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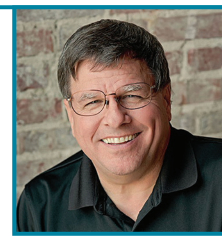

Death by Service Agreement

Do you remember when "Death by Chocolate" became a cliché? You can easily find over 50 recipes by that name, and they all sound wonderful. The connotation of course was that chocolate tastes so good that you may just eat so much it kills you. Scary right? But, did you catch yourself saying, "What a way to go!"

There are a lot of names for what I call service agreements—maintenance agreements, discount agreements, preferred customer agreements and on and on and on—but let's make it simple and I'll just use the term "service agreement" for this conversation.

Service agreements have been treated like the chocolate of the service business, haven't they? At one time, they were used to place a value on your business. The prime example was that one Service agreement customer was equal to $1,000 in company value. So, if you had, say, 5,000 service agreement customers then your company would be worth $5 million. So, how did that method work out as a business valuation tool? Well, it worked out great for those of you who sold your business to someone foolish enough to use that method. History has shown that most businesses purchased using that method either died a slow agonizing death or were resold for pennies on those dollars. Some of you bought your companies back for pennies on the dollar, didn't you?

Once again, I am chuckling to myself when I think about how many times some companies exchanged hands at an unsustainable price. We all make mistakes and sometimes it is bank error in your favor but more often it is, "The bank called, and they want that money today!" Yikes.

Let's look at some of the problems caused by that thinking.

Maybe you need to take a hard look at what those service agreement programs are really costing you.

The first problem is thinking that "if my company is worth X dollars per service agreement, then I can spend any amount of money up to X dollars to get a service agreement and still come out ahead."

The second problem is thinking that you can spend money to acquire service agreements. This can take the form of:

- Incentives to the person who sells the service agreement
- Discounts on today's work if a customer buys a service agreement
- Future discounts on service work for Service agreement members
- Priority treatment such as same-day or front-of-the-line-service, which has a high cost if it bumps a paying customer
- No dispatch or call-out fee or a reduced call out fee for members
- Work given away or discounted, such as tune-ups
- Printing, filing, and management costs for the program

Chances are I left something off of this list. By my calculations, the three-year cost for this service agreement customer is about $2,745, but you got paid $567, so you are only out $2,178.

Maybe the numbers aren't perfect, but they had to come from somewhere. So, let's say I'm only half right, which is what my brother constantly accuses me of being. Let's say you only lose $1,089 per agreement. When do you get the big payoff? Do you get it when you sell a new piece of equipment? Not really because you should have gotten that sale anyway just by being a great company. Now you have to take $1,089 off the top of the sale, and that likely is most if not all of your profit.

I'm guessing that if you are still reading this you may want to throw knives at me, but I prefer forks. I can use them to eat my chocolate.

"Prove your numbers," you might say. Well, how about this. What is the number you build into your pricing for profit on service calls? 15 percent, 20 percent, or 30 percent? And what is the number you build into your pricing for profit on equipment sales? Is it 10 percent, 15 percent, 20 percent, or more?

Let's get really honest. The numbers are not static. They change, but you do have some static numbers, don't you? For example, when you set up your pricing you had a budget for direct costs and indirect costs. You made some predictions. Your service agreement program is part of your strategy to meet those predictions. So, here is the proof. Look at your bank accounts. Are all of your obligations and expenses paid in full, and do you have an amount in your bank equal to your profit prediction plus your unused budget predictions? If you do, you are likely very solvent and in excellent shape, just like you predicted you would be.

But if money is harder to find than a snowball in the desert, well then, maybe you need to take a hard look at what those service agreement programs are really costing you. And the other side of the coin is there are not too many buyers coming around offering $1,000 per agreement anymore.

What's the solution? Be honest about your numbers. If you are not thrilled with your bank accounts then what happened? Did your billable hour calculator let you down? Did your consultant let you down? Did your accountant let you down? Did your technicians let you down? Or are you just approaching business with some outdated thinking?

I am a student of Ford Motor Company. It's been over 40 years since I first noticed that the local Ford garage gets four times as much money for an average repair than the local service company does for an average service call. Why? Not only have I asked that question since 1971, I have also bought stock in Ford so I can look at their reports. I have also made friends with Ford dealers so I can ask pertinent questions, and I attend dealer conventions when I can to listen to speakers telling auto dealers how to make money in the car business. And, of course, books and tapes. So, what would Ford do? You tell me. How much did your auto dealer discount your most recent repair as an incentive to get you to buy a service agreement? Did the place look profitable?

I can go on and on with comparisons, but let's get you out of trouble. First, if you do two visits per year for your service agreement members, drop it to one. That doubles the price of your service agreement. Your customers will be glad you did. Almost no one wants you to come twice a year. They simply don't have time to deal with it. Second, drop your discount to 5 percent immediately. Believe it or not, high discounts buy you nothing. Third, change immediately to monthly billing. This takes all the pressure off of retention, almost nobody cancels monthly

➤ Turn to Death, page 40

agreements, and it makes it easier to sell.

More than likely what you believe about service agreements is no longer true. For example, "service agreement customers are more loyal than non-service agreement customers." Really, let's think about that for a while. Make a list of ten of your most loyal customers. You know the ones. Now circle the ones that have service agreements. Now underline the ones who would be just as loyal even if they did not have a service agreement.

Is It possible that you could have loyal customers without a service agreement program? Of course. Should you get rid of your service agreement program? No, but it should make money and not cost money. Evaluate true retail companies like Home Depot and Lowe's. Home Depot offers ten percent off on your first purchase when you take on their credit card. I'm a little disappointed with them because I thought I got ten percent all the time so I took the card. Nope, only on the first purchase. Lowe's, on the other hand, gives me five percent discount every time I use the card, and I love it.

Pay attention, learn best practices from other industries, and do anything you can to eliminate death by service agreement. C

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