

Pricing Cremation

With a 40 percent cremation rate, you can't offer a discount to the majority of cases, and taxing the minority will not make a profitable year. You must allocate pricing to all parties.

Dear Dan,

I am working in a family business. My father owns the business and is 60 years old. He reads your articles but just grumbles when I ask him if we should implement any of the ideas. A few months ago, you had an article on setting prices, but when I told him we should do this, he said it was too complicated. Last month, he produced our 2015 GPL and just added 2 percent to most items. This is a real problem. We are making less each year, and I have not had a raise in four years because the business cannot afford it (but Dad's boat slip is still paid for by the company). We are now at a 45 percent cremation rate for the 200 families we serve and I know that pricing our services to cremation families is our weak point in the GPL. Is there a simple way to set prices for cremation consumers?

Signed, Pricing Problems in Pottsville, Pennsylvania

Dear "Pricing in Pottsville,"

I recently gave a seminar in Florida, in which I had 45 minutes to explain pricing for cremation. If you've ever attended one of my seminars, you would know that my bad jokes can take up half of my presentation time. Because I was unwilling to cut back on my jokes, I needed to settle on a simple approach for an audience that had a cremation rate ranging from 60 percent to 85 percent. Here's what I came up with.

The first step is to calculate overhead for the entire business. You can start with your accountant's profit and loss statement. First of all, do not worry about cost of goods sold as these are a variable expense, and since they are also a source of revenue, they are unnecessary to include in this simplified tally. Furthermore, we will only need to compute the gain from selling any merchandise.

Next, add a few additional items to

your operating overhead. I like to add these four:

1. *Non-deductible items:* These are things that you spend cash on but are not deductible in the tax code. Since they are not deductible, your accountant does not (should not) be including them in your overhead. For example, if you are paying off the purchase of real estate, each mortgage payment to your bank includes interest and principal. The interest is deductible and probably in your overhead already. However, the principal amount is not included in overhead. Life insurance is typically not deductible but is a cost of doing business. Many meals and other promotional items are also not deductible. Add up all of these things.

2. *Capital replacement items:* Currently, you take depreciation, and depreciation is included in your overhead. However, depreciation is a tax benefit on the purchase of capital assets used in your business. I am more worried that in the future, when these assets need to be replaced, they will be replaced at their future cost. So I want clients to start saving today for those future items. For example, a new roof might be \$20,000. If the current roof might be expected to be replaced in 10 years, I suggest that a client put \$2,000 a year into overhead and put that money into a segregated bank account. Do the same thing for furniture, fixtures, carpeting, automobiles, computers and other capital assets. Add these up and add to your overhead.

3. *Minimum profit:* I find that if a funeral home builds a minimum profit into its overhead, the firm winds up with a profit. The way to estimate what this minimum profit might be could be a function of the value of your business. If the business is worth \$1 million and you are a very conservative person, you might assume that you should get a low interest rate on that,

as your minimum profit. If you are more aggressive, you would assume a higher rate. So if you thought you were entitled to a 5 percent return on your business value, you would multiply the value by 5 percent and add that to overhead.

4. *Taxes:* We have to pay taxes. Every year, I read about one funeral home in some part of the country that hasn't paid federal or state income taxes. The owner will present himself or herself to the court, exclaiming, "I am a good funeral director but a bad businessperson. Please have mercy on me!" It's not that tough to pay taxes, but often your cash is limited. By putting taxes into your overhead, you can guarantee that you will have the cash to pay them.

So now we have the direct and indirect costs of operation. For the sake of this example in Pottsville, let's say total overhead is \$1 million. With a cremation rate of 45 percent, burial families must account for 55 percent of total overhead and cremation families 45 percent. Therefore, cremation families should provide for \$450,000 of revenue.

This first leap of faith is important. I constantly see funeral homes with GPLs that say something like:

- Basic Non-Declinable: \$1
- Removal: \$1
- Transport to Cemetery/Crematory: \$1
- Cremation Fee: \$0.50

While this totals \$3.50, their FTC-mandated cremation package pricing will be \$2.75! In fact, several years ago, my firm did some research on this and found that about 90 percent of all funeral homes were pricing this artificial discount. I do not know who promoted this discount, but if we can discover who it was, let's visit the grave and hold a vigil – we must exorcise this from the profession!

When cremation was 5 percent of your business, you could make all of the mis-

takes you wanted and it didn't really hurt your business. The only way to give a discount to the minority is to assess a premium on the majority. However, with national cremation averages at 40 percent, and Pottsville at 45 percent, you can see that you cannot offer a discount to the majority of consumers. Taxing the minority of cases is not going to get you a profitable year. So Pottsville, regardless of the math, you have to allocate pricing to all parties.

Now it's just a matter of creating our hypothetical pricing model. Make a chart in a spreadsheet of the total services and merchandise offered to families. It should look something like this:

	Number of Events	Price	Total
Basic Non-Declinable			
Removal			
Sanitation Care Only			
Embalming			
Transport to Cremator			
Visitation			
Service			
Profit From Sale of Urns			
Profit From Sale of Caskets			
Rentals/Sales			
Cremation Fee			
Total			

You may have other items to compute. In that case, build them into your chart, as this is simply an example. Next, start to estimate the case count you will have. Last month, my column answered a note from Counting Cases in Cleveland, so I won't repeat the method of estimating case count here again, but feel free to reference it at either www.nfda.org or www.f4sight.com. If you are doing 200 cases in Pottsville, with a 45 percent cremation rate, you would assume 80 total cremation cases, as shown in the next chart.

Next, we want to guess at the allocation of a service fee for each event. Again, please keep in mind that this is simply an example. This is not an attempt to establish pricing for funeral homes, but the analytics can be illuminating. We are trying to generate \$450,000 in service fees from cremation consumers, so the sum total of the fee charged for each event multiplied by the number of events in the aggregate must equal or be greater than the objective.

Now, Pottsville, I know this is getting

	Number of Events	Price	Total
Basic Non-Declinable	80		
Removal	80		
Sanitation Care Only	60		
Embalming	20		
Transport to Crematory	80		
Visitation	30		
Service	20		
Profit From Sale of Urns			
Profit From Sale of Caskets	20		
Rentals/Sales	30		
Cremation Fee	80		
Total			

a bit complex, but trust me, on a spreadsheet, this can be done in five minutes! So my first go at this is:

	Number of Events	Price	Total
Basic Non-Declinable	80	\$2,000	\$160,000
Removal	80	\$500	\$40,000
Sanitation Care Only	60	\$450	\$27,000
Embalming	20	\$750	\$15,000
Transport to Crematory	80	\$250	\$20,000
Visitation	30	\$500	\$15,000
Service	20	\$500	\$10,000
Profit From Sale of Urns			
Profit From Casket	20	\$50	\$1,000
Rentals/Sales	30	\$300	\$9,000
Cremation Fee	80	\$350	\$28,000
Total			\$325,000

As you can see, the first go-round does not work. Our goal is to generate revenue of \$450,000, and with this allocation, we generate only \$325,000. I know there are some items not shown on this chart in services and merchandise, but they are nominal. This leaves us with two options: Reduce overhead (ready for a pay cut, Pottsville?) or raise the prices on services.

If I am going to change anything with service prices, let me change the GPL items that will result in maximum benefit. I would strongly recommend that you have your Basic Non-Declinable be the same for all cremation and burial consumers. That is what it was intended to be in 1984 and should be now, 30 years after the FTC Funeral Rule. You might also find that a removal costs you more than you think. Or the embalming or care of a body could be two hours of a \$50/hour job, plus require a specialized work space. That could be charged as a profession-

al would charge for it. You might work harder at merchandising urns or casket rentals.

Furthermore, the cremation fee could be set higher; after all, it is a \$125,000 investment in equipment and at least two hours of a specially trained operator's time. So go back into the spreadsheet and reallocate different fees until you hit your total overhead.

Pricing Problems in Pottsville, I understand that adding 2 percent to the 2014 GPL is easy for your father. The problem is we are assuming that the 2014 GPL was set correctly, which it wasn't. I encourage you to remind your father that in 1984, someone guessed at the GPL allocation. We have added a bit to that guess each year, and coincidentally, I'll bet your profitability as a percentage of revenue has been on the decline each year since.

You may also hear from Dear Old Dad that you can't allocate your prices this way because the competition is charging less. Please direct him to the September 2014 issue of *The Director* and show him the chart on page 54 that reveals that only 10.3 percent of consumers use pricing as a main reason for choosing a funeral home. Then remind Dad how many times he has told you that the competitor is an idiot and conclude with the fact that setting your prices based on the pricing of an idiot is not going to reward you in any way. *

Daniel Isard, MSFS, is president of The Foresight Companies LLC, a Phoenix-based business and management consulting firm specializing in mergers and acquisitions, valuations, accounting, financing and customer surveys. He is author of several books and host of The Dan Isard Show at www.funeralradio.com. He can be reached at 800-426-0165 or danisard@f4sight.com. For copies of this article and other educational information, visit www.f4sight.com. Connect with Isard and The Foresight Companies by following them on Twitter at [@f4sight](https://twitter.com/f4sight) or on Facebook.

The financial and tax advice contained in this article is for informational purposes only and may or may not apply to your individual position. Readers are strongly encouraged to seek the counsel of qualified advisors before undertaking any action based on this information.