FINANCE
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Key Performance Indicators You Should Follow, Part II

My Knowledge Transfer Plan, Chapter 18

As I explained in last month's column, key performance indicators (KPI) are simple mathematic equations that can help you run your business. When calculating these analysis points, the results are usually shown as a fraction, but if you divide the numerator (the top number) by the denominator (the bottom number) and multiply it by 100, you end up with a percentage.

For example, let's say you want to determine what percentage of your revenue your auto expenses take up. If your total auto expenses are $50,000, and your revenue is $1,000,000, then that fraction is written as 50,000/1,000,000. If you divide the numerator by the denominator (50,000 ÷ 1,000,000) and multiply the result by 100, the percentage is 5%.

Now, knowing whether 5% is good or bad business-wise is another story. That takes a frame of reference, and I have seen study groups formed that will contrast these figures. Of course, you can also retain consultants and industry specialty accountants to give you their impression of the results of this and many other KPI as well.

That said, there are three reasons why a KPI might just be flat-out incorrect:

Reason 1: The numerator is wrong. In this case, the amount spent on an item could be too high or too low.

Reason 2: The denominator is wrong. Using the example above, if the revenue is too low or too high, then the amount of the expense could be perceived as too high or too low as well.

Reason 3: Both the numerator and denominator are wrong. I see this as the reason for incorrect KPI all the time!

Last month, I introduced you to four KPI I hope you will use to run your business in the future. Since I won't be writing this monthly column forever, I now present the remaining KPI that I consider crucial to running your firm. I will be happy if you remember me after I retire because of this list!

CASH ON HAND TO OVERHEAD

This KPI reflects not just cash on hand to overhead but, actually, working capital to overhead. The latter comprises cash and "good receivables" after deducting current liabilities. That total should equate to a number of overhead days – a quantity based on the size of the business.

Generally, I think larger businesses (300+ calls a year) have greater "patronage predictability," so for businesses of this size, their working capital should be equal to or greater than 45 days of their overhead. For a business performing 200-299 calls, I suggest maintaining working capital of 60 days or more of overhead. Businesses under 200 calls should have working capital equal to at least 90 days of overhead.

Keep in mind that one component of working capital is *good* receivables. You must keep a handle on which of the amounts due your firm come from insurance policies you are processing, preneed contracts or other strong, credit-worthy parties. Don't just assume all of your receivables will be paid in full!

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PRENEED

You must look at this particular KPI in several different ways, as you will see. Before I detail why, however, please accept that preneed is critically important to your business. Prearranging and prefinancing services with families is no longer something you can choose to do. Families that prearrange a casketed service usually do not opt for cremation. Families that enter into a preneed contract with a firm almost always go to that funeral home when the death occurs. Once a family prearranges, rarely do they price-shop other providers at need. In other words, preneed takes away some of your operational obstacles and is important to your success.

That said, here are some of the most critical preneed-related KPI:

• *Total Preneed on Books* Your total preneed should equal at least 140% of your annual caseload, i.e., represent 140% of your annual revenue. If you hit that, however, you're still average! Firms at 300% or more usually dominate their market.

• *Total Preneed Written Per Year* This one should total at least 40% of your annual cases served, or 40% of your annual revenue. Again, that is only average! I have seen firms achieve 80% or more, and they dominate their market.

• *Total Preneed Maturing Annually* This KPI should represent about 25% to 30% of your annual caseload – a percentage that makes a strong argument about ensuring that your preneed insurer or trust can underwrite your preneed contracts. If you knew that one person in your community was going to pay for 25% of your annual funeral services, for instance, wouldn't you look at their financial statements to make sure they could actually pay?

• *Average Revenue Preneed vs. Average Revenue At-need* Preneed offers a great window into the future of your business. Imagine that 70% of your preneed cases involve cremation dispositions yet, today, your cremation rate is only 50%. Can you predict your future based on that?

BAD DEBT WRITE-OFF

In the world of lazy tax planners, bad debt write-off and depreciation are the only two keys to turn at the end of your business year. In a perfect world, however, you should not incur any bad debt unless you choose to allow it.

Think about it this way. There are at least eight ways a family can pay for a funeral. In advance, there is personal insurance, preneed insurance, or a payable-on-death account. At-need, there is the kid's bank account, the parent's bank account, life insurance, credit cards, or taking out a bank loan. None of those options should include a GoFundMe page or borrowing from the funeral home.

Personnel costs are rising because staff and benefit costs are rising at a rate higher than most funeral service managers are raising pricing.

If you cannot adhere to a payment policy, then never let your accounts receivable exceed 11% of your annual sales, and never let bad debt get above 0.05% of your annual revenue.

PERSONNEL COST AS PERCENTAGE OF REVENUE

This KPI is crucial. First, add up your personnel costs, including reasonable owner(s) compensation, all staff compensation, the cost of benefits for employees and the cost of payroll taxes. Next, divide that sum by your revenue and multiply by 100 to obtain a percentage. If your business has one location, then that percentage should range between 26% and 32%. If you have multiple locations, that expense should be within 32% to 34%.

Unfortunately, personnel costs are rising because staffing is getting tougher. It's the number-one problem for the future of your profession, in my not-so-humble opinion. The reason is because staff and benefit costs are rising at a rate higher than most funeral managers are raising pricing. Therefore, the ratio of personnel costs to revenue is increasing, and I have seen some firms at 50%. You can't stay in business at that rate!

FACILITY UTILIZATION MIX

If staffing is the operating conundrum for the future, then facility utilization will be the savior. Families will use your building if you invite them. How much they pay to use it is another issue. If you charge more to use your chapel or reception room than you do for embalming, families will start to see value in gathering at a nearby restaurant. The food and the service are better, and funeral directors do not make good bartenders or waitstaff. Do everything in your power to make your building inviting and you will do well in the future.

PARTING THOUGHTS

The KPI I identified here and in last month's issue can help you focus on the efficacy of your business. You might have some of your own.

That said, the KPI I didn't focus on should be just as noteworthy to you. I'd watch the average wholesale KPI, but when 50% of families buy minimum utility merchandise, there is not much to focus on. Likewise, the old days of designing a funeral home from the selection room outward are gone. The virtual selection room (except to the degree required by state law) is the new selection room.

I urge you to stay focused on the services you offer that face no competition. You provide care to the living and necessary aid to the deceased. You have experience in what a service can involve. You have creativity. You know how to get a family from the day of death to the day of service or interment.

In 1984, funeral homes used a merchandise business model. People paid for the goods and got all the accompanying services they wanted thrown in. After the Federal Trade Commission enacted the Funeral Rule, firms shifted to a blended merchandise and service business model, where everything a family needed was à la carte. Today and down the road, funeral homes will use a service and merchandise business model. Everything is still à la carte, but there's more focus on service. Your KPI should help you design the funeral home of the future in that regard.

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