Re-Engineering Your Business: Increasing Merchandise Profit

Revenue is *the* key factor to consider when managing your business, akin to altitude for a pilot or air for a scuba diver. If you were a pilot and discovered you had a problem and had plenty of altitude, you would have time to find a solution. As a scuba diver of 30 years, I know that anything that could be a problem can be dealt with as long as I have air in my tank. As a business owner, revenue is the most important factor for you to meet in order to produce the best chance of a success for profit.

I know many of you come into this business to be able to best serve families with compassion and professionalism. Profit is not your goal, but it should be. Profit is not a dirty word. Without profit, you cannot serve families with the best staff, the best education and the best tools. Being understaffed is a problem, as staff burnout can be a big factor. Not having the best education is problematic because it does not allow you or your co-workers to be trained to serve families with superlative services. Profit allows you to keep your capital expenditures up to date, facilities maintained and vehicles commensurate for your brand name. So, please, understand that profit is important. Lack of profit is a terminal problem, so we need to make sure the revenue is right!

In last month's column, I dealt with the concepts of understanding your overhead. Revenue must be equal to or greater than overhead. Please take a few minutes to reread the January column because I am going to demonstrate how to get your revenue where it needs to be and I do not want you to chicken out!

Revenue comes from two components:

- Profit from the sale of merchandise
- Service fees.

Unfortunately, over the past 30 years, we have gone from a "Merchandise Business Plan" to a "Service and Merchandise Business Plan." In 1980, a family came in and picked out a casket. For the price they paid for the casket, they got everything else thrown in. It was a package. In fact, it was that way for hundreds of years in the United States. I once did a valuation for a funeral home that had been continuously operated since 1785 and got to see some of the records that had survived. The oldest was a receipt from 1815. The ledger statement said, "Casket $7.95," and since this was long before embalming, it was the total cost of what the family paid that funeral director for the casket, the removal, the livery to transport the casketed body to the cemetery, care of the body until the funeral and preparation of the body. I found it funny that as I read the balance of the ledger, I found that other than embalming, things had not changed much. The balance of the ledger said, "Casket $7.95; Paid $3.00; Owe $4.95." Even back then, funeral homes had receivables and I am sure they also had bad debt.

I am not, due to fear of government violations, trying to write something that looks as though I'm attempting to organize pricing for all funeral homes. Everyone's overhead is different. The price any two firms charge should factor in each of the overall objectives of their business. I mention this because when it comes to setting pricing on merchandise, there are different methods to use. Each business manager gets to determine the way he or she prices merchandise. Each method leads to different results of profit from merchandise.

There are three main ways business managers set their prices on merchandise. Allow me to summarize these without prejudice:

1. *Flat dollar amount.* It's not used very often, but some people add a flat dollar amount to the cost of each piece of equipment. For example, if a casket costs you $1,000 and you wanted to add the same profit to all caskets, you would add that magic markup on each unit. So if the magic markup was $500, that unit would be sold to the public for $1,500.

2. *Flat markup percentage.* Most mark up merchandise by a similar percentage. If you wanted to add a markup of 100 percent to this $1,000 casket, you would sell the unit for $2,000. This is a great profession, but it doesn't understand math; most funeral home managers would call this a 2.0 markup. It isn't. It is a 1.0 markup!

3. *Bell curve.* This is a complex method intended to have a different markup on units at the low end of the price spectrum versus those at the high end. You might have a 200 percent markup on lower-cost caskets and a 100 percent or lower markup on more expensive caskets.

There are problems with all of these methods. The first is that most funeral directors have contracts with their suppliers that give "discounts" equal to some percentage. Of course, so many of these "discounts" are contingent on your total production because if you don't sell the required minimum number of units, you might not get that full discount. So the problem is, do you mark up the unit from the gross cost (base cost before any discount) or the net cost (the base cost less the discount)? Almost all of the hundreds of funeral homes for which I see financials, regardless of the three types of markups you can use, set their markup on the gross cost. That doesn't mean it is right, but it is part of the complexity of setting your prices.

Not only is itemized pricing of service fees difficult, but the portion of your overhead that you expect to recover from your merchandise is affected by trends of service. We have seen in all parts of the country that partial services are increasing. They are partial services, in part, due to the lack of merchandise sales. We have had a flat number of caskets sold throughout the country for about 10 years, even though the number of deaths has increased in most of those years. The difference is due to families choosing non-casketed services.

The number of non-casketed calls is increasing, and as they increase, your profit from merchandise will decline. That becomes a problem in planning your revenue. So we need to be conservative. Look at your case count for the last three years and break it down by casketed, non-casketed, a ship in/out without a casket sold and indigent/children.

When setting objectives for merchandise pricing, we are looking to see the casketing trend, which in most cases is declining. To plan for your revenue, you need to pay attention to the trends. The trend for burial, and therefore dependence on a casket, is declining. In 1980, there were about two million deaths and in 2012 about 2.5 million. However, there were about 1.8 million burials in 1980, but about 1.4 million burials in 2012.

So if the casket rate is declining, we have to beware when planning for the portion of revenue to come from this area. If you have fewer casket sales, you may also have fewer vault sales on a 1-to-1 basis. When looking at national figures, the average lost gross revenue per call from each casketed call that becomes a non-casketed call is about $1,500. That gross revenue is not made up on the profit from the sale of an urn!

Look at the chart below:

	2011	2012	2013
Casketed	100	95	90
Non-casketed	20	25	30
Ship in/out without a casket	5	5	5
Indigent/children	5	5	5
Total calls	130	130	130

	2011	2012	2013
Cost of goods sold	$130,000	$135,000	$140,000
Total calls	130	130	130
Average wholesale/call	$1,000	$1,038	$1,077

So, if you are to set your expectation of casketed cases for 2014, would you use a three-year average? No! Would you use the 2013 number? No! In my opinion, you could use 85 percent or 90 percent of the most recent number. You have to get ahead of these trends.

If you use 90 percent of the 2013 number (that's 81), now there are three things that will happen. At the end of 2014, you will either be at 81 casketed calls, more than that or less than that. If you budget for 82 casketed calls and hit 82, then there is no problem. If you budget for 82 and do more, you will have more gross revenue, and that again falls into the "no problem" category. If you find that you are tracking through the year with a number lower than 82, maybe you need to adjust your pricing mid-year (there is nothing written in stone that says you cannot change your pricing mid-year).

The biggest consideration is: "What is the average merchandise that you are selling?" To answer this, we look at a key calculation – the average wholesale/call. We all know the average revenue/call, but we don't do the same computation for cost of goods sold (COGS). So, look at your COGS and divide it by the number of calls. Using the chart, let's compute average wholesale/call.

Do not assume that the future is going to increase more than a nominal amount. In this chart, average wholesale/call is increasing about 3 percent to 4 percent over the previous year, so I would estimate that the 2014 average wholesale/call is going to be about $1,110. Then apply your markup to this. If we are using a 100 percent markup (as an example), then we can estimate that our profit from merchandise/call is going to be about $1,110. If I now assume that I will do 82 calls, I can guesstimate that my profit from merchandise is going to be about $90,950 (82 x $1,110, as an example).

So far this year, we've dealt with establishing your overhead and the first step toward meeting that overhead from your merchandise. In March, I will lead you through setting your itemized prices. Then in April, I will do the impossible and explain how to re-engineer revenue via packages (where allowed by state law). Stay tuned… ✶

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