

# If You Build It, They Will Come

***Not necessarily! Before building another facility to attract new business, first consider cost, revenue and cannibalization.***

Dear Dan,

I own and actively run a one-location, 150-call funeral business. My firm has a 40 percent non-casketed rate that is increasing. I am the largest operator in my town; my competitor does about 100 calls. He advertises that his services are cheaper than mine, although our market share has not changed for 20 years.

A town 10 miles away, surprisingly, does not have a funeral home. The prison is the largest employer in that town of about 6,000 non-incarcerated residents. I am thinking about building a funeral home in that town. I estimate there are about 50 calls. My competitor and I get about 25 of them and the rest go to a funeral business 10 miles on the west side of the prison. How do I proceed with going from one funeral home to two funeral homes?

Two Be or Not Two Be

Dear 2B,

There are three tangents of thought to be considered when expanding a funeral home into a new building or opening a new business. Only after reviewing each of these issues can we determine whether the benefit justifies the risk. Two of these tangents cover cost and revenue. The third factor is cannibalization.

Cost is the first concern. It includes the cost of construction and the land to be purchased. You cannot have one without the other. The cost of land and construction are the largest barriers to entry.

Land prices vary in each town and throughout the country. What does not vary is the size of the land you need. A small funeral home is about 6,000 square feet of building, a mid-size funeral home about 9,000 square feet and a large funeral home (enough to do about 300 calls a

year) is about 13,000-15,000 square feet.

The universal need, regardless of funeral home size, is land. Most of the land is for parking. You can put a small facility on two acres of land, but typically it's going to take closer to three acres.

If you want good sightlines of traffic, that land will be more expensive than the land three blocks off the main road behind the paper mill (downwind is even cheaper). Since the building is the largest investment in a business and is itself a form of advertising, being on a main road is usually a good idea. Being away from a paper mill is also usually a very good idea.

The cost of construction ranges from \$150-\$300 per square foot. Most funeral homes have simple construction needs. The modern funeral home is usually one story unless a second story has living quarters and/or apartments. A large part

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of the design footprint is garage. Some are building reception centers; others a retort within the building (which can cause some neighbors to attend your zoning hearing).

Years ago, a client built a retort on his cemetery. Many years after that, houses went up all around the business. One day, my client got a call from a neighbor complaining about his retort. The neighbor shouted that they could smell the retort's exhaust from their house a block away. My client calmly explained the use of the special chimney and the retort's high heat, which eliminated any visual sight or odor of emissions. The consumer complained again loudly, and finally my client just said, "Madam, we don't use teriyaki sauce in our retort. You smell your neighbor's barbecue!"

I think it's beneficial for anyone building a new funeral home who thinks he or she will be providing cremation services to at least 100 families a year to build a retort in the new building. It will pay for itself in about 12 years, over what you would be paying a third party.

Often, funeral home-building owners

try to control the area around their funeral home. This is an issue on main streets and in areas near hospitals and other developed areas. Imagine a confrontational business opening near your building. It causes a

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loss of reputation to the area. That is a big fear, but frankly, there are early warning signs to these seedy neighbors moving in and you should be aware of them. While you might think your property is hard to move, it is easier to move today than it was 50 years ago.

Finishing the construction requires you to have rugs, lights and furniture.

Just having the building but no livery is a mistake. You need cars to facilitate removals and transfers. In reality, the building, equipment, decorations, computers and furniture are all part of your construction budget.

Typically, funeral home owners build and own their own buildings. This is a balance sheet item. If you have a third party build the funeral home and you lease it, then it becomes a profit and loss statement item. Assume this building and the land on which it sits is \$1 million to construct. Assume your business builds this building. Now let us move on to the second concern.

The second item is revenue. Will you get enough calls to stay in business? Prior to your building in that town, families chose funeral homes, including yours, to serve them. You will need families to break their previous alliances to other providers. Some will, some will not.

If the locals choose you, will you get enough money from each call to remain in business? Twenty years ago, everybody was a casketed case. Not so today, so you need to look at the mix of business.



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In the olden days, price was not a big factor, yet today, price is influencing patronage. As we construct a revenue model for a new building, we have to look at the mix of business and the approximate pricing within the region. For example, if you add 25 calls to a mix, which results in an average revenue per call of \$8,000, that produces \$200,000 in revenue. You cannot generate enough profit to pay off a \$1 million loan on \$200,000 of revenue! If your market area has a 50 percent non-casketed rate and the revenue, on average, is closer to \$4,000, that's just \$100,000 a year. That will not generate any profit either.

Profit is the key. A 20 percent cost of merchandise on \$200,000 a year is \$40,000. That means you have \$160,000 a year to pay for staff, vehicles, advertising, insurance and mortgage. At 5 percent interest, a \$1 million mortgage will require principal and interest of about \$80,000 a year. With \$40,000 going to merchandise and \$80,000 to mortgage, that leaves very little for staffing, marketing and profit! In fact, it would be a loss no matter how hard you tried.

Also, there's no guarantee of patronage.

It's not as if a new island formed and a population inhabited the site overnight.

I had a client who built a new mortuary in a market offering about 120 calls after a few ministers begged him to build a new funeral home in their town. My client, without my review, built a \$2 million building and never got more than 15 calls a year! He lost his shirt. When we were hired, I interviewed the ministers. It seems they had been upset with the existing funeral home, as the owner no longer "cash-advanced" their honoraria. Their delayed gratification of \$100 cost my client his livelihood.

The third factor is cannibalization, which is the theory that you are already serving some of these families. Therefore, you are spending money trying to gain the additional calls. If there are 50 calls in a market and you are getting 25, maybe you'll do 25 calls in the new location the first year. Well, you are already serving those people, so you've spent money and have gotten nothing for it.

So, 2B, it looks like you want to build a place to do, at most, 25 more calls. It does not sound feasible. If you want to do

something to attract new clients, spend time prearranging as many people in that area as possible. If 25 people are coming to your existing facility, maybe you can get a few more each year. It's cheaper to do it with preneed than to spend big money building a building that will not give you any return on investment.

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