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Preparing for the Sale

By Robert L. Pierce

I have been involved in more than one thousand individual funeral home sales. In the course of my work with buyers and sellers, I have identified two very different traits among sellers.

Some sellers spend considerable time and effort preparing for a sale. These are usually people who also spent considerable time working on their businesses before they decided to sell it. Others, a much larger group, wake up one morning tired and decide to cash in their chips. They call a broker or a potential acquirer and they start sending out financial information.

As you might expect, they get very different results. I mean really different results.

The Negotiation Process

There is a popular misconception that one can negotiate their way around poor preparation to get more for a business than its financial attributes justify. This is, of course, an illusion caused by the dynamics of the negotiation process. The negotiation process typically begins with a very low offer followed by a series of offers and counter offers. The flaw in this process is that no matter how aggressively and expertly you negotiate, you can never sell a funeral home for more than is justified by it profitability. Great negotiations can only get you, best case, to the value of your business in the state in which it is operated and not a penny more.

This does not mean that the negotiation process has no value. Negotiations are essential to a successful transaction. Great negotiating alone, however, will not get you paid appropriately for your funeral home.

Structuring for a Sale

I break the down preparation for a sale into two components; intangibles and tangibles.

Intangibles are things that make a person comfortable and likely to want to pay more for a business. Intangibles include management systems, management succession, a focused and empowered employee team, service delivery systems, employment contracts, non-competition agreements, effective marketing programs, an effective preneed program, an effective training program, effective accounting and reporting systems, appealing facilities, effective communication systems, etc. Intangibles are things that will impress a buyer but do not necessarily increase their ability to pay more for the business. They make a buyer likely to want to pay more for the business and for that reason, they can be very important.

Tangibles, as the term is defined here, are attributes of a business that actually increase the ability of a buyer to pay more for a business. There are three basic tangibles that I am going to discuss here, profitability, income taxes of the buyer, and banking. These are the three most basic components that dictate how much a banker will lend and how much a sophisticated buyer can pay for a business. They are, for the most part, under the control and influence of the funeral home owner if they are addressed proactively and timely.

This means that a proactive business owner has considerable control over the sale price of their business. It means that funeral home owner’s post retirement lifestyle is under their control.

A passive seller is never in control of the sale process. They are at the mercy of a hopefully benevolent buyer and they have to hope that their negotiating skills are adequate to get them close to the value that their preparation level justifies. It is not a fun place to be and even the best results are disastrous.

Managing a Sale

Intangibles not only affect the value of a business by making it more appealing to a buyer, but more importantly, they can be a serious driver of profit, and profit is what drives the value of a funeral home. It is not the intent of this article to focus on the process of improving the intangibles of a business. It would quickly grow to the length of a book. This article is not about niceties. It is about increasing the value of a funeral home business in a short period of time in preparation for a sale.

Remember that intangibles do not increase the ability of a buyer to pay for a business. Strong intangibles increase the likelihood that a buyer will want to pay more for a business. As such, their impact on the value of a business is indirect except to the extent that they directly affect the profit of the company. Since it is a proven fact that a well-managed business is significantly more profitable than its lesser managed counterpart, intangibles have to be incorporated into the sale plan at least to the extent that they directly affect profit.

Profit, the income taxes of the buyer, and financing are the primary elements that drive the value of a business. As a result, an effective sale planning process will tend to concentrate on these factors because they have the most direct impact on the value of the business.

Profit is driven by many factors, some operational and some entrepreneurial. Both should be addressed in the sale planning process.

For this purpose, I define entrepreneurial costs as expenses that affect the reported profit of the business but will not be paid by a buyer after the sale occurs. They typically include dues (not directly related to the public relations of the company,) “non-essential” travel, convention costs, life insurance, vehicle costs, etc. Non-essential costs can have a significant impact on the value of a business if they are not addressed properly. Inclusion of entrepreneurial costs in the reported profits of the business, even if they are properly disclosed to the buyer, can make the buyer’s banking difficult and may reduce the amount that the buyer can to pay for the business.

Now, our Profit and Loss Statement is scrubbed of entrepreneurial costs and we can begin to look critically at our operating profits. The operating profit of the business is the primary determinant of funeral home value. As a result, most of your planning time and energy will be spent building programs and systems to increase the operating profit of the business. Luckily, the profits of a funeral home respond quickly and dramatically to simple management methods and the value of a funeral home can often be doubled in a very short period of time.

Increasing Operating Profits

Gone are the days when buyers paid for a company's potential. In today's world, you have to actually "have" profits in order to be paid for them. That means that you either make the effort to increase your profits or you will sell for less than you should.

Every person with a funeral home knows intuitively how to increase the profits of a funeral home business. The challenge is that many funeral home owners do not know how to increase the profits of their funeral home business. In theory, it is easy. The practical becomes more difficult when one superimposes the day-to-day realities of running a business into the mix.

Funeral home owners can have a dramatic impact on the operating profit of a business in a very short period of time by addressing a few areas of the business; planning, merchandising, communications, reporting systems, and quality of interaction with one's families.

Planning – Planning is perhaps the most important element of a successful business. If you do not plan to be successful and profitable, you almost certainly will not be as successful and profitable as you should be. The planning process builds a road map for the business. It is a written framework for the implementation process. It is the benchmark by which one measures ones successes. It is a critical element of a highly successful business and a serious contributor to the profitability and value of a business.

Merchandising – Pricing and merchandising are a critical part of a funeral home's profitability. A nineteenth or twentieth century merchandising program simply does not cut it in a seriously competitive twenty-first century. You have to build a merchandising program that makes a family's choices clear, understandable, and satisfying or they will respond by choosing the least costly product that they can tolerate, or none at all in the case of an urn. Merchandising takes considerable time and effort but it will pay back handsomely in terms of increased profits and better family satisfaction surveys. It will also take the pressure off of future price increases.

Communications – In order to perform at their best, employees have to understand the company's plan, understand their role in it, understand what is expected of them, and know when they are successful and when they are not. Within a proper communication framework there are very few bad employees. The communication systems of a company are a primary contributor to both its long and short-term profitability.

Reporting Systems – In order for a company to communicate effectively, management has to know what is happening versus the benchmarks that have been established in the planning process. Employees have to have a consistent and reliable means to measure of their effectiveness. Management needs timely and reliable information to make sound business decisions and evaluate the performance of employees. Timely and reliable reporting is an absolute must if a company is going to reach its full profit potential and value.

Family Interaction – It is easy to view family interaction from the perspective of the funeral home, easy but extremely unreliable. It is important that the funeral home view every interaction from the perspective of the family and their guests, not from the vantage of the service providers. If you make the effort to make every interaction special for the family, you will be rewarded handsomely in the long run. If you make the family's experience comfortable and their choices simple, understandable, and satisfying, you will be rewarded handsomely in the short run with better sales and more profits.

The processes surrounding the management of a funeral home have evolved by light years in the last decade. Funeral Home management processes have evolved from being an art form to being a science. In the sale planning process, techniques and systems that might have evolved over a decade are implemented in a relatively short period of time. It takes effort but the pay-off is substantial, particularly for a retiring business owner.

The impact of the sale management process is dramatic, virtually immediate, and does not require a fancy degree or a high level of sophistication. It simply requires the initiative to do it. The prospect of retiring in comfort should make the decision easy.

Income Taxes

A typical seller explores the impact of income taxes on their sales proceeds. Their accountant dutifully makes the calculations and reports back to the seller so income taxes can be factored into the seller's retirement planning. This obviously is an important part of a seller's decision making process. While the income taxes of the seller are an important part of the sale planning process, they do not affect the ability of a buyer to pay more for the business.

This article is about how one increases the value of a business. It is the “income taxes of the buyer” that directly affect the ability of a buyer to pay for a business and the impact can be substantial.

We have established that buyers are buying the operating profit of the business. Put simply, operating profits represent the gross income of the business less its cash operating expenses. This, of course, over-simplifies the valuation process. Let’s step back for a minute and look at the transaction from the buyer’s perspective.

The buyer is buying the cash flow impact of your businesses profits. As a result, a sophisticated buyer is very focused on the federal and state income tax costs of the transaction. Income taxes represent another and often very significant level of cost for a buyer that often stays below a seller’s radar. Not only are the income taxes that are paid by the buyer very real, federal income taxes are not deductible for income tax purposes so their impact is magnified. They can have a greater impact on the buyer’s ability to pay than the operating costs of the business.

The balancing of the income taxes of the buyer and seller is a very important part of the sale planning process. It can very directly affect retirement lifestyle.

Financing

Financing is becoming more challenging as our banking system continues to deteriorate, particularly when banking is viewed from the perspective of a small business. It is important for a seller to understand that the financing of the transaction is not just a buyer’s issue. It is both a buyer’s and a seller’s issue because it can dramatically affect both the value and the salability of the business.

The impact of a buyer’s banking on the value of a funeral home can be both direct and significant. Here are some examples to illustrate this point. Interest rates directly affect the value of a business. As interest rates increase, the value of the business will decline. The collateral included in a transaction also directly affects the value of a business. Secured loans tend to have a lesser interest rate than unsecured loans and that can make a business with significant real estate worth more than a similar business with less real estate.

Some bankers are now requiring that sellers carry a small portion of the purchase price, usually not a first choice of a seller, but one which may become even more important as lending sources continue to become even more timid. Collateral is becoming more important to lending institutions. In fact, many lending institutions simply do not make loans unless the loan has significant real estate collateral. It is also becoming more and more common that banks will not even consider a loan without an SBA guarantee.

Financing is an important part of a transaction. The seller should approach the issues surrounding banking with an open mind and their overall best interests in mind.

An Overview

It is interesting to note that while the sale planning process can double the value of a business; the buyer of the business does not receive one penny less value for the greater amount that they pay. Whether the buyer is a key employee, an independent funeral director or a public company, the buyer will ultimately be happier with their purchase even thought they paid considerably more for the business.

A buyer is buying profit and cash flow. A planned sale delivers a greater tax-effected cash flow, and therefore, represents a greater value to the buyer. On top of that, the buyer receives a business that is well run operationally, has less pressure on price increases and will have employees that are happy and more productive. A planned sale is the ultimate win-win scenario.

The benefits of a well run and profitable business is important outside of the sale planning process. In a perfect world, a funeral home owner would implement a focused profit management program long before they begin the sale planning process, the longer the better. There is value in adding a thousand dollars per call or more to the profits of the business while it is owned too.

A proactive seller absolutely has the ability to control the sale price of their business and the earlier they begin the process, the greater will be their reward when they sell. They have an unprecedented opportunity to impact their wealth and retirement lifestyle. Those who plan for their sales will be rewarded. Those who work until they are too tired to put forth the effort will get what they deserve, about half that of a planned sale.

Bob Pierce is the President of and a partner with his son Mark in Pierce CFO, a Company that specializes in the management of funeral home profits and the application of profit management concepts to the purchase and sale of businesses. Formerly, he was a partner in Thomas Pierce & Company, a Company that specializes in purchases and sales of funeral homes and cemeteries; the Chief Financial Officer of Cem-a-Care of Florida, a funeral and cemetery company; and a Certified Public Accountant. You can reach Bob if you have any questions at 888-860-6468.