the EW business of Hewlett Packard for the three years ended 31 October 2002.

TABLE 8.4 Hewlett Packard: summary of the profitability of the EW business

	£'000		
	Years ended 31 October		
	2000	2001	2002
<i>Direct income</i>			
Sales of EWs after VAT/IPT	())
Commission income			
Total direct income			
<i>Direct expenses</i>			
Contribution before investment income		✂	
Net interest income on funds invested			
Contribution from EWs			
Indirect expenses			
Profit before tax from EWs			
<i>per cent</i>			
<i>Profitability analysis</i>			
EW contribution/EW sales	(✂)
EW PBT/EW sales			

Source: Hewlett Packard.

8.39. Hewlett Packard has told us that it was unable to provide any information prior to 2000 and also could not calculate an ROCE for the EW business.

Apple Computers

Background

8.40. The Apple Group is an international group responsible for the procurement and sale of computer hardware, software and peripherals. Apple's business operates on a pan European basis.

EW business

8.41. To support its products the Apple group sells the Applecare Protection Plan (APP) which provides telephone support, diagnostic software and EWs.

8.42. The EW business is undertaken by Apple Computer International. This business is not underwritten by an insurance company. The APP provides three-year cover.

8.43. APP is sold via Apple's Internet-based Applestore, support agents known as Apple Authorised Service Providers (AASP), authorized resellers and non-authorized independent resellers (these agents acquire Apple products from Apple authorized distributors).

8.44. In 2002, Apple sold [✂] EWs for £[✂] million (2001: [✂] for £[✂] million).

8.45. APP was launched in January 2000. Prior to this, Apple provided AppleCare Hardware Support, a product which was never actively marketed and whose sales never exceeded £[✂] a year.

8.46. Apple chooses to retain the risk of its EW policies on its own balance sheet rather than obtain insurance cover from third party insurers. The group had a cash balance at the end of 2001 of US\$4.3 billion which it considers sufficient to safeguard against insolvency.

8.47. EWs may be purchased at any time in the first year but no renewals are offered after the three-year EW expires. A 28-day penalty free cancellation period is allowed.

8.48. All repair work is carried out by independent AASP since Apple has no in-house repair capability. AASPs are appointed once they have demonstrated their ability and competence.

EW profitability

8.49. Apple has stated that it is unable to provide a profit and loss account for the EW business. The EW business operates and is accounted for on a European-wide basis and management accounts are not maintained for the UK business alone.

Utility companies

8.50. Despite not being in the business of selling or manufacturing DEGs many utility companies now offer EW policies on DEGs to their customers. They have based their EW provision on their ability to market these to their existing customer base. For example, Centrica has a scheme which is targeted at its customers who already hold an annual service or insurance policy for another appliance but whom they believe would be attracted to an EW different from the POS offer. Others use their EW scheme as a means of attracting and retaining core energy supply customers.

Centrica

8.51. The Centrica non-POS EW offering is targeted at those customers with whom it has an existing commercial relationship. The Kitchen Appliance Care (KAC) scheme which was introduced in 1999 is targeted mainly at those who have already purchased maintenance contracts (known as Central Heating Care (CHC)) sold by Centrica.

8.52. For the year ending 31 December 2001 the DEG EWs provided by Centrica accounted for approximately [%] per cent of their Group turnover (2000: [%] per cent). CHC accounted for the majority of these percentages.

8.53. The profit contribution made by the KAC scheme can be seen in Table 8.5. Since we do not believe that service arrangements for central heating are part of the reference services, the CHC scheme has been disregarded.

TABLE 8.5 **Centrica: profit contribution from the non-POS EW business**

	£'000	
	Years ended 30 December	
	2001	2002
Direct non-POS EW income	())
Costs—breakdown		
Non-POS EW contribution		
No of non-POS EW policies sold		
Single appliance		
Multi appliance		

Source: Centrica.

8.54. The non-POS EW contribution shown in Table 8.5 is after charging direct costs only. No support activity costs or overhead administration costs have been allocated. Centrica has stated that it is unable to assess the effect of allocating indirect costs and therefore unable to calculate ROCE based on profit after deducting indirect costs.

8.55. Centrica has its own national network of trained gas and electrical engineers covering the whole of the UK. A small number of manufacturers subcontract the repair service element of the manufacturers guarantee to the servicing division.

South Staffordshire Group Plc

8.56. South Staffordshire Group Plc (SSG) is involved in the EW business through its subsidiary, Regency Warranties Ltd (Regency). Regency was acquired in May 2002 to extend the range of domestic assistance services. SSG does not sell DEGs and is therefore not involved at the POS.

8.57. The net EW turnover on DEGs for Regency in 2002 was £[§] million (2001: £[§] million). This accounted for approximately [§] per cent of the company's turnover and [§] per cent of group turnover in 2002 (2001, [§] per cent of company turnover and [§] per cent of group turnover).

Other utilities

8.58. The majority of utility companies offering EWs act as agents for insurance companies. Many of these EWs add a supplementary feature to the EWs offered by other providers, in that they include a planned maintenance element during the period under cover.

Banks and credit card companies acting as agents for insurers

8.59. Many credit card companies offer EWs to certain categories of their cardholders as a perk. In most cases, the EW is given free of charge to the customer when they purchase a DEG using their credit card.

8.60. The credit card company uses the free EW as a means of differentiating itself from its competitors and therefore pays the EW premium to the insurance company to cover the risks but does not pass this cost onto the customer.

8.61. These free EWs are usually for a period of one year after the manufacturer's warranty expires and are generally not as comprehensive as three- or five-year policies purchased either at the POS or directly from an insurance company.

8.62. To qualify for free EWs customers must register their DEG purchases. At this stage the insurance company uses this opportunity to try to sell an extension of the free EW to the customer. The customer is under no obligation to purchase the extension. The customer details are also available to the insurer for soliciting for renewal business when the free EW nears expiry.

Accounting for EWs

8.63. Manufacturers selling their own EWs account for their EW business by deferring income over the period of the policy and expensing costs as incurred.

Servicing and repair

8.64. Manufacturers such as Whirlpool and Miele tend to use a combination of their own engineers and authorized repairers for repairs due under both the manufacturer's own first-year guarantee and under the EW policy.