

## COMANCHE NEW YEAR'S RESOLUTIONS

By Matt Michel

### **Response Charges, Service Pricing, Equipment Pricing**

Every year, millions of people make New Year's Resolutions, and some even keep them. Because we live in such a sedentary society and often feel bloated following the holiday feasts, our resolutions are often related to physical fitness. We resolve to get shape, but too often we do not.

By the same token, many people make resolutions about the fiscal fitness of their businesses. They resolve to get fiscally fit, but find themselves in much the same condition at the end of the year as they were at the start.

\*Resolutions\* to boost profitability are about as useful as \*resolutions\* to get in shape. Resolution without action is merely intention. Fiscal fitness, like physical fitness, results from specific actions.

This year, resolve to get your business fiscally fit and back your resolutions with specific actions.

The fastest way to a strong bottom line is to build the top line. While the small business owner must always watch expenses, no one can save their way to prosperity.

The surest way to build the top line is good marketing. The four P's of marketing are product, price, place, and promotion. Over the rest of this Comanche Marketing series, we will deal with each, but will start with pricing. For service companies, pricing breaks down into four areas:

1. Your response charges
2. Your service rates and material mark up
3. Your replacement pricing
4. Your service agreement pricing

## **PART 1: RESPONSE CHARGE PRICING**

Let's start with response charges. Few service companies put much thought into response charges. They charge about the same as their competitors charge. Or, they charge what they've always charged. There's no thought. No strategy.

Response charges are called by different names. Whatever the name, a response charge is the price you charge to show up at the customer's house and present them with a repair estimate. This encompasses trip charges, truck charges, first half hour charges, first hour charges, diagnostic charges, troubleshooting charges, and so on.

Response charges cannot be examined in isolation. Your hourly rate must also be considered. It gets messy because many companies use response charges to supplement their hourly rate. They charge a diagnostic fee so they can keep their hourly rate artificially low. This is especially important for companies charging time and materials (T&M) because most consumers simply do not understand (or care) what it costs to run a service company. Present them with your true hourly rate and they start hyperventilating.

T&M companies must balance their response charges with their hourly rate. The true hourly rate equals the response charge plus the hourly rate. For example, if a company has a trip charge of \$45, and then professes to charge an hourly rate of \$60, the true hourly rate is around \$105 (i.e., \$45 + \$60), depending upon the average length of repairs per job. If the average repair is less than one hour, the true hourly rate is greater than \$105. If the average repair is more than one hour, it is somewhat less than \$105.

When a T&M company changes the response charge, the company changes its true hourly rate. For example, a T&M company that is marginally profitable may find itself operating in the red if the response charge is changed and the hourly rate is not increased to offset it.

On the other hand, a T&M company that wishes to be perceived as charging less can lower its hourly rate and offset it by a change in the response charge. For example, a T&M company may charge a trip charge of \$30 and an hourly rate of \$75. If the average repair is 30 minutes long, the company's true hourly rate is \$135. Because the company is encountering price resistance over the \$75 rate, they can lower their stated hourly rate to \$50, and invoke a one hour minimum. Though the company appears to charge less, the true hourly rate increases to \$160 (\$30 minimum, plus \$50 across an average time of 30 minutes). Like I mentioned, it gets messy.

Flat raters are not immune. They often fail to consider the impact of their response charge on their true hourly rate. Like a T&M company, a flat rater should consider the impact to the bottom line that results from a change in the response charge. Yet, flat raters have a luxury T&M companies do not. The flat rater can easily shift dollars out of the response charge and into the base service rate, regardless of appearances to the base rate because it is hidden from the customer and bundled into the flat rate.

Regardless of your pricing method, the response charge should be set by design, not happenstance. Ideally, your hourly rate should be set at the level where you do not need the revenue from your response charge to be profitable. Then, you can use the response charge purely as a marketing tool. From a marketing standpoint, there are four common marketing approaches.

### **1. Low Price Approach**

Some companies set the response charge a token amount for a response charge and market this. When people call and ask for a price, they quote the response charge. "We charge \$25 for a service call," they cheerfully respond. This is a classic retail strategy of quoting a low opening price. Wal-Mart, Home Depot, CompUSA and a host of other retailers market low opening prices.

Why bother? Why not, for example, state that you do not charge by the hour? Consumers want you to quote \*something.\* When you state that you do not charge by the hour, the homeowner thinks you are being evasive.

Even a low response charge can make a positive contribution to the bottom line. Twenty-five dollars doesn't sound like much, but if you run 350 annual service calls per truck, a \$25 charge delivers \$8,750 in gross profit per vehicle. California super plumber, Maurice Maio was an advocate of the \$25 charge.

### **2. Response Charge As Promotion**

Other companies give away their response charge as a promotion. Ahron Katz who sold the Dallas A-ABC to a consolidator used to send out \$60 coupons, which was the amount of his response charge.

### **3. Demand Management**

Some companies use the response charge to control demand. Gary Katz (Ahron's son) changes his response charge for Total Service in Minneapolis based on incoming call volume. Same day service costs more. Priority service (two to three days) costs a little less. Service when he can get to them doesn't involve a charge at all. Gary then focuses his marketing efforts on the customers who are willing to pay a little more for better, faster service.

Frank Blau implemented a similar approach in Milwaukee. His call takers give people an option to pay more for faster service. Almost all are willing to pay more for faster service and those who are willing to live with a hot or cold house for a few more days in order to save a few dollars are probably not good customer for Blau.

#### **4. Service Agreement Benefit**

I've always liked the idea of giving away the response charge to service agreement customers. It gives these key customers one more tangible benefit.

The first Comanche New Year's Resolution is to review your response charge pricing.

- What are you trying to accomplish with it?
- Should you raise it or lower it?

### **PART 2: SERVICE PRICING**

Service pricing should be set at a level where you can pay your bills, yourself, your employees, provide training, invest in the growth of your company, and leave a little left over. Sounds obvious, right? The question then, is why do so few service companies charge what they should?

Your base service price should never be set on what you think your competitors are charging. Setting your service price based on the price of others is like the blind leading the ignorant. When you were a kid, at one time or another you probably told your mother, "But Moooom, all the kids are doing it."

Your mother likely responded, "If all the kids jumped into the lake, would you follow them?"

She was a wise woman, your mother. Of course, you probably didn't listen to her then, but listen to what she said now. Don't jump into the lake of bankruptcy with the rest of your competitors, slowly drowning. Set your prices so that you generate a desired net profit.

If you don't think your service is worth what you charge, then raise your service to the level needed to match the price you must charge to make money. Later in this series, we'll discuss how you can do that.

Proper pricing, however, is not enough. Price is part of your marketing mix. Inject some marketing strategy into your pricing.

#### **DISCOUNTS**

Some customers should get discounts. Most notably, you should offer a discount to your service agreement customers. You offer this to reward their loyalty and to give them a greater incentive for enrolling in your service agreement program in the first place.

Hey Michel, you might be thinking, doesn't that screw up your targeted net profit? Yup. It sure does.

Rather than discount your targeted price, make the target price your discounted price. Charge everyone else a premium. For example, if you need to charge X to be profitable, don't charge your service agreement customers X minus, say, 15%. Charge your service agreement customers X and then bump the rates for everyone else (i.e., X divided by one minus 15%, or X divided by 85%, or X times 1.18).

Remember, your targeted price is what you need to charge, so charge it. If a customer is not going to purchase a service agreement, charge them a little more because it costs you more to service them due to the marketing costs you incur in attracting them.

Why not just call it a premium? Because people get mad if you tell them they are paying a premium. Non-service agreement customers feel like you are punishing them because they do not own a service agreement and service agreement customers do not feel like they are getting special treatment. So you tell non-service agreement customers they are paying a standard rate and tell service agreement customers they are getting the discounted rate. This way you do not make the non-service agreement customers angry and you make the service agreement customers happy because they get special treatment.

It's semantics. So what? Much of marketing is semantics. Tell a woman she looks like "the end of a long, hard winter" and you probably will not enjoy her reaction. It's much better to say she looks like "the first breath of spring." It's just semantics.

Speaking of semantics, don't simply call your discount a discount. Call it "preferred customer pricing" or "value pricing" or something similar. Call it a discount and people will think they deserve the discount whether they own a service agreement or not.

## **MATERIAL**

There are various schools of thought on the proper way to handle material mark ups and frankly, seldom does much thought go into it. Often companies use their material mark up to help cover company overhead and keep their service rates low. They create a mark up schedule with the mark ups decreasing as the material cost increases.

I follow a different school of thought. I prefer to apply all overhead against labor hours. Labor is perishable. You cannot put a direct labor hour on the truck bin and use it later. With material you can.

I like to mark up the material enough to cover direct material costs (i.e., carrying costs), plus a targeted net profit. Direct material costs include the cost of money, inventory and handling costs, shrinkage, and so on. The old rule of thumb I was taught from a factory environment is that the carrying costs for inventory is usually around 33%. It's probably a little less for a service company.

Ideally, you or your accountant will perform a detailed examination of your carrying costs annually. That's the ideal. In reality, few do, which explains the presence of rules of thumb. Mark up a dollar of material by your carrying cost and you've got your true cost. If you determine your carrying cost to be 25%, then \$1.25 is the true cost of a dollar of inventory.

Once you know your true cost, you must factor in a profit. Divide the true cost of a dollar of inventory by one minus your targeted net profit before taxes to arrive at an across the board mark up. For example, if your "before tax" profit target is 20% (this may sound like a lot, but it's not, especially after Uncle Sam and your governor take their cut), you would divide the true material cost by one minus 20%, or 80%.

If the true material cost of a dollar of inventory is \$1.25, dividing this by 80% yields \$1.56. This becomes the material mark up... 1.56.

### **FLEX PRICING**

Pricing should have a nuance or two. Pick up a circular for a big box retailer and they will prominently promote 60 to 90 SKUs. The pricing on these circulars is loooow. Once, I lived in a town where big box A sent its employees to big box B to buy diapers because the big box B was selling them for less than big box A could buy them. Hmmm. What's going on?

The diapers were one of those products on the circular. The big box heavily promoted them and they became a signal to the public that prices were great at that store. However, if you were walk into the bowels of the big box, you would find other back shelf SKUs that are less of a bargain. Try it. Go to a Home Depot and compare the prices for some of the less promoted items with the price you get from a supply house. There's a big difference between the pricing for those items and the signal prices on the circular.

The big boxes and other retailers flex some prices up and other prices down. If something is easy to compare, they flex the price low. If not, they flex the price up. They have a targeted net profit as well, but the target is the overall average. Some items are more profitable and some are less profitable.

You can play this game too. You can flex the prices for some visible repairs down and the price for others up. If nothing else, it will drive your competitors nuts. Remember though, the objective is to achieve the targeted net profit.

### **OVERTIME**

Service companies stick it to customers for overtime. I don't know why.

If you correctly allocate your overhead, you can pay your technicians time and a half for overtime, charge straight time to the customer, and make more money doing it.

Uh, how's that? Simple. I have yet to see a case where the hourly overhead allocation did not exceed the fully burdened excess pay to a technician receiving time and a half, or even double time. Stated differently, the payroll difference between time and a half and straight time for an hour of labor is less than the overhead allocation for that hour.

If all of the overhead is allocated against the standard work week, what's left to allocate? Zero. Zip. Notta. So you can pay your employees a premium for overtime and because there's no overhead to allocate, more money falls to the bottom line than with straight time where you're covering overhead in your service prices.

Don't you want to charge a premium for overtime to discourage people from calling you after hours? Well, I never want to discourage people from calling me; never, ever.

Look, it's as big a pain for your customers to call you for after hours service as it is for you to provide it. When they need it, they need it.

Plus, service stakes are rising every year. All night grocery stores have become common. Most, if not all Wal-Marts and some Home Depots are open 24/7. Retailers are extending their hours in recognition of the fact people are pressed for time. They don't charge the customer more for shopping during hours that are convenient for the customer and neither should you.

## **PRESENTATION**

I don't want to get into the great flat rate versus time & materials debate... again. I will offer this. Flat rate is associated with lower cost, fairer pricing in the minds of most people. Even the post office is promoting flat rate these days.

I spent seven years working for one of the country's largest marketing research firms. Because of my background, I did a LOT of work for companies in the "building products" industry. In survey after survey, in focus group after focus group, flat rate pricing was preferred over time & materials.

There's a misperception among many service companies that going flat rate means you must charge usurious rates. Nonsense! You can charge exactly the same amount as you do today. Only the presentation of the prices differs. Time & materials pricing is open-ended and threatening. Flat rate pricing is fixed and reassuring.

Give your customers the reassurance they want. Give your customers the pricing presentation method they prefer.

## **SUMMARY**

Proper pricing is always the starting point for a Comanche Marketing initiative. If you price too low, you will never be able to afford to execute other marketing tactics.

It's a new year. Resolve to...

- Review your pricing to ensure you are pricing for profitability.
- Examine your discount structure to make sure you are giving your best customers better treatment, that you are not penalizing yourself with your discounts, and that your semantics are good when describing your discounts.
- Review your material mark ups to determine the carrying cost of inventory, the true cost of a dollar of inventory, and the correct mark up.
- Examine your portfolio of products and services to identify items you might want to flex up and down.
- Review your overtime price structure.
- Consider changing your pricing presentation to be consistent with customer desires.

### **PART 3: EQUIPMENT PRICING**

Most service companies sell equipment, whether it's air conditioning, furnaces, water heaters, RO systems, landscape lighting systems, swimming pools, security systems, or something else. Equipment sales differ from service sales.

Equipment sales are higher dollar.

With the exception of breakdown driven sales, homeowners usually have more time to make a decision.

Homeowners often have the option to gather competing estimates.

Sales professionals often enter the picture with equipment sales, while technicians make service sales.

As a result of these differences, contractors must approach equipment sales differently. There are books written on this subject too. I don't have the room to produce a book. Well, actually I do. This is the Internet. But you don't want to read that much and I'm too lazy to write that much in one sitting. Instead, here are a few ideas about making your equipment pricing more effective.

#### **OFFER CHOICES**

My local grocery store carries over 100 varieties of salad dressing and nearly the same variety of hot sauce and spaghetti sauce. There are even more choices for soup and a whole aisle dedicated to cereal. Why carry all that stuff? Simple. People like choices, even for minor purchases. So why should we expect them to be different when it comes to a major purchase?

Offer choices in brands, in quality, in energy efficiency, in color, in combination. Give them more than one option. If you don't, it's an invitation to call a competitor.

If you give them the choices they want, the homeowner has less of a reason to call a competitor. Here's a secret. Homeowners really don't want to call anyone else. They may not tell you that, but it's true. Survey them confidentially and most people admit they only call one or two companies. But they won't tell you that. They'll tell you they are talking with other companies just so you won't try and take advantage of them. Sometimes they will get multiple bids. Sometimes they will not. You can reduce the odds they will call your competitors by offering them a variety.

When I give speeches, I often tell the story of the first washer and dryer my bride and I purchased. We were newly married and broke. We decided to walk into a Sears "just to look." This was going to be our starting point. Venturing into a Sears store to look at the appliances is like walking down the cereal aisle in the grocery store. There was a million choices. We kept looking at one brand versus another, one feature set versus another.

"Look honey. This one's only \$15 per month more than the other one!"

"Oh wow, this one beeps when you press the buttons!"

"Hey, a black model."

"Oooo, pinstripes."

We never made it to the next store. We didn't see the point. Everything we could possibly imagine was right there. We ended up walking out with the top-of-the-line Kenmore washer and dryer. It was way too expensive given our precarious financial condition. We didn't care. We were HAPPY!

Offer choices. And make sure the choices you offer represent a range of prices. Some people want the least expensive option. Some want the best. Others want something in between.

### **BUBBA SYSTEM**

One of the greatest challenges in equipment sales is justifying the difference between "Bubba's" prices and yours. For example, Bubba comes in, quotes a low end piece of equipment, strips all frills, offers a low margin, and generally does a cheap job. Then, you come in and your basic equipment offer is 50% more. It's tough to close a gap that big.

Bubba says his system is good. You say yours is good. The homeowner doesn't know what to believe. As far as the homeowner's concerned, both of you are issuing opinions. Nothing's objective. But the price is real, quantifiable. The only objective piece of information the homeowner has is price, which works out in Bubba's favor. Big time!

If the homeowner shares the price difference with you, you're in a no-win situation. You can't tell the homeowner what's wrong with Bubba. No one likes it when one company slams the competition. Yet, it's almost impossible to point out why your equipment is better without highlighting Bubba's deficiencies.

And remember, if Bubba's selling an air conditioning change out for example, he doesn't highlight the fact he's not replacing or cleaning the line set. He doesn't mention the evaporator. He doesn't speak of filter-driers. He doesn't say a word about the pad or leveling the condensing unit. Bubba doesn't talk about permits. When you talk about these things, the tendency is to assume that everyone does them. So Bubba gets credit he doesn't deserve.

It's a dilemma. The solution is to offer a Bubba option. Huh? A Bubba option?

Price up a low end, budget system, doing the bare minimum and call it that. Call it your "Budget" system. Cut the margin on it to the bare minimum you'll accept. Then, use it as a foil.

Tell homeowners about your own Bubba (Budget) system. Point out the differences between it and your basic system. Be clear about the differences, about why they matter.

If you take a low end approach, with a reduced margin, the odds are you can get within 10% to 20% of Bubba. That's a difference you can justify by the quality of your company and the trustworthiness of your salesperson. Now, when Bubba offers his lowball quote, the homeowner thinks, "Ah ha, that's like the budget system."

Be warned. Some homeowners will select your budget system. They might be planning to move in six months, out of work, cheapskates, whatever. If you present it, you must be prepared to install it from time to time.

I talked with a large air conditioning contractor who added a low end system to his company's portfolio. To his surprise, he sold half a million dollars worth of these systems. Did he cannibalize more profitable sales? Possibly. But he didn't think so. In his opinion, this was business he would not have gotten otherwise. As long as you've got the capacity, it's marginal business that helps cover overhead.

What if you do not have the capacity? What if all of your installation crews are busy? Tell the homeowner that it might take longer to get the budget system installed, that one of the reasons it costs less is you schedule these installations after you've completed your others. You might lose a sale doing this, but it's better than winning the job and losing a more profitable sale in the process.

## **PRESENTATION**

There are a variety of schools of thought about the best way to present the price on an equipment sale. They range from verbal quotes to scratching a figure on the back of an envelope or business card to preprinted proposal forms to written proposals. This doesn't include the presentation books and computer-aided presentations that super sales professionals like Steve Kerr utilize.

Obviously, scratching a number on a piece of scrap paper is Bubba's method. Hopefully you are using preprinted forms or full written proposals. Regardless of the method, present the options side by side. Layout four columns for the customer. Start with your Bubba system on the left and increase the features/quality/price as you move to the right. In each column, list capacities, efficiency, each feature, each accessory, the warranty, and the price.

## **FOCUS ON MONTHLY PAYMENTS**

Present the total price, but also present the monthly price if financed. Emphasize the latter. Show the monthly payment difference between the "good" and the "better," and then the difference between the "better" and the "best."

Calculating the finance charges should be relatively simple. You can use the customer's own credit card payments to illustrate. Typically, any credit card involves a revolving charge plan where the minimum payment is 3% of the outstanding balance (note: most manufacturer financing plans are revolving plans with the exact same 3% minimum payment). Thus, a "good" system costing \$3,000 will result in a minimum payment of \$90. The "better" system, costing \$3,800 will only cost \$24 more per month (i.e.,  $\$3,800 \times 3\%$  or \$114, minus \$90 equals \$24).

When you shift the dialogue from total payments to monthly payments, you shift from a discussion of \$3,000 to \$90 per month. When you shift to the difference in monthly payments, you've changed the focus from \$3,800 to an extra \$24 per month.

Isn't this shifty? Not at all. A few years ago I bought a hole in the ground. Some people refer to my hole as a swimming pool. Given the way cash gets sucked into it, I prefer the term "hole" or "pit," as in "money pit." Regardless, I could not afford the pool. I could afford the monthly payments for the pool.

People buy based on cash flow, not total price. This is one of the reasons leasing is so popular. Think about it. How do most car dealers present their prices? They sell payments, not price. So should you.

## **FINANCING SOURCES**

You should take another tip from the car dealers and line up multiple sources of financing. Don't depend on the manufacturer program that's limited to "A" credit. Find an alternative or two. If you offer to finance and fail to secure credit approval, the sale is dead. The homeowner's too embarrassed to buy for starters. If they are rejected by the finance company, then financing is the only way they can buy. Finance companies prefer to offer financing to people who don't need it.

Find a company that offers installment financing. The payments become much more affordable when you stretch them out over a ten year note.

Work with a bank or another third party lender who offers home equity loans. Not only does a home equity loan generally result in higher approval rates and lower interest rates, it gives the homeowner the ability to deduct the interest. People go to all kinds of extremes to avoid paying taxes. While the interest deduction is unlikely to amount to much, the idea of deducting the interest is attractive enough to serve as a tie-breaker with some people.

## **STEPPING UP**

Whenever I've suggested presenting FOUR system options, many salespeople's eyes glaze over. "Four systems?" they gasp, "That's a lot of work. I don't even have four systems." Sure you do.

There are many ways to step up your offering. The manufacturer of a particular plumbing product, for example, sells a "5 year" and a "7 year" model, with the five and seven referring to the warranty. The product is identical. Only the price, nameplate, and warranty change. In fact, the nameplates are affixed by the supply house. A plumber walks in and asks for a "5 year" model and someone in the warehouse slaps the appropriate nameplate on the unit before taking it to the loading dock.

Increase the warranty. Purchasing a manufacturer or third party extended warranty, or create an in-house risk management program to cover it yourself. You can increase the efficiency. You can bundle extra accessories. Get creative.

When super salesperson, Tom McCart, was in the field, he prepared a variety of ways to step up. He used to ask questions and listen to the homeowner to determine what he would present (what a concept!). If the homeowner was concerned about efficiency, Tom would step up the efficiency. If efficiency wasn't important, but the accessories were, Tom would step up by bundling more accessories into the higher end system. Have more than one way to step up the offer.

## **RESOLUTIONS**

This year, resolve to get your equipment pricing in order...

- Resolve to offer homeowners choices on every sales presentation.
- Resolve to create a "Bubba" system.
- Resolve to review and improve your presentation method.
- Resolve to present monthly payments, rather than total price.
- Resolve to line up multiple financing sources, including a long-term installment financing source and a home equity financing source.
- Resolve do design a variety of ways to step up the offer.

## **PART 4: SERVICE AGREEMENT PRICING**

The modern service agreement is a creation of the air conditioning industry, but has application to any service industry with variable demand. I want to spend a few minutes on the history of the service agreement because it has bears on the pricing philosophy.

### **CREATED FROM NEED**

If necessity is the mother of invention, desperation is the mother of the service agreement. While I'm not sure if he was the first to design one, Ron Smith gets credit for bringing the service agreement to national prominence and he continues to be at the forefront of improving it. On the foundation of the service agreement Ron Smith built one of the largest and most successful residential replacement air conditioning companies in the nation. He started with one truck and grew Modern Air Conditioning to \$15 million when he sold it. That's not shabby by anyone's standards, but Ron hit \$15 million way back in mid-1980s. And he did it in Ft Myers, Florida.

What's so unusual about that, you ask. Isn't Florida air conditioning country? Sure. But that's all it is, at least that far downstate. There's not a heating season to speak of in Ft Myers. The state of Florida has always attracted "carpetbagger contractors" who come down from the north to take advantage of the robust cooling season, and then return home in the winter like some kind of migrant farm worker. If it sounds like I'm critical of the practice, I'm not. The state's air conditioning industry needs help in the summer, but not the winter.

Ron Smith, however, wasn't a migrant. His company needed to pay the bills year round in the Gulf side town of Ft Myers. All air conditioning companies have a problem with seasonality. Ron had it worse than most. But Ron is one of the creative marketing geniuses in the industry. He's not one to let a little thing like, no need, want, or desire for his services stop him.

### **THE OBJECTIVES OF A SERVICE AGREEMENT PROGRAM**

Ron created the service agreement. I don't know whether Ron started with these objectives, but usually companies start service agreement programs for the following reasons ...

1. Provide some off-season work to keep technicians busy when demand service dries up.
2. Help cover overhead.
3. Tie in the customer.

Of the three, the last is most important. As Ron says, "a service agreement is a replacement sale waiting to happen." Sell a service agreement today and you can expect a replacement down the road. Furthermore, it's a replacement that's less likely to involve multiple bidders and competitive price pressure. It's a replacement sale with a customer

that believes in your company and has been a loyal customer. In other words, your close rate should be far higher.

A service agreement program is a customer retention program first, an employee retention program second, and a profit generator third. A service agreement does not need to make money to be successful, though it should make money. However, service agreements are profitable on a marginal cost/marginal revenue basis. You cannot burden them with your standard overhead and expect them to be affordable.

### **HOW SERVICE AGREEMENTS MAKE MONEY**

Ron Smith found that one out of every eleven service agreements in any given year would result in a replacement sale. In other words, for every 1,100 agreements, he could plan on 100 replacements. He says the ratio varies in different parts of the country, but today Ron thinks he would achieve better than a 1:11 ratio in his old stomping grounds for the simple reason that people are more inclined to make replacements before equipment dies the good (or bad) death.

The close rate was also much higher with service agreement customers. Ron employed some top shelf sales professionals at Modern Air Conditioning (e.g., Tom McCart and Charlie Greer). His sales team's close rate was 31% when the prospect did not own a service agreement. Among service agreement customers, the close rate jumped to 86%!

Want more? Attracting an equipment replacement prospect is expensive. By comparison, the costs of attracting an existing service agreement customer are inconsequential. If you do a good job performing the service each year, the customer will give you the first opportunity to buy.

Service agreement customers are also higher margin buyers. They are more likely to trust your company, more likely to buy top-of-the-line equipment from you, and less likely to price shop.

Your service agreement program should be profitable on a marginal cost/marginal revenue basis. However, the real profit is in customer retention and future sales.

### **HANDLING OVERHEAD**

The only overhead you should apply to service agreements is marginal overhead that results from the program. When you first start a service agreement program, this is incidental. It might include the printing cost of the service agreement itself and a brochure. Later, when you add a service agreement coordinator, this individual's salary and benefits should be charged to the service agreement program.

Once you start allocating overhead to service agreements separately, you must-I repeat, must departmentalize. The service agreement program needs a separate P&L. Frankly, you should already have separate P&Ls for your installation and service departments.

Why not burden service agreements with the same overhead that's applied to service rates? Because service agreements are marginal business. Take them away and the overhead doesn't change. Remember, overhead should be allocated against the expected number of standard service hours throughout the year.

### **CALCULATING COSTS**

So how do you cost them? Take the fully burdened cost of the technician who will perform the tune-up, add vehicle cost, your material cost, your sales spiff, and other direct costs (e.g., post card reminders) to arrive at a base cost for performing the service. Your material cost won't be much in most cases because you are not replacing parts, but merely inspecting, cleaning, adjusting, and tuning.

Of course, if you do have a service agreement coordinator, or dedicate part of one person to managing the service agreement program, you should spread the fully burdened cost for that person against the number of service agreements you expect to perform for the year.

Now add your pre-tax profit. It's probably less than the going rate for a service agreement in your market. Does that mean you should lower prices? No.

### **PRICING IS AN ART**

Service agreement pricing is an art, more than a science. You should price them high enough for the homeowner to perceive value, but not so high that they question whether they are worth it.

If all of that's true, then why go through the exercise of pricing them up? To be sure. Calculate the price so that you're sure you will make money on a marginal cost/marginal revenue basis. My guess is that you will generate a higher margin that you earn on service because service is saddled with overhead that does not apply to service agreements.

### **MULTIPLE SYSTEMS**

Many homes have more than one piece of equipment. When there are multiple pieces of equipment, that should be covered under separate agreements, the homeowner should get a break. The break is the truck cost and the fully burdened labor for the average time between calls. If you have already figured these costs, simply discount the second agreement by that amount.

## **TUNE-UP PRICES**

If you offer tune-ups separate from the service agreement, make sure that they cost more than the service agreement. You want to give people an incentive to buy the service agreement for the relationship opportunities they present.

Remember, the service agreement only "presents" relationship opportunities. You must follow up with these, your best customers, through the year to get the most from the program.

## **AUTOMATIC RENEWAL**

Many companies with strong service agreement programs utilize an automatic renewal. Once a homeowner enrolls in the program, he remains in it until he says he wants out. This places the burden of ensuring the service is performed squarely on your shoulders. And it is a burden.

Every year, I have to pay my vehicle tax. If I don't pay it by the due date, the cost of the vehicle goes up by a third. Thus, there's every incentive to pay on time. Yet, I often forget. Though I see the sticker with the date every time I get behind the wheel, I don't think about it. Your service agreement customers are the same. You will need to mail to them and call them, sometimes successively, to get the service scheduled. It's your responsibility to schedule it, just as much as it is the homeowner's responsibility. You can't renew if you don't perform the service.

## **CHOICES**

More service companies are offering choices in service agreements today. They offer a low end, low cost inspection only agreement (i.e., a "kick and check"). They offer the traditional tune-up and cleaning type of service agreement, and now, some are offering a full coverage or partial full coverage agreement.

With a full coverage agreement, you are basically covering anything that could go wrong with the listed equipment. Yes, it's an extended warranty. Some companies cover themselves by taking out extended warranties with Equigard or other companies that offer extended warranties. The beauty of the full coverage agreement is that it generates work now, when it's sold. In order for the system to be covered, it must be brought up to your standard. This is a time honored approach of the commercial market that is slowly filtering down to residential. Just like most homeowners prefer the certainty of flat rate, many prefer the certainty of knowing all repairs are covered.

A partial full coverage agreement is similar, but with exceptions. You might except the compressor for an air conditioner, labor to replace the heat section of a furnace, or the tank of a water heater. You might cover labor only and place the burden of materials on the homeowner.

If you choose to offer a partial full coverage or full coverage plan, you are choosing to engage in risk management. You must estimate the number of repairs you will need to cover and spread that cost over the number of coverage agreements you think you might sell. Then, be sure to set the money aside in a reserve account.

## **NAMES**

It's a mistake in this day and age to call a service agreement a "service agreement." The big box consumer electronics companies have taken over the term. It no longer means the same thing. Today it's synonymous with "extended warranty." You're not offering an extended warranty because you are going to service the equipment, saving energy, preventing breakdowns, enhancing safety, and so on. Call it something else.

You can come up with all kinds of exotic names for your service agreement. It's pre-planned service. It's scheduled maintenance. It's comfort protection or plumbing protection or electrical protection or what have you. HVAC consultant, Jackie Rainwater, the most recent inductee into Contracting Business' HVAC Hall of Fame, says to simply call it a maintenance agreement. Few people have built a program as strong as Jackie did with Peachtree in Atlanta. If all else fails, follow his lead.

## **PRESENTATION**

Presentation of multiple service agreements is the same as presentation of multiple pieces of equipment. Use the column approach and spell out the differences and the cost. You might want to break the cost down to a daily basis, to emphasize how little it is.

The Service Roundtable (<http://www.serviceroundtable.com>) has a terrific form for selling service agreements on a service call. The form has two columns, one for service agreement customers and one for non-service agreement customers. In the column for non-service agreement customers show the cost of a repair at the standard rate, the cost of the diagnostic or show up charge, and the cost of the tune-up(s) you would perform under the service agreement.

In the second column for service agreement customers, show the cost of the repair at the discounted rate for service agreement customers, the cost of the diagnostic (it's included), the cost of the tune-up(s) (also included), and the cost of the service agreement. It will always be less expensive for the homeowner to buy the service agreement. If the technician presents it half way right, people will buy.

## **MULTIPLE YEAR AGREEMENTS**

You may want to sell multiple year agreements. Give the homeowner a discount when they purchase more than one year at a time. How much? Give them 5% to 10% per year. Remember, you're locking them in. This is gold!

Juan Cardona of JC Heating & Cooling in West Virginia put together a form for new system sales where the customer agrees to purchase a service agreement for every year the new system is under warranty. Juan's form is legally non-binding, but when the customer signs it, he is committing. Because Juan presents it at the time of the final inspection for a new system, he is hitting the customer up at exactly the point where he is happiest and most apt to make the commitment. It's good psychology. As a result, Juan has a high service agreement conversion rate. He pushes the system with the ten year warranty and at the end of ten years, persuades people that it's time to buy a new one because the warranty coverage has expired. Brilliant!

### **NEW EQUIPMENT BUNDLE**

Whenever you sell new equipment, bundle a service agreement into the sale. Price it in. Do not include one with your Bubba system, but include one with everything else. Consider stepping up coverage as you step from good to better to best. People are starting to expect this. When you purchase a new BMW, for example, three years of full maintenance are included.

### **RESERVE ACCOUNT**

Make sure that you place the revenue from a service agreement into a reserve account and draw from it as you fulfill the agreements. Otherwise, you could artificially inflate your cash position and run out of cash when it's time to pay the technicians for doing the work.

### **PAYMENTS**

Ron Smith's latest advance in the art of service agreement sales is to charge the customer for a service agreement monthly through a credit card or bank draft. This drops the price to an inconsequential monthly amount. It is the perpetual service agreement.

If you're not ready to tackle a perpetual agreement, time your service agreement billing to periods of greater demand. For an air conditioning company, this means sending out the renewal invoice when it's hot, not when it's mild and people are not thinking about air conditioning.

### **SCHEDULING SMART**

Okay, I'm getting off the subject of pricing. This is profitability. Want me to stop? Didn't think so.

The real trick to making service agreements profitable in their own right is to schedule smart. Cluster agreements as tight as possible. Too often service companies send techs 30 miles between calls. You do not make money on windshield time. You make money when the tech is working for the customer. With service agreements you have scheduling flexibility. Schedule them to minimize windshield time.

Ideally, you will sell a cluster of homes in a neighborhood, so your technician can go from house to house to house, accumulating a grand total of five miles or less on the truck between calls. I know, it's wishful thinking. It took me a long time before I stopped believing in the tooth fairy too.

You can train your dispatcher to look at the call board and try to wrap up the day with a service agreement near the final call for a technician. Work them in. Some homeowners need a lot of advance notice. Others will be able to accommodate you with little notice. Learn your customer's habits and preferences and note them in their file.

### **FULFILLING THE PROMISE**

Once you sell the service agreement, the burden falls to your technicians to deliver. They have got to do more than some of the technicians on the sting TV shows. They have got to do a good, thorough job. They have got to go to the extra step of waxing equipment, cleaning fixtures, and so on. It's often these little steps that convinces the homeowner the value is present.

In addition, it's always a good idea to give the homeowner a written report. Check off the work performed, record operating parameters, and so on. Steven Howard at the ACT Group (<http://www.theactgroupinc.com/>) has a good service agreement starter kit with such forms for HVAC. Maurice Maio (<http://www.maiomarketing.com/>) has a kit for plumbing.

Whenever a technician services equipment, he is not merely a technician. He's in show business. It's time to demonstrate his abilities, to show off, to dazzle the customer. Given the effort most technicians make, your technician will shine brighter than the newly waxed furnace.

### **RESOLUTIONS**

This year resolve to...

- Review service agreement overhead to ensure you are not artificially raising the cost of your service agreement beyond acceptable market prices.
- Set a service agreement price that is high enough for homeowners to believe your service agreement holds value, but not so high it prevents sales.
- Review your multiple system pricing to ensure it is correctly discounted.
- Review your service agreement and maintenance pricing to ensure that maintenance costs the customer less when a service agreement is purchased.
- Consider adding an automatic renewal clause, perpetual service agreement, or multi-year offering.

- Offer a choice of service agreements.
- Develop an apples to apples comparison form for evaluating a service agreement purchase on a service call.
- Bundle service agreements with new equipment sales.
- Schedule service agreements so drive time is minimized.

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