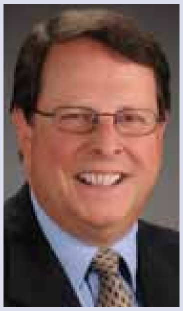
**by Daniel M. Isard, MSFS**



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### ICCFA Magazine spotlight

➤Isard 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.

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### More from this author

➤Educational information, including copies of this article, can be found at ***www.theforesightcompanies.com***

➤You can follow Isard on Twitter at *@f4sight,* LinkedIn and "like" The Foresight Companies on Facebook.

### Editor's note

The Cemetery Impossible column is written by the staff of The Foresight Companies. **If you have a question you want to be featured in this column, please send it to danisard@theforesightcompanies.com.** Dan Isard or a member of his staff will call you to get more information and a recommendation will be provided via this column, helping not only you but also others who are facing similar challenges.

**MANAGEMENT**

Funeral and cemetery businesses continue to be attractive to investors. Everyone dies, so they're a sure thing, right? As we've seen over the years, that's not true. Buying a successful operation and being able to build on that success are two different things.

# Why is it hard to manage a national company?

"Why have some national companies had problems?" I have gotten this question more than any other one I have been asked in the past the years. I entered the funeral/cemetery world in 1984. There were several small- to medium-sized companies with big ideas. Many were privately owned. One was a public company.

By the early 1990s, there were several that had crossed over from the privately-owned world to the public world. Public companies have a duty to inform their shareholders about their business. The business plan they aspired to fulfilling was:

1. Buy multiple businesses
2. Operate multiple businesses in an area
3. Bring in operating synergies to those businesses
4. Acquire merchandise and capital assets at better prices through quantity discounts
5. Maximize staff efficiencies
6. Have a lower cost of capital
7. Make more profit

I have seen the history of companies growing, shrinking and selling off. I have followed the bankruptcy pleadings of some private companies and the few public companies that sought protection from creditors via the bankruptcy courts. I write this column with no agenda or conflicts. These are my opinions.

## The business model was not right

The business model had flaws. It is not that the national and regional companies could not buy businesses. They could. They did. When someone thinks their business is worth $2 and you offer them $3, and they have no succession plan, you will buy many businesses.

It's the operations part of the model that was flawed. Companies were more focused on acquisition and less on operation, and it showed. If you bought a funeral home doing 200 cases a year and you took your eyes off operations, within a few years that business was serving about 150 families a year. In some cases, companies thought they could raise prices to make up the revenue shortfall. That just accelerated the decline in location case count.

For many years, the analysts for brokerage houses were analyzing the big companies by their total revenue or total case count or profit. However, when a company is buying new businesses each year, you have to imagine they will have increasing revenue, case count and profit.

It was not until the early 2000s that analysts started to run an analysis called "same store sales." Analysts compared a company to the locations that had been on line the previous year, omitting the new acquisition results. This showed the decline in revenue, cases and profit in many cases.

It turns out that in many cases, the operating synergies could not be capitalized upon. Synergies from common benefit providers, software, insurance and other non-essential areas of operation could certainly be put in place.

However, the largest costs of operating a funeral home or cemetery business are in staffing. In a cemetery, grass grows at the same speed regardless of who owns the

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cemetery, therefore property maintenance cannot be reduced. Sales need to take place at each location, so there is no synergies in that dynamic of staffing. Accounting, recordkeeping and other costs of a funeral home or cemetery are what they are.

There may be some savings over time, but they add up to a small amount because funeral service is a 24-hour-a-day staffed business.

The lower cost of capital is a benefit of the growth of acquisition companies. However, the debt in the operation of the business is rarely paying down the principal. Therefore, some companies grow but their debt also grows.

Imagine what the benefit would be if these large companies paid down debt systematically? The large operators of funeral homes and cemeteries would resemble a utility stock, spinning off large dividends and therefore bringing shareholder value based upon the annual dividend.

## Lost focus

One company, now bankrupt and absorbed into many others, is a perfect example of what happens when a business manager loses focus. Imagine you buy a funeral home. The soon-to-be-former-owner is willing to hang around as a manager and consultant.

The semi-retired seller is told they will get a base salary and a bonus of about $5,000 if the business makes $X or more. To the semi-retired former owner, this seems wonderful. The public sees the former owner is still there, so market share doesn't shift.

Then, the acquiring company says to the now-former-owner, "Hey, find some of your buddies to sell to us and we will give you a bonus based on the purchase price." That bonus is more than the seller would make in three years of operations. What do you think happens to the focus of the former owner? This was not happening to just one or two people. It happened system wide. The former owners became recruiters and lost the focus on their local business. Therefore, market share shifted. Therefore, company profits declined.

Large businesses have to keep everyone in the organization focused on the operating goals. When two goals compete for the attention of an employee, we generally see failure in both goals.

Essentially, when a large company pays $1 million for a business, they are then going to a manager and saying, "please manage this $1 million investment for us." There are not many people capable of managing a $1 million funeral home or cemetery. Now, what happens if we look at $2 million or $5 million businesses?

When I refer to the importance of staffing, I'm not just talking about the people needed to run funerals or sell cemetery interments, I'm also talking about the people needed to manage that investment, to keep it safe and growing.

## The financial capital

Borrowing money is inversely difficult. It may be difficult to borrow $1 million, but borrowing $10 million is actually easier. When you look at these large private or public companies, they are borrowing hundreds of millions or even a billion dollars.

Funeral service and cemeteries are secured loans, but not in the form of tangible collateral. They are secured by their cash flow. In our 21st century world, we have learned to live with "disruption."

Disruption is when the traditional mode of operations changes. We see it in this business every day. However, what we do not see is a cure for death. Therefore, death is going to be a business *ad infinitum*. Financial markets love this.

Prior to a famous bankruptcy in the late 1990s, of all of the standard industry codes, funeral service and cemeteries had the second lowest rate of bankruptcy! There were about 8,000 SICs and only benevolent associations had a lower incidence of bankruptcy.

Of course, we have had some large and famous bankruptcies since then. That is because funeral service and cemetery businesses require someone who understands the "calling" and also can run a business successfully.

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Since the 1980s, there have been many people wanting to come into the funeral and cemetery sphere to invest. There is even more intelligent money waiting in the shadows to come forward to invest in this business.

They may not understand the business model, let alone the fractured points of the business model. They do know that there is a predictable return on their investment by owning funeral homes, cemeteries or companies supplying goods and services to these businesses.

## The future

So, are we past the possibility of any more bankruptcies or financial failures? Absolutely not. This is a tough business. In funeral service there is:

- A large capital investment in facility and equipment
- A large fixed overhead
- A shrinking labor pool
- A change in consumer utilization
- Antiquated state laws regulating the operations

On the cemetery side, we have even more difficult operating issues. We see:

- A change in consumer utilization
- A large investment in illiquid assets that are converted to inventory
- A reliance on an advance sales staff to generate income
- The need to have income from trusts that are part of the operating business and which are subject to various investment risks

Finding investment capital is not the problem for the future. Finding human capital to run these businesses successfully is the biggest issue.

I suspect we will have some failures of funeral homes and cemeteries. I suspect businesses will be bought and sold to meet the needs of the lenders. In multiple-location businesses, I suspect some location assets will be sold to repay lenders.

We must learn from the past or we are doomed to repeat mistakes. ❒