

Preneed 101— The Good, the Bad and the “How To”

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In Search of the Funeral Industry’s “Hybrid”

With cremation at all-time highs, discounters entering the marketplace, and fading family loyalty, many firms are searching for one big thing to preserve and build their profits far into the future—the auto market’s hybrid car, if you will. Some believe the funeral industry’s “hybrid” is preneed. But, is it? On the surface it appears to overcome many of the major threats funeral directors face. But what are the downsides?



A Funeral Director’s Perspective: The Most Compelling Reason

The most compelling reason for a funeral director to consider preneed is that it is a proven way to secure growth and family loyalty at a time when those commodities are scarce.

If a funeral is prearranged, the family rarely moves to a different funeral home. Likewise, if a traditional funeral service is prearranged, the family rarely changes to a cremation service. The Cremation Association of North America (CANA) reported that in 2003, cremations were used in 29% of all deaths in the U.S. This number is projected to reach 30% in 2005, 35% in 2010, and 46% in 2025. In some regions, the cremation rate is much higher, as much as 80% or more.

Cash flow ramifications

Today, NFDA and CANA report that the average revenue per traditional funeral is \$6,500 and the average revenue per cremation is \$2,200. The combined overall average revenue per family served (assuming a 29% cremation rate) is \$5,253. Using the projected cremation rates above, this number will erode to \$4,995 in 2010 and to \$4,522 in 2025. At today’s slim margin of 7% to 10% per funeral, future profits look meager when cremation is factored into the equation. The average firm will need to grow by 5% in the next five years just to preserve today’s level of cash flow.

The million dollar question is “How to grow?”

Many firms have found the answer is preneed. And, many have found that a pleasant by-product of marketing a preneed program is the growth of at-need demand. Heightened community awareness builds both income streams. Preneed also boosts family satisfaction because survivors feel confident that the deceased’s needs are met satisfactorily. Survivors of prearranged funerals are more likely to prearrange themselves, having experienced the benefits firsthand.

What if the majority of prearrangements are for cremation services?

Although traditional services generate more revenue than cremations, prearranged cremations are significantly more profitable than those not prearranged. Here’s why:

- Funeral homes generate a commission on prearranged cremations.
- It’s difficult to suggest additional services when an at-need family is requesting direct cremation. A preneed setting presents a much better opportunity to discuss all of the options available and to organize cremation services that exactly meet a family’s needs. Some will opt for simple and non-religious, while others will opt for personalized and ceremonial. The bottom line—the chance of increasing the scope of services is better with preneed than with at-need cremations.
- Prearranged cremations prevent funeral homes from having to compete with discounters who offer packages for \$495, and further commoditize the industry. Prearranging also prevents funeral homes from having to accept the discounts negotiated by hospice providers.
- Receivables are guaranteed with prearranged services so the funeral home avoids inevitable collection hassles.



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The biggest downside: Full commitment

Preneed requires staffing, marketing, management and follow-up. A part-time approach yields very little success. Many shy away because they don't feel they have the time or budget capacity. Funeral directors interested in preneed have two choices:

1. Find a preneed partner who offers full-service support, including market assessment, advertising, direct mail, staffing and follow-up. Some will provide this level of support at no cost, making this a low risk, sensible choice.
2. Staff, budget and dedicate. Firms without full-service partners must be prepared to do more than get their feet wet.

The second downside: Shortfalls

Shortfalls occur when the funeral price increases faster than the growth of a preneed insurance policy or trust fund. For example, a prearrangement written in 1985 is fulfilled in 2005 with a policy value of \$6,000 and a funeral cost of \$6,500, resulting in a \$500 shortfall for the funeral home. Shortfalls can occur in 30% of prearranged funerals depending on historical price increases.

The shortfall issue is magnified when a trust fund is used because many states allow funeral homes to withhold a portion of the funds to cover administrative costs. For example, a \$5,000 funeral is placed in a trust paying 5% interest. The firm takes 10% off the top and deposits \$4,500 to grow until the funeral is needed. However, with a starting point of \$4,500 instead of \$5,000, interest growth is hobbled and the likelihood of shortfall is almost guaranteed.

A Funeral Director's Perspective: The Pros and Cons of Preneed	
Pros	Cons
Extends family loyalty.	Requires full scale marketing and support.
Deters rising rate of cremation.	Shortfalls may undermine profit.
Provides some element of control over the inevitable cremation trend.	Trusts magnify shortfall potential.
Improves overall community awareness.	
Improves at-need business through increased community awareness.	
Broadens scope of services and overall family satisfaction.	
Survivors are likely to also prearrange.	

Conversely, with insurance, 100% of the funded amount is growing for the firm. Insurance also allows the following solutions for offsetting shortfalls:

- Apply the insurance commission generated against the shortfall amount.
- Take advantage of insurance companies' face value enhancement programs, which allow funeral homes to add up to 1% growth.

- Partner with a company that offers a shortfall pool that grows with the preneed sold.

Each solution implemented reduces the risk of shortfalls—implement all the insurance solutions and the risk of shortfall is almost non-existent.

Some perceive shortfalls as damaging to their businesses. But are they? Consider the following: 1) If the family was not prearranged, the funeral home may never have gotten the funeral in the first place. 2) If the traditional funeral was not prearranged in 1985, odds are good that the family may have opted for cremation in 2005. What's the shortfall then? Remember, according to CANA, the cremation rate doubled from 1985 to 2003.

The Family's Point of View

There are two primary values to every preneed funeral arrangement:

Documenting final wishes

This requires no money. The planner's wishes are thoroughly and accurately recorded after receiving guidance and information from the facilitating funeral home. The planner and the funeral home both retain a copy of the final wishes for future reference. The planner feels peace of mind knowing that arrangements are made and the survivors are alleviated of the burden of making over 50 decisions all while grieving.

Prepaying for funeral arrangements

The funeral arrangement is fully price guaranteed. The planner saves money by paying for the funeral at today's rates, and has peace of mind knowing that his/her family will never have to face the added financial burden. Family members are sheltered from many stressful details and appreciate that the remaining estate is preserved. Many survivors go on to prearrange themselves, rewarding firms with years of patronage.

Planners and survivors almost universally report positive experiences. The only potential downsides for families are aggressive, insensitive marketing or poor service—both easily avoided with a professional, insightful approach.

In Conclusion

Those considering a preneed program should start by defining their goals and evaluating preneed's role in meeting those goals. Those who are busy should consider a full-service partner who can immediately deploy tried and proven strategic marketing and follow-up services. Preneed, when managed right, can increase family satisfaction, loyalty and profitability for the firm, and may well be the funeral industry's hybrid. The key is managing it RIGHT.

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