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Losing Sleep over the Issue of Profitability

By Robert L. Pierce

I have been studying funeral home profitability on a full time basis since the mid 1980's. It is my passion.

Independent funeral homes have experienced two life altering "events" that have changed the industry more than any other. The first change occurred as a result of itemization which caused funeral homes to critically look at the pricing of their services for the first time. This was followed shortly thereafter by the influence of the public companies who introduced the independent funeral home owner to a clearer focus on profitability. These were the funeral industry's first baby steps out of the ice age and still remain significant influences today.

It has been about twenty five years in development but I believe that the industry is on the brink of a giant step forward. It is my belief that the two initial "life altering events" that I noted above will be dwarfed in comparison to what is coming. Profit management will evolve from a "seat of the pants" art form to a "near-science" as it continues to be developed, implemented and refined by more and more funeral homes. It is my belief that very simple and easy to implement management methods will transform the profit structure of our industry and every funeral home in it.

It is with this backdrop that I will relate a conversation that I had with the editor of a popular industry newsletter but first let me give you an understanding of the circumstances that surrounded the interview.

I had written the pre-convention issue of our New Horizons newsletter about the current opportunity inherent in buying funeral home businesses. The basic premise of the article is that bankers have tightened up their lending parameters which have caused the amount that can be paid for funeral home businesses to decline. As a result, funeral home values are down and buyer's returns on investment are up. This means that a funeral home business that is purchased today will be less risky and more profitable than in the past.

My newsletter went on to look at the impact of modern profit management methods on the profit and cash flow of an acquired funeral home. My quote from the article reads as follows, "The amount of the opportunity component of a purchased funeral business is often greater than the profit that was purchased. This means that the application of basic management methods by a buyer will cause the cash flow from an acquired business to increase significantly, often doubling.

The question that was posed to me was, "How would a buyer know that they are acquiring an unmanaged funeral home? How would one know that the opportunity component will be there?" My answer was that 95 to 99% of independent funeral businesses approach management from an "other than profit" perspective and, as a result, the opportunity component will be there in virtually every acquisition.

When I actually saw this in black and white, it caused me great consternation. It was much easier to give my answer in the interview than to see it in writing in front of the entire world. Could I really be right that 95 to 99% of all independent funeral homes leave a very substantial portion of their value on the table when they sell and thereby transfer a significant portion of their value to a buyer without being paid for it? Does my thirty plus years of experience really bear this out? I lost most of two nights sleep as I wrestled with these questions.

I established a three pronged approach to building the answer to my question. First, I spoke with people who acquire funeral businesses for a living. Next, I worked through my almost twenty years of experience working with buyers and sellers of funeral homes to see if I could shine some light on the answer. And then, I looked at my current experience helping funeral home owners manage their profits.

Based on my informal interviews with people who buy and then run funeral homes or have done so in the past, an independent funeral home owner always leaves substantial opportunity on the table for a buyer. It is how buyers of funeral homes make their money. It is also what allowed funeral home prices to reach their 1980's and 1990's levels. This part of my search was a

formality since I have been in the funeral industry for many years and I know the buyer's side of acquisitions intimately.

I then began looking back over my twenty years of funeral home brokerage. Based on my analysis of thousands of funeral homes, I can only come up with a handful of funeral homes that managed their businesses, merchandising, pricing and training effectively. That is a very low percentage and is consistent with my assertion that 95 to 99% of independent funeral homes do not manage their profits effectively.

Before I get into today's funeral homes, let's explore the evolution of profit management. In the 1980's and 1990's, there was no template for a well managed funeral home. Both publicly owned and independently owned funeral businesses were struggling to find methods to manage the long-term profits of their businesses. It is only within the last several years that effective profit management methods are being developed and put into practice. Independent funeral owners, however, are lagging their publicly owned counterparts and they are paying the price. A funeral home that does not manage its profits effectively has only one means to increase their profit and that is to raise prices which is not the best long-term solution for the independent funeral home or any funeral home for that matter.

Now let's look at my experience with today's funeral homes. To begin the process, I will explore the results of firms that have implemented profit management programs. These results are limited to clients of our Company since they are the only results to which we have access. To do this, I have calculated a rote composite revenue average of our funeral home clients as follows:

	<u>Year One</u>	<u>Today</u>	<u>Increase</u>	<u>Percent</u>
Burials:	\$6,833	\$8,566	\$1,733	25.35%
Cremations	2,473	3,479	1,006	40.69%

Our client firms tend to be larger, locally prevalent funeral homes with focused and motivated management. The firms represent a reasonable cross section of the country. The average results do not necessarily represent the results of the individual funeral homes in the group but the lowest increase in at-need burial average was \$943 to give you a perspective.

In addition to our experience with our client firms, we occasionally get the opportunity to tour non-client independent funeral homes. Based on my excursions, it is my experience that funeral homes that only do a portion of a comprehensive profit management program get very little in the way of results even if they do the portion that they do very well. I have toured several funeral homes that have spent considerable time and money on what might appear to be excellent merchandising and pricing programs and did not get the kinds of results that they deserved for their efforts. It is not enough to brush the edges of a profit management program.

On reflection, I stand by my statement that 99% (up from 95 to 99%) of independent funeral homes do not have effective profit management programs and I even suspect that the number is higher. As a result, there is a significant opportunity component for the purchaser in virtually every independent funeral home that is purchased. And, that makes the purchase of a funeral home a better opportunity today than it has ever been. But I did not set out to talk about buying funeral homes. I set out to talk about managing them.

This creates a dilemma for a buyer of a funeral home. How does one implement an effective profit management program when there are very few models out there? How does one actually implement a profit management program? It is highly unlikely that the information can be gotten from a friend unless that friend happens to be a member of the elite one percent who has effective profit management programs in place.

I will outline the basic requirements of a profit management program for you. It is a simple outline that does not require superior talent or an MBA. It only requires the ability to communicate effectively and the desire to be profitable.

The Planning Process

A written business plan is a prerequisite to becoming an objective driven Company. It is a singularly important element of business management.

In order to develop a successful business plan, one must assess and understand the strengths, weaknesses and opportunities inherent in the existing business. You have to understand who you are and how you fit and then, you have to decide where you ultimately want to be. This makes a strategic plan highly dependent on the goals of the owner.

The planning process has three very distinct steps. The first step is to define the vision, aspirations and objectives of the owner. The next involves building the strategic vision into a longer-term strategic business plan; more concrete, more priority sensitive, and more specific. And the final step in the planning process is to build a manageable business plan for the budget year based on the incremental accomplishment of the long-term strategic plan. The current year plan is specific, immediate, and focuses on the practical incremental accomplishment of the strategic business plan. It must be specific, communicable, capable of being accomplished, and capable of being converted to a budget. It establishes the short-term objectives of the Company.

The importance of the planning process cannot be overemphasized. It is the foundation of a focused employee team. A company without a business plan in place will wander aimlessly.

The Budget – a Means of Holding the Company Accountable

The budget process is a simple matter of converting the business plan into dollars and cents and then presenting the Company's monthly Profit and Loss Statement versus the Company's budget. The budget becomes the scorecard for the Company, the means by which one measures the success of the implementation of the business plan. The Company's monthly Profit and Loss Statement becomes, in effect, a scorecard by which one monitors, reinforces and modifies the business plan and its implementation. It is a primary measure by which the organization is held accountable for its results.

It is a common misunderstanding that the budget is used to reduce costs. On the contrary, the budget is often used as a tool to manage the impact of a specific budgeted increase in costs.

Reporting

Management by the seat of one's pants is ineffective and will, over time, cause the employer-employee relationship to erode. Management needs a scorecard to be effective. Management needs to know who is producing and who is not and, where the business plan is on track and where it is not.

An effective actionable reporting system is the cornerstone of profit management. Without it, the manager lacks the tools to be consistent and responsive to the needs of the business and its employees.

Pricing and Merchandising

Pricing and merchandising is a critical aspect of profit management. In most circumstances, it will account for 50% or more of the additional profit that is generated by a profit management program. It requires the following to be responsive to the needs of the Company and its customer families:

- 1) **General Price List** – The General Price List has to be clear, concise and focused on both family choice and Company profits. The GPL is, in effect, a road map for the over-all merchandising program. Even if the GPL is not considered to be a primary part of one's marketing, it is always a part of the message to one's employees. The GPL review begins with a critical contract by contract analysis of its revenue impact. The GPL is not about presentation. It is about results. A significant amount of revenue and profit can escape if the GPL is not prepared and monitored carefully.
- 2) **Showroom** – Do a critical review of the showroom to determine that it is equally responsive to the needs of the funeral home's client families and the revenue needs of the funeral home. The Showroom should be "family friendly." It should virtually eliminate the need for the funeral planner to be a salesman because funeral directors, for the most part, are not trained sales people. It only takes one misplaced unit to completely undo an otherwise great showroom.
- 3) **Reporting** - Determine and develop the reports that are needed by management to monitor the effectiveness of the pricing, merchandising and training programs. Make sure that the reports are actionable, actually prompt the appropriate action, and are universally understood.
- 4) **Communication** – Hold regular meetings of funeral planners to establish and reinforce objectives, assess their continuing development, provide consistent and structured feedback, and to provide regular training so each arranger's positive traits are reinforced and their negative ones are corrected.
- 5) **Service Level** - Continue to define and redefine the definition of service level and its practical delivery including post-service programs. It is easy to become complacent. Highly visible service is an important part of a profit management program

Some of the greatest successes that we have seen have come as a result of a client funeral home redefining itself and its service delivery. The particular funeral home to which I am referring experienced a 64% increase in its burial average (an increase of a little more than \$4,000 accomplished with almost no increase in prices) and at the same time, the funeral home experienced a 30% increase in calls. A transformation like this is not easy. It involves just that, a

transformation, but it starts with a renewed focus on the needs of the family, merchandising, the funeral planning process, and a focus on visible service level.

The implementation of a well designed and implemented merchandising and pricing program will allow families to make voluntary decisions that increase their satisfaction and at the same time increase the revenue and profit of the funeral business. It will allow funeral planners to have more time to do what they are good at, planning funerals.

As an industry, we suffer from the continued erosion of profits as cremations increase. I have worked for and in other service businesses and profit and service have always been co-equal objectives of the business plan. The “service only” focus of funeral homes is in my experience, unique to independent funeral homes and it will eventually become a drag on their ability to deliver a consistently high level of service to their families.

Every year when FFDA publishes its funeral statistics, there is a general malaise as we internalize the fact that the FFDA’s client funeral homes have experienced another decline in both the profit per funeral and the percentage profit per funeral. It would seem to me that every funeral home owner and manager would at some point, grab the bull by the horns, and spend the time and effort it takes to build a profitable funeral home.

A very basic profit management program will add substantially to the existing profits of virtually every funeral home in the US. It seems to me that even if one does not need the additional profit to improve facilities, upgrade one’s service level, replace a deteriorating vehicle or take a well-deserved vacation; it would at least help reduce the psychological impact of next year’s FFDA statistics, and that is worthwhile in itself.

This article gives you the framework for a profit management program so there is no longer an excuse for having an under-performing funeral home. Spend the time and effort and you will be more profitable (and happier too.) A well managed business is a thing of beauty.