Daniel M. Isard

Re-engineering Your Business Revenue

The purpose of setting revenue to a predictable point is to protect your business.

For the 2014 Finance columns, we will chronicle a concept called "re-engineering," in which we'll delve into the financial operations of a business and look at specific components in addition to looking at it from a holistic perspective. The first segment pertains to revenue. Therefore, this first column will follow through on how funeral home owners/managers can increase revenue.

Funeral homes are divided into many categories. Some are positioned in high non-casketed communities, while others still have 80 percent or more of families using a casket in their service. Some businesses have more than 30 percent of their calls resulting from preneed services, while others are at that point and many are lower. Some firms have a high use of facilities – more than 70 percent for visitation or services or both – while others see less utilization of their facility. There has never been a greater divide than there is today. It is my hope that by providing several examples in each column you can associate with one of them and determine how to make some of these changes for your firm.

It's important to note that I am not trying to get the entire North American funeral profession to unite on prices. But I *would* like to see the entire profession use more analytics when determining overhead and set prices and merchandise markup based on analysis. As it is, we so very often make two major mistakes in setting prices.

When I first meet a client interested in re-engineering his or her revenue, I ask one simple question: "How did you establish your prices for your General Price List this past year?" Before you read any further, please answer this question in your own head. The two answers I tend to hear are:

1. Dan, I add a little bit to last year's prices.

2. Dan, I try to be a little bit higher/lower than my competitor.

To the first group, I give a comforting smile and ask, "How do you know your prices were validly set the year before to produce the profit you want for your business?"

Imagine, if you can, the first GPL your business set in the mid-1980s. *That* was a wild guess. The entire profession was mandated by the government to go to itemized pricing after mostly having used a package pricing model. So the business owner almost 30 years ago probably guessed how to put a price on each GPL line item. About 29 years ago, that original GPL was adjusted due to inflation, but it was probably increased by the Consumer Price Index. Unfortunately, CPI has no legitimacy to the true increasing annual overhead of a funeral home, yet this factor was used year after year. Thus, the original GPL was probably set incorrectly and every year thereafter, it was increased by some factor that had no basis in reality. It stands to reason, therefore, that pricing today is probably wrong because it's been wrong for almost 30 years!

To the second group, I also pose a simple question: "Does your competitor have the same overhead you have?" Setting your firm's pricing this way is akin to being on a diet based on your competitor's food intake. Your height and weight are probably different, as is your caloric burn rate. So setting your prices based on the competition is outright silly. (I use the phrase "outright silly" because my editor prefers I don't curse in this column. In person, however, there'd be another two-word phrase I would use!)

The purpose of setting revenue to a predictable point is to protect your business. Revenue must be equal to or greater than overhead + desired profit. So before I can re-engineer revenue, I have to know about overhead.

I hope you get a profit and loss statement from your accountant, bookkeeper or internal accounting software, as this is the perfect place to start to estimate overhead since the P&L records your deductible items of overhead. However, you may have to add a few items, as there are many bills you pay that are not deductible. The largest of these is usually the principal payments on your debts. Then you also might want to add an annual reserve for capital expenditures. Your overhead will show depreciation; however, depreciation is a tax-driven number. In reality, we need to establish a capital expense budget that will systematically set money aside for significant repairs and new assets. I also recommend that a client estimate his or her federal and state income taxes and put that into the overhead numbers as well.

Lastly, I would advise a client to build profit into his or her overhead. Profit should not be a surprise at the end of the year – it should be an objective of operations. If we tell our staffs, "I will pay you a salary," and tell our bankers, "I will pay back what I borrow," why do we tell ourselves, "I will work very hard and hope to see a profit." No! A profit should be part of your overhead. If you are going to estimate how much this profit should be, certain computations can be used to help derive that amount. For example, we can use investment value. If your business is worth $1 million and you think you should get a profit equal to a return on investment, then determine it based on ROI. If you think 5 percent is reasonable, then profit should be $50,000. Someone might assume a profit should be a higher or lower percent of investment value. It helps to have an accurate valuation of your business to use this method.

We take the operating overhead from the P&L and add:

- Non-deductible overhead
- Capital expenditures

- Income taxes
- Profit.

When these are added together, we arrive at total overhead. Most business owners have never done this. For some, that fact demonstrates an error in setting their pricing, which is a dramatic realization. However, it happens to be accurate. So the revenue that will be sufficient to provide total overhead will come from two sources: profit from merchandise and profit from service fees.

To determine merchandise profit, we have to assume what we will sell to families and in what quantity. Frankly, this is not too complicated. Look at Example 1.

Example 1

	2011	2012	2013
Retail Casket Sales	$200,000	$205,000	$210,000
Number of Caskets Sold	100	96	92
Average Retail Casket Sold	$2,000	$2,135	$2,283

So if I were to assume retail revenue from caskets, I would assume something slightly higher than $2,300. However, I would also assume about 85 to 88 caskets sold. You can do the same for vaults and each piece of merchandise you sell. That will set your gross revenue from merchandise. Then I just have to divide by my markup. Given this example, look at Example 2.

Example 2

	2011	2012	2013
Wholesale Casket Cost	$100,000	$103,000	$106,000
Number of Caskets Sold	100	96	92
Average Casket Cost	$1,000	$1,073	$1,152

I would assume that on caskets, I would have an average of about $1,200 on 85 to 88 sales. I can do the same thing for each component of merchandise and I am then able to subtract from my total overhead my merchandise profit.

Next up is net overhead from service fees. The objective is to allocate the needed service fee revenue items of the GPL to get the outcome you desire. The single greatest error in setting prices in a funeral home is the inability to allocate the correct amount to the non-declinable service fee.

To understand this, allow me to take you back into history to the darkest days of funeral service. The time was the early 1980s. The place: the cold, musty meeting rooms of the FTC in Washington, D.C. Sitting on a hard, uncushioned chair was Howard Raether. Unfortunately, funeral service is starting to forget Raether, who was the executive director of NFDA during the initial FTC hearings.

As I understand the way things went (because at the time, I was a mere child sitting on my Uncle Murry's knee), funeral service was being eviscerated by the FTC. Raether's version of a Hail Mary came when he started to explain the importance of an idea that ultimately became the basic non-declinable service fee. Raether explained that every family, regardless of what services or merchandise they used from a funeral home, should be required to pay for this unassigned overhead. There is a cost to providing services to a family that is a flat fee based on general overhead. The brash FTC staffers were unable to refute this notion and acquiesced to it. Funeral directors the nation over could be heard shouting Raether's name in joy based on this limited victory on Monday, while on Tuesday morning, they started to find ways to give up this limited triumph. Year after year, funeral home managers and owners have worked to give up this victory a little bit at a time. Yes, we need to go back to 1984 and really embrace that non-declinable service fee.

This fee is supposed to be paid by every family, regardless of what type of service they choose. Thus, this should be paid by families wanting burial and those wanting a direct disposal. Families requesting a shipping case (either in or out of the country) should be paying this also. So, you see, sometimes it's not the math that's the problem in setting prices but the failure to employ logic to the matter.

Next month, I will address allocating the GPL line items. Do not throw this article away. Either clip it and put it into a separate binder or file it in a specific folder on your computer. Save this and each of this year's columns. I will also provide videos on my website *(www.f4sight.com)* that will take you through the math in greater detail and example. ✶

Dan Isard, MSFS, is president of The Foresight Companies LLC, a Phoenix-based business and management consulting firm, author of several books and publisher of Preneed Perspective. *He can be reached at 800-426-0165 or danisard@f4sight.com. For copies of this article and other educational information, visit* www.thefuneralcoach.com. *Isard also produces a semi-monthly video blog at* www.f4sight.com. *Connect with Isard and The Foresight Companies by following them on Twitter at @f4sight or on Facebook.*