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Re-Engineering Your Preneed

There is no subject in funeral service today fraught with more misinformation than preneed. Funeral home managers "do" preneed. That means they write it and honor it as part of serving families. The reason it is a big part of our re-engineering series is that most funeral home owners do not have any standards of production and service. My goal is to create those objectives so we know if the preneed dynamic is performing in a businesslike fashion.

Preneed has always been a simple idea. The idea is that human beings are the only creatures on Earth who know their days are numbered. Therefore, just as we plan for other life events, we can plan for the inevitable. Writing a preneed helps families plan for their death in advance. Unfortunately, this simple service has been flawed in so many ways. And by flawed, I mean from the perspective of:

- Writing preneed contracts
- The contract itself
- Funding sources
- Guarantees
- State law
- The costs of acquisition and marketing.

The first question I ask myself when analyzing a client's preneed contracts is, "Is his or her profit margin the same on a preneed call as it is for an at-need call?" If it is, he or she is on the right track. If not, then we have to determine the reason it isn't.

To answer this question, we add up the value of all of the preneed contracts and divide it by the number of preneed contracts. This is the average revenue/preneed contract and has the same merit as average revenue/at-need contract. The two ratios combine for average revenue/call.

One of three results can be expected:

1. *Average revenue/preneed contract is higher than average revenue/at-need contract.* This is the desired result. In fact, it is the result we see about 65 percent of the time. It is this way because we tend to see more casketed calls prearranged than non-casketed calls. For example, if the casketed/non-casketed mix for the overall business is 60 percent/40 percent, for the preneed business segment, it would not be unusual for the mix to be 80 percent/20 percent. Most consumers think cremation is inexpensive, so they don't prearrange for this type of service. This is a benefit to prearranging; I call it the "peer pressure of cremation." If your non-casketed rate is 40 percent today, do you expect it to be higher into the future? You certainly should since the consumer attitude toward choosing cremation is increasing. Therefore, many of the casket-favoring consumers today will be converting to cremation before their death, which we see in the Wirthlin studies.

2. *Average revenue/preneed contract is lower than average revenue/at-need contract.* This is not the norm and is, in fact, indication of a problem. It could be because you're writing more non-casketed preneed than casketed. It can also be due to your funding source not producing a higher crediting rate each year, which is an indicator of lower revenue and earnings in the future, which means lower business value as well. The only solution is to write more preneed contracts and try to secure more market share. Also train your preneed agents to understand all of the options for cremation services. Another solution, and one very few funeral homes will do, is to resolicit your preneed accounts. Find other items (services and merchandise) to try to add to the existing preneed consumer's contract.

3. *Average revenue/preneed contract is the same as average revenue/at-need contract.* This middle-ground result is not good or bad but does require additional scrutiny. We need to look at the individual preneed contracts for answers. What is the casketed/non-casketed mix for the preneed contracts? If it's the same as the current mix of at-need contracts, it is comforting. However, it usually indicates a higher casketed mix in your preneed, so that means you have funding problems. Another aspect to probe is the length of time from writing the preneed contract to servicing it. In most cases, this is about 50 percent within the first eight years. Another is to understand the mix of single-pay and multi-pay contracts. Almost 80 percent of all preneed contracts are single pay and are generally written on consumers age 78 or older. The multi-pay average age is about 72. With multi-pay, the average length of time from writing the preneed contract to service is about 10 years (50 percent mature within 10 years and 50 percent mature beyond 10

years). So younger people are going to be on the preneed books longer than older people. This makes the crediting rate important.

I am always leery of using this word, but I must – "shortfalls." A shortfall is the difference between a preneed contract value and what the equivalent value would be if the same arrangement was billed out on an at-need basis. The only reason anyone would have any shortfalls is the guarantee. If you guarantee your preneed, you will have shortfalls. The more multi-pay you issue, the more shortfalls. The lower the crediting rate for trusts or insurance, the more shortfalls. Most readers know I am not a fan of the guarantee.

I have studied funeral service inflation rates for 30 years and can tell you that the cost of doing business goes up each year. It has gone up more than the Consumer Price Index in 29 of the past 30 years. So with casketed calls, you cannot make that guarantee. I know there are some insurance companies that have teamed up with casket companies to fix the price of the casket. That's great. However, the casket is about 20 percent to 25 percent of the total cost of performing a funeral. Who is going to offset the other 75 percent to 80 percent of those costs for you?

The funding crediting rate is a problem only if you guarantee. There is no way you can invest money long term and outperform the funeral service inflation rate without taking significant risk. We have seen what happens when you take risks. We have seen many state associations try to get a higher yield and fail. With no guarantee, the consumer takes the risk. But the risk is for the consumer to absorb anyway. As a consumer, you take a risk when purchasing items; so do consumers when planning their funeral. To manage that risk, consumers can overfund the value of the assets and, when death occurs, get a refund.

I have argued against the guarantee, but I can also make an argument in favor of it. The argument, unfortunately, is not applicable to most readers. To guarantee and be successful, you need to have an overall increasing case count, with that increase coming directly from preneed cases. Imagine a firm does 100 at-need calls and 30 preneed calls. If half of the 30 preneed calls have less revenue per call than at-need calls, it's a problem. However, if you can increase the number of preneed contracts served to 40, there may actually be a financial benefit. Assume the 10 extra preneed cases have a shortfall of 10 percent. If you get 90 percent of your at-need revenue/calls for the 10 additional preneed contracts, you will be doing fine. Remember, your cost to service those additional calls is just a little more than the cost of merchandise and part-time labor. If these calls cost you 30 percent (cost of goods and labor) of the dollar received, even getting 90 percent of your at-need revenue/call gives you an extra 60 cents of profit on these extra-calls dollars. That is because funeral service is such a fixed-cost business that additional calls, above your anticipated budget, have a high profit margin.

Regardless of the client's domicile, we also have to understand the effect of state law on their preneed funding. Different states have different funding requirements and different rules on the earnings of a trust. One state may not allow insurance and another makes insurance almost mandatory due to its restrictions on trust operations. Some states allow preneed to be portable to the consumer and others do not. We ultimately should work for one universal preneed law or a congressional committee will do it for us.

Many insurers try to argue that their commission is to be used for the cost of acquisition, but no one seems to really understand what that cost is. Trust companies tell you to pay those uncalculated costs out of your operating expenses because you will get more paid at the time of service. The key is to know what your costs of acquisition are on a per-contract basis. This cost is the advertising and commissions paid to the writing party. I have seen this be around $800 per contract. Most of you would not guess it to be that high.

The objective for a funeral service provider's preneed program should outline:

- The number of new preneed cases they are going to write each year
- The mix of preneed business they are servicing each year
- The revenue per call on preneed cases relative to at-need cases.

The average funeral home writes new preneed contracts equal to about 30 percent to 40 percent of total cases each year. So if you are going to guarantee, you have to increase the preneed contracts written to equal 50 percent to 60 percent of your annual case number.

The average funeral home services about 30 percent of its total calls as preneed. If yours is lower, it could mean you are writing more multi-pay contracts, so it is just a matter of time as those calls will be on the books longer.

The goal is that preneed serviced should be equal to the at-need. If not, examine with whom you are entrusting your preneed deposits. If your preneed is higher than at-need, it probably means you are not raising your prices according to any mathematical need. Don't worry about this – the bankruptcy trustee will do it when he or she takes over.

If you can control the items mentioned above, you will have a solid preneed program. This should be part of your overall marketing program since it's a service for families and will help your overall business stay strong. ✶

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