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Using Financial Measures to Evaluate Your Business

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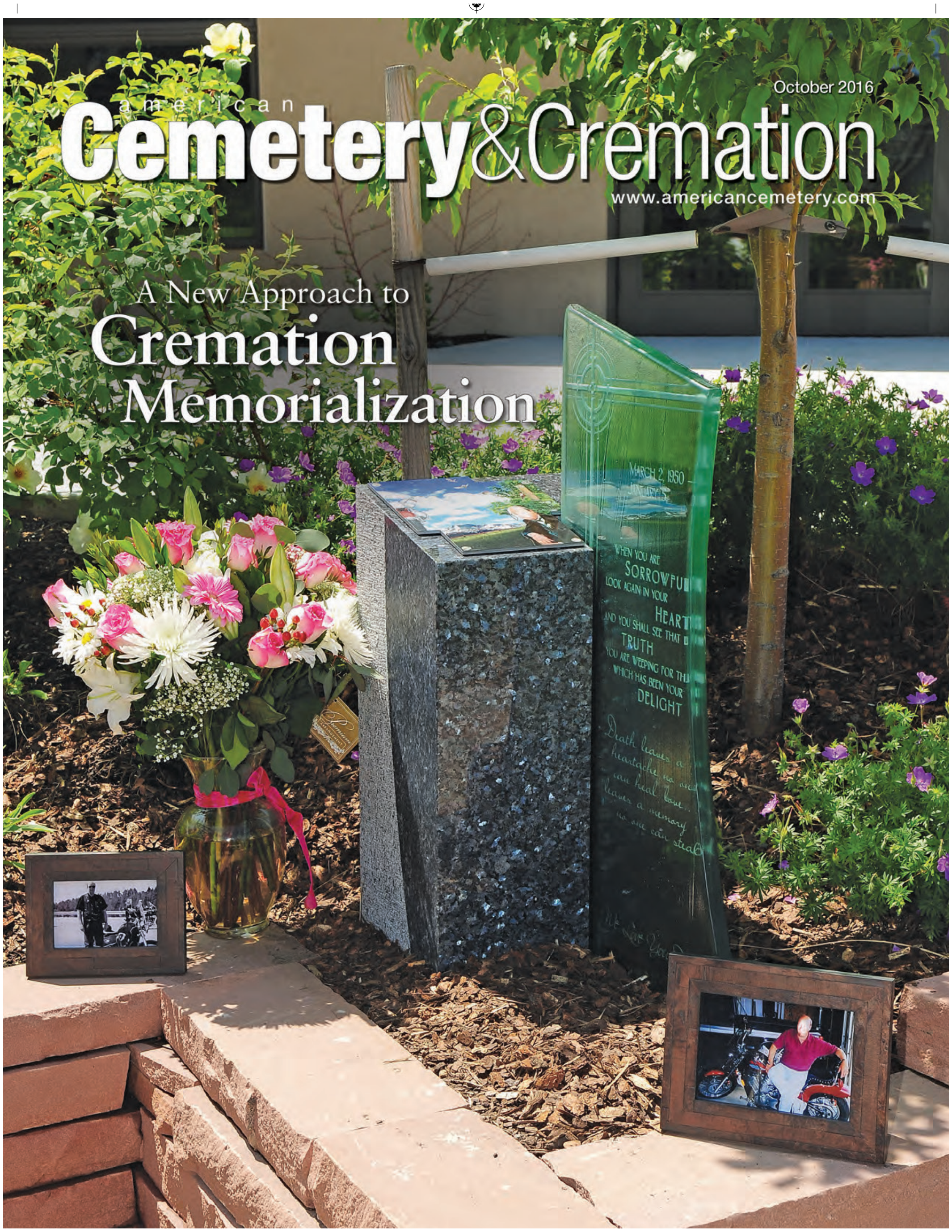

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By Todd D. Mannix

Using Financial Measures to Evaluate Your Business

As the economy continues to slog along, it's safe to say that many cemeteries are feeling the impact the most. In an industry where money is already a scarce resource, the very long run of declining and low interest rates is felt by every cemetery. For many cemeteries, there is little to no opportunity to drive new revenue from sales. Even in large cemeteries or cemeteries with land available, the lack of consumer dollars to spend and the lower returns on conservative investments are a worrisome reality.

Financial measures are a tool used by almost every business to determine how well they are doing. Whether you are a manager working for a company responsible for a part or all of the bottom line, an entrepreneur, or a multigenerational owner who has or will take over the business, there are financial measures that can help you understand how the business is doing.

Many small businesses simply use a profit and loss sheet. At the end of every month, or perhaps every year at tax time, they put all their income in one column, and all the expenses in the other – and the result is the net income (or net loss). This is probably the easiest measure to understand, especially when things are going well or running along smoothly. You work hard and business comes through the door and it always seems to come out OK.

But what happens if all of the sudden, it isn't going so well? In reality, it is never "all of a sudden." In almost every case when a business starts to realize it is struggling, there are measures that can be used to help improve business operations before the income statement really starts to suffer.

One of my favorite reads in business school was "The Goal: A Process of Ongoing Improvement," by Eliyahu M. Goldratt and Jeff Cox. I liked this book, first because it was an easy read as it was the rare business school book written like a novel, and second because the narrator, Alex, gave specific examples of understanding process and improvements that could be applied to any business.

Recently, a business associate shared this book with me as a gift, and I revisited the lessons I enjoyed learning many years prior. The premise, as the title might allude to, is to first understand the goal of your organization. In the book's example, Alex manages one of many manufacturing plants for a large organization. As with many organizations, performance measures are often put in place to justify large expenditures or investments. In Alex's plant, the company had purchased a couple of new robotic machines to help make the process smoother, increase efficiency, and increase throughput. To justify the cost of these machines to upper management, they needed to be running around the clock and measure how many parts could be processed using these machines every hour. The thing Alex couldn't figure out was that if the addition of these two machines was to help improve efficiency, and increase throughput, then why was the plant failing and in danger of being closed down? Customer orders were constantly late, in process inventory was high and costly, but the measurements on these new machines was well within the guidelines of what the higher–ups wanted to see in order to justify their investment.

The problem began to be solved once Alex realized the measures he was taking were not the ones that made sense to accomplish the goal of the company, which was primarily to make a profit. Everyone in the plant was focused on keeping the robotic machines running to max efficiency, but that had nothing to do with meeting customer demand, keeping overall costs down and turning a profit.

The authors point out in specific detail how oftentimes the wrong line of thinking, while seemingly logical on the surface, can lead to disaster. Once staff began to focus on the customer and using the machines to meet customer demand, they found they were able to break records for delivery time in getting products to customers, which led to more orders and increased profits. The most ironic thing was that in changing the focus (and ultimately turning the plant around), the efficiency reports on the automated robotic machines were terrible based on the criteria given for measurement prior to Alex's analysis. They had been measuring the wrong thing. Yes, it made sense on the surface that if you spend a million dollars on a piece of equipment, you would think that in order to make your money back on it, you should be running it all the time. But the goal of the company was not to run machines efficiently. The goal was to turn a profit. If anything else is being measured and cannot be directly translated to how it helps to accomplish the goal, it isn't worth measuring.

In our profession, people always want to point to the altruistic part of the job in helping families in their time of need. It is one of the things I love about working with our clients in the death-care industry. In a world where so many people are out for themselves, even at someone else's expense, it is great to see people helping their community and dedicating the time and talents they have to shepherd families through the grieving process. However, that being said, you still have to put food on the table, you still have bills to pay, and turning a profit should not be a dirty concept. So how do you identify and measure your goals beyond your income statement? What other types of things can be indicators as to the growth, slowing, strengthening, or weakening of your business?

Year-Over-Year Trend Analysis

In our business, year-over-year comparisons can be great indicators as to the health of the business. Furthermore, if you dive into the details of what specifically has changed year over year, you will be better equipped to understand movement in the industry. The more data you have, the easier it will be to see trends.

For example, if a cemetery reviews its sales over the last 10 years, chances are it will see a trending decrease in the number of traditional burial spaces versus the sales of disposition for cremated remains.

This increase in cremation is a clear trend that everyone is aware of, but the example can be used for any other line item. Are more or fewer people preplanning an opening and closing? As the traditional funeral process is being rethought by the consumers of today, are more families using the cemetery grounds or chapels for ceremonies? Are there new items that are popping up on your books for things you purchase for a burial that can point you to a new trend as to where things are going and what the consumer is looking for?

Cost of Customer Acquisition

Another useful measure is the cost to acquire a new customer. This is a little less specific than the year-over-year trend analysis, but it may give a company insight as to the impact of its marketing and community investment and how it translates into new customers. It can give you an idea of where your dollars are best spent should you realize you are serving fewer customers or would like to increase your sales. You can look back at years where you spent more money on marketing to see if there was an impact versus years where you cut back on marketing costs. You can also do this for specific items you advertise, display, or suggest to your clients as they come onto the property. The cost of customer acquisition can be calculated by taking the money spent on acquiring a customer (marketing expenses) by the number of customers you acquired in that specific period.

Operating Expense Ratio

Another useful measure to look at is how efficiently a company is managing the day-to-day business in relation to the revenue coming in. This is especially important for cemeteries as ongoing expenses are usually the heaviest weight on a property's profitability. How much are you spending on utilities, building maintenance and landscaping – and are there opportunities to cut some of these costs to be more efficient?

To calculate this measure, simply take all of your operating expenses and divide it by the total revenue in a specific period. The lower the ratio, the more efficient your company is in managing expenses to generate new revenue. The operating expense ratio allows a manager to determine if there are costs that can be shaved without hurting the customer experience or the bottom line. Can you or one of your employees do some of the yard work yourself? If electricity is a large burden, installing energy efficient light bulbs or switches that turn themselves off if there is no movement in the room can assist in bringing costs down. Generally what people find who have not looked at this ratio before, is that the changes do not have to be huge swings in cost savings. Generally, a few dollars saved in a number of areas add up and increase your efficiency.

These are just three examples of measures some businesses use to evaluate and understand what is impacting their business' profitability. There are many other metrics and even variations of these metrics that companies can use to really understand what is impacting their business the most. When determining what measure to use or how to make modifications to your business, it is important to stress that the goal should always be kept in mind.

This is a service business, and it is a community business. You do not want to cut costs to the point where your customers feel a negative change. You could be smart for today in saving a dollar, but if the customer has a negative experience, it will cost you more in the future. •