

Service Agreement Success

Disciplines in Service Agreement Development



Residential Service Agreement Success

“Service Agreements are the life-blood of any residential service organization.”

Service agreements have been around for more than half-a-century. So why haven't we done a good job as an industry getting them in place within our service businesses.

Certainly, some contractors have, but more than 70% of the contractors in the U.S. do not have a healthy service agreement program. Let's define this now, so when we discuss what a service agreement is, we are not thinking about a different kind of service to the homeowner.

A service agreement can be defined a regularly scheduled visit to conduct a PTU or Precision Tune-Up on the home's equipment. There are any number of strategies that accomplish this goal, and all forms of products you can market in the maintenance market segment, so let's keep it that simple for now.

Interestingly, 80% of the net profit in our industry is made by 20% of the contractors. And guess what? One of the common themes is the 20% of contractors that make the profits...right...you guessed it.... they maintain a thriving, growing and healthy service agreement approach in their residential businesses. It isn't a coincidence.

By the way, it is also not impossible to be very successful without having a strong service agreement approach! It just correlates that most that are have a strong service agreement approach. Meaning, it gives you a few more arrows in your contracting service bag to shoot at the target. The target being 20% or better pre-tax operating profits!

So why can't or won't the other 70% of us get on with it and get a service agreement approach in place?

There are a couple of reasons:

1. We don't know how to do it well.
2. We don't want to do service agreements because it takes a lot of work – And it does!
3. We don't believe in service agreements.
4. Never had time to do service agreements – Just trying to make payroll.

There are no doubt some other reasons, but if you are reading this far, you have to be at least semi-interested in developing a service agreement approach in your business.

Let's take a look at some of recommendations, of what it takes to create or simply improve a service agreement program!

Philosophies for Service Agreements

Many companies have been successful marketing service agreements. They all share a basic common high-level theme. They have a philosophy of what their company does with residential service agreements and the stick to it.

Once they decide they like what they are doing and it works for them, they maintain their approach and do not change their philosophy of how they go to market.

An example of this is the philosophy of developing as many service agreements as possible on a volume basis – Not worrying about making a lot of money on the service agreements but instead focusing on volume. The philosophy here is called LOST LEADER!

A second and more common philosophy is to price the service agreement out to make a desired margin for the company, and sell them if and when you can when the opportunity presents itself.

Neither of these is right or wrong, they are just the beginning philosophy of what you will have to do operationally to create success in service agreements.

Types of Service Agreements

After you decide which of the philosophies you think you want to implement, the next consideration is what kind of products or services will you offer?

1. Precision Tune Ups – An inspection & cleaning only – Defined by the product.
2. 1 Year service agreement platform – May consist of several (2 or 3) PTU's a year.
3. 1 Year Labor only – Covers the equipment for labor on repairs for 1 year.
4. 1 year parts and labor – Full coverage on all parts and labor for 1 year.
5. Extended years labor – Labor coverage for a specified amount of years.
6. Extended years parts and labor – Full coverage full specified number of years.

The products and services we offer are based on what operational comfort levels we have as a company, and more importantly what we want to accomplish for our marketing plan.

Aligning the products we offer as service agreements with your philosophy is a key point. This also applies to how you will price these products/services in the next section.

Example of how a company might offer products:

Volume based program – Priced as a breakeven margin to overhead rate.

Offer 1	Basic PTU -	\$ 59.00 for 1 PTU
Offer 2	Service Agreement	\$ 99.00 a year (1st year 3 full PTU's) - Year 2 and beyond (2 PTU's)

Operationally – Discount off all demand service repairs great enough to allow for a reduced price for a service agreement.

In this offer the type of products contains a basic premise. No extended coverage is offered. It is the simplest offering that can be made. Buy a PTU, or buy a service agreement for the year.

It does not make it right, it makes it simple. As an example it clarifies for the technicians or anyone required by the company to offer these options to the homeowners that we have two options, buy a PTU or buy a 1 year service agreement which is in the 1st year a better deal for the homeowner. Simple!

Choose your product offering and decide what it is you want create a strategy around, then price it!

Pricing Service Agreements

The pricing of service agreements is not complicated. In fact, in the website under the template support section there's a number of EXCEL pricing template tools for you to use so you can price the service agreement products and determine what the correct pricing structure needs to be.

The pricing of service agreements is also somewhat dependent upon what kind of product selection you choose to offer. The various products will have different components in them such as:

- Direct Labor
- Direct Labor Benefits
- Materials
- Extended Warranty Coverage costs – If purchased through outside vendor.

Please refer to the service agreement pricing templates in the learning center, as you need to be certain your prices are set correctly.

Let's go ahead and look at the template for a basic service agreement approach following our earlier example of offering a PTU based service agreement 3 times a year.

PROACTIVE SERVICE AGREEMENT- 1st Yr. Tune-Up Price

	Data Entry	Output
Step 1 - What is your unburdened cost of Labor	\$ 16.67	
Step 2 - What is your Burden Rate (24%)	24%	20.67
Step 3 - Equipment to be serviced - Time Required?		
3 ton A/C System	90	
90% York Furnace	45	
Humidifier/Air Cleaner	15	
Total minutes to Complete PTU Work on Site		150
Travel time in actual minutes	15	
# of Calls in PTU Strategy	2	30
Step 4 - Conversion to Hours		3
Step 5A - Your Labor Costs to complete work		\$ 62.00
Step 5B - Parts Miscellaneous	\$ 2.00	
Step 5C - Any Commissions in Dollars	\$ 10.00	
Step 6 - Desired Gross Profit	38%	\$ 119.35
Step 7 - Tax - Labor Taxation/State - Final Price	0%	\$ 119.35
Step 8 - What if Market Price - Enter Price - Get Margin	\$ 99.00	25.25%

At loss leader price point



PROACTIVE SERVICE AGREEMENT- 2nd Yr. Tune-Up Price

	Data Entry	Output
Step 1 - What is your unburdened cost of Labor	\$ 15.00	
Step 2 - What is your Burden Rate (24%)	24%	18.6
Step 3 - Equipment to be serviced - Time Required?		
3 ton A/C System	45	
90% York Furnace	45	
Humidifier/Air Cleaner	15	
Total minutes to Complete PTU Work on Site		105
Travel time in actual minutes	15	
# of Calls in PTU Strategy	2	30
Step 4 - Conversion to Hours		2.25
Step 5A - Your Labor Costs to complete work		\$ 41.85
Step 5B - Parts Miscellaneous	\$ 2.00	
Step 5C - Any Commissions in Dollars	\$ 5.00	
Step 6 - Desired Gross Profit	50%	\$ 97.70
Step 7 - Tax - Labor Taxation/State - Final Price	0%	\$ 97.70
Step 8 - What if Market Price - Enter Price - Get Margin	\$ 99.00	50.66%

The example pricing spreadsheet above is the 1st year of the offering. It dictates that the three precision tune-ups are priced for that 1st year, and this leaves a margin of 25% after we figure a commission on the sale of the service agreement and some basic materials required in our tune-up procedures.

Since the second year counts as two tune-ups, instead of three, and you may be using a lower cost of direct labor through a tune-up specialist instead of a regular service technician, it makes sense to review the 2nd year and blend the margin together for the maintenance department. Why this makes sense is as we move forward in our life with service agreements, we will have many more 2nd, 3rd, 4th, 5th, 6th and beyond year agreements that are two PTU based than we will the 1st year 3 PTU based products. So our Service Agreement mix tells us that we should review the 1st and 2nd year together, as this is really what will determine the outcomes of our margin in maintenance.

NOTE: Do not forget – You will likely sell additional parts by **BEING THERE!** We are not considering this but only are considering the impact of our pricing strategy on the maintenance department margins.

Since the 1st year we conduct 3 tune-ups, one piece of equipment will get 2 visits of 45 minutes each = 90 minutes. The other will get 45 minutes. We are also there on the 1st call for demand service, so the diagnostic covers 1 of the three travel times, leaving only 2 additional travel times on the 1st year 3 visit model. Notice in the cell c41, we blend a technician labor hour, with 2 PTU specialists' labor hours 1st yr. costs!

The two year blended margin is 37.95 % with no parts or ancillary items added to the sale. Each year the blended margin will move higher.

What we just accomplished was a pricing exercise for a basic strategy in selling service agreements.

We did the simplest version of a service agreement, which was the PTU of spring, or fall, and a second product offering of a 3 PTU approach the 1st year, with the 2nd year being a 2 PTU approach.

We have **NOT DISCUSSED OPERATIONS** yet!

This was simply a pricing exercise that aligned with the chosen example strategy.

Here would be another example of pricing extended coverage agreements – Refer to the training & support materials EXCEL template if you want to price your own offerings.

Labor Coverage Service Agreement Price		
	Data Entry	Output
Step 1 - What is your unburdened cost of Labor	\$ 15.00	
Step 2 - What is your Burden Rate (24%)	24%	18.6
Step 3 - Equipment to be serviced - Time Required?		
3 ton A/C System	90	
90% York Furnace	45	
Humidifier/Air Cleaner	15	
Labor Adder for Coverage of Failures	20	
Total minutes to Complete PTU Work on Site		170
Travel time in actual minutes	30	
# of Calls in PTU Strategy	2	60
Enter extra minutes - added risk for labor coverage	0	60
Step 4 - Conversion to Hours		3.83
Step 5 - Your Labor Costs to complete work		\$ 71.30
Step 6 - Materials Required - Costs includes taxes		
Filter Material - Quantity of 2	\$ 4.00	
	\$ -	
Total Materials Costs		\$ 4.00
Step 7 - Total Labor & Materials Costs		\$ 75.30
Step 8 - Desired Gross Profit	43%	\$ 132.11
Step 9 - Tax - Labor Taxation/State - Final Price	0%	\$ 132.11
Step 10 - What if Market Price - Enter Price - Get Margin	\$ 135.00	44.22%

Here is the pricing template for full coverage:

Full Parts/Labor Coverage Service Agreement Price		
	Data Entry	Output
Step 1 - What is your unburdened cost of Labor	\$ 20.00	
Step 2 - What is your Burden Rate (24%)	24%	24.8
Step 3 - Equipment to be serviced - Time Required?		
3 ton A/C System	90	
90% Furnace	90	
Humidifier/Air Cleaner	0	
Total minutes to Complete PTU Work on Site		180
Travel time in actual minutes	30	
# of Calls in PTU Strategy	2	60
Enter extra minutes - added risk for labor coverage	60	120
Step 4 - Conversion to Hours		5
Step 5 - Your Labor Costs to complete work		\$ 124.00
Step 6 - Materials Required - Costs includes taxes		
Filter Material - Quantity of 2	\$ 4.00	
5% equipment Replacement cost- Failure Rate	\$ 50.00	
Total Materials Costs		\$ 54.00
Step 7 - Total Labor & Materials Costs		\$ 178.00
Step 8 - Desired Gross Profit	43%	\$ 312.28
Step 9 - Tax - Labor Taxation/State - Final Price	0%	\$ 312.28
Step 10 - What if Market Price - Enter Price - Get Margin	\$ 269.00	33.83%

What you can see in both the labor only coverage and the parts and labor coverage products is there are additional factors to consider.

1. The amount of extra labor you will incur on a failure.
2. The amount of extra parts, and or materials you will incur on a failure.
3. One must also determine the percentage of risk failure – That amount of failure, which is certain to occur over time, which needs to be estimated, then marked-up into your price.

Strategies in Marketing Service Agreement

The marketing of service agreements is a key element in developing a service agreement culture and success in your company.

You need internal marketing and you need external consumer marketing.

It all starts internally with these areas:

1. Convincing your employees this is a good thing.
2. Creating buy-in among your employees – Commitment to go forward.
3. Appointing a CHAMPION of Service Agreements on your company (Focus).
4. Training and education of ALL employees – Convincing is not education – TRAINING!
5. Developing bonuses and spiffs around the service agreement process.
6. Creating operations practices that work to create service agreement sales.
7. Developing a process to take advantage of service agreements – Leveraging the service agreement and maintenance business we now have.
8. Tracking and measurements for service agreements – Goal boards, reports, service technician debriefing and all manner of work with the service team.

The fundamentals are listed above, and they MUST be dealt with! You should craft your company solutions to these fundamental areas and present the approach to the employees.

Here are some additional marketing thoughts for service agreements.

1. Technician Sales Support Materials

What source of sales presentation materials do you arm your service technicians with to allow them to speak less and sell more, through the use of materials pre-prepared and packaged for the service technicians to give to homeowners while they are conducting demand service calls with new customers, or those that do not currently own a service agreement. The closure rate on such calls is close to 70% if properly organized.

That's 7 out of 10 Demand Service calls can become service agreement customers!

2. Technician Flat Rate System

What system of service pricing do you use? Are you allowing your demand service processes to compliment and work for your company and the technician to sell more service agreements? A properly organized flat rate system will offer the discount for the customer in a manner that makes the service agreement sign-up a no-brainer. See the math in the following pages that details this concept further.

3. Technician Made Easy Marketing Approach

The technician needs to be properly organized with service agreements that are easy to use and with service invoices that work WITH FLAT RATE, or WITH the TECHNICIAN to allow the sale of service agreements to happen as a natural part of any demand service call!

By creating marketing support materials in # 1 above, a pricing system in # 2, and a set of invoices and forms that allow the technician to be 100% COMFORTABLE, you have created a powerful platform for the technician to do the work required of him!

4. Technician Training Manuals

The technician needs to practice the system. That means a training manual that supports the ideas in # 1, # 2, and # 3 above. And we need to practice the sales process with our technicians once in a while to keep their customer communication skills sharp!

Technician Role Plays are the best way to conduct your training.

These very role-plays are the basis for how a technician is going to learn to offer the following options to homeowners on demand service and/or a maintenance agreement call:

- a. Thermostats that are new and sexy.
- b. Humidifiers/Air Cleaners
- c. IAQ Solutions (See the ISQ Model in the site content) – Example- duct cleaning.
- d. IAQ Diagnostic tools like Air Advice.
- e. Air Duct Modifications
- f. New Replacement Lead Opportunity

If you do not have a training manual with a defined approach for your technicians to follow – That YOU PRACTICE once on a while, you will get varying degrees of results based on your individual technician's skills. Practicing through role-Play scenarios, and a training manual helps them understand what skills you want – So we can allow CUSTOMERS to BUY FROM our company by educating well, and presenting solutions as options!

Thus far we have been focused on the internal marketing of service agreements. By far the best way to create service agreement sales and growth is inside the company. However, there are plenty of potential PTU's and service agreements that can be obtained through marketing externally to the community who currently may not understand what a value this is for them!

External Marketing

Direct Mail:

Direct mail is an excellent method of targeting certain areas and zip codes, and narrowing down your target audience of customers who may be potential prospects for PTU's and Service agreements.

Flyers:

Using flyers through services or through the newspaper as free standing inserts is also an excellent method, and is tied to the all-important TIMING of when the weather is breaking.

PTU Door Hangers:

Always a nice touch to drop letters or post cards inside door hangers with a premium gift like a magnet promoting tune-ups of service agreements.

Coupons for Precision tune-ups on your invoice:

These are part of the invoice and the technician tears the perforated letter off after the service call, and the letter contains coupons for service, service agreements, and PTU's.

Free PTU's for Friends and Family:

Granting a free PTU creates trial, not necessarily repetition.

A FREE:

Service agreement on each sale you make in Residential Replacement Market.

Operational Support for Service Agreement Success

Operationally, an example of how a Flat Rate manual and the actual service invoice can work together to help a technician sell a maintenance agreement is illustrated below. As the invoice is calculated, the amount of money saved by the customer, if they invest in a service agreement today is listed in the invoice column next to the BIG RED STOP SIGN!

The customer discount can range anywhere from 10% to whatever amount your company wants to allow, knowing this amount reduces your service margin some, you must set your street labor rate to properly adjust for this so your service margins remain at or near 60%. Given this framework, the technician can make the decision to invest in a service agreement a no-brainer. Look at the match on the next page.

Operationally Here Are Some Ideas For You To Consider In This Model:

1. The technician creates a price for the demand service call. A discounted version of this price appears in the bold highlighted yellow column. This savings amount is calculated. Depending on the actual service performed that day, it could be any amount. The strategy is to promote to the homeowner that this amount can be saved if they invest in a basic Service Agreement. See the math below in the chart. The diagnostic fee is NOT waived, as it is how we pay for our travel time to get there, and the actual time it takes to perform a quality diagnostic on the system. These costs are now part of our demand service call. However, we will discount the demand service total costs by some discount percentage (20% in this example) from \$ 400 to \$ 340 to make the homeowner economically interested in a service agreement today.

Which if they sign-up for we will go right back to the equipment and perform on-site and this will be their 1st of the three PTU's will perform.

The Math for Service Agreement Sales Strategy

Standard – No Process	Process	
\$300.00 Invoice	\$300. Invoice – Discount 20%	\$240.
\$ 59.00 Diagnostic	\$ 59. Diagnostic	\$ 59.
\$359.00 Total		\$299.
No PSA/NO PTU	PSA	\$ 99
	Total	\$398

For an additional \$ 39.00 homeowner gets 3 PTU's 1st year

2. The 1st year use 3 Precision Tune-ups instead of two – it costs more, but it places the PTU specialist or service technician (who is now trained to educate and discuss options with customers) in the home one additional time the 1st year.

1st PTU

- No Travel – Diagnostic covers
- Costs are 1.5 Hrs Labor w/Burden

2nd/3rd PTU

- = 3 Hrs Labor with Burden
- Typically a 25% Margin with 4% Sales Commissions and Renewal Commissions (\$5.00)
- 38% is Essentially Breakeven
- Each PSA 20% Lead rate – 1 out of 5
- Generate \$ 650. Replacement Revenue Average PSA – through Accessories/New Equipment Replacement – per Year per PSA the Company has.

2ndYear2 PTU's

- = Blended out with 1st year is closer to 50% margin – blended to 38% when combined with the 1st year lower margin. (See pricing examples earlier).
3. The second year and beyond, we go back to 2 PTU's each year.
 4. Have your technicians design the proper time and tasks for the PTU. This creates a quality product and the buy-in necessary for the answer to the question – is a good value – for the technician's response to be a believable YES it IS!
 5. Create a class of PTU specialists once your company has enough service agreements. This becomes a feeder position for future service technicians.
 6. Operationally, sell your service agreements through your demand service as opposed to marketing through spring and fall. Some direct marketing we discussed earlier will follow the spring and the fall weather patterns in your market area, but the vast majority of service agreements can and will be sold during the period of WHEN THE TECHNICIAN IS IN THE HOME! Consider this opportunity. It creates the need for you to plan operational labor hours around the newfound need to satisfy your new service agreement customers. That is why a PTU specialist is a good operational tactic.
 7. Renewal procedures are simple. The PTU specialist or technician on the call the last PTU check-up renews the agreement for the next year. No letters, no postcards, just a simple process. A spiff is paid for the renewal. In addition, it is much harder for a customer to attach value to a direct mail letter or postcard than it is to a real life technician who has DONE A GREAT JOB for the customer!
 8. These agreements are always collect up front or what we call full pay, so you have the money up front prior to completing the work.

Financial Measurements for Service Agreement Success

Financially, service agreements are one of the most dynamic and healthy ways to improve your profitability.

A few financial key performance measures to keep in mind:

1. Each Service agreement should produce approximately \$ 650.00 in recurring replacement revenues for each agreement from now on as an average.
2. The minimum target for service agreements is 1000 per 1 million in replacement, service, maintenance and IAQ revenues. The best target is 1500 agreements per million. These are full pay (up front pay) agreements.
3. 90% or better renewal rate
4. \$65,000 revenue per maintenance truck minimum – Pure maintenance.
5. Maintain labor as a percent to maintenance sales at 34% or less (non-burdened).
6. Overall gross margin percentage between 45-50% including ALL parts/labor sales.
7. Service & maintenance together as a % of total company sales should be between 25%-30%.
8. A replacement sales or accessory lead on 1 of every 5 maintenance calls.
9. Lead closure rate of 75% or greater on the maintenance generated leads with a gross margin of between 42-45% on those sales closed from the maintenance leads.
10. Materials & parts at 6-8% of maintenance sales.

The financial equation of how a strong and healthy maintenance agreement program affects your company's profitability cannot be understated. It may be one of the most important things you can do for your company.

1. Maintenance allows more freedom in the management of your labor force. It allows you to shift your labor around some, not perfectly, but enough to smooth out the rough edges of not having enough backlog during certain times of the year, having the effects of keeping your people busy instead of putting them on furlough. If you send them home, they do not always come back, and this costs you money and production capability.
2. Service Agreements allow you more direct contact with customers who own a trusting relationship with your company, allowing you to educate them in a different manner than those customers who are brand new and do not have a relationship.
3. Service agreements allow you to lock in a customer, which has the financial impact of reducing your external marketing expenses. Since you will be able to count on more leads internally from these customers, you can spend less to get leads and the resulting revenues. This reduces your company overhead by reducing your marketing expenses.

4. Reaching a target of 1000 or 1500 maintenance agreements per million in residential revenues allows your company to train more effectively the next generation service staff through the maintenance PTU specialists. You are paying this position less money, and they affect you less if they leave you, or do not work out as you had hoped. It still is costly, but not nearly the same as hiring a bad service technician right off the street. This becomes the feeder for your service organization. This also has the effects of increasing your productivity, which directly relates to your profits at the end of the year!
5. Is it possible if we have a trained force of service personnel that we may actually generate a high margin replacement sale that does not have a competing bid? 75% closure rates on these leads from maintenance is only rivaled by referrals in terms of lead tracking results, and further these margins are among the highest due to customers that WANT us to talk to them about their needs and listen to our technicians more favorably than a typical sales person.
6. As you develop your service agreement products, remember to price them appropriately against your costs, and any liabilities you decide to incur. When you decide to extend your services to labor coverage, and or parts and labor (full coverage) coverage, you begin to incur more risk. That is okay, as a business you simply need to identify the risk, and properly price the coverage for that risk you assume. Many customers like the idea of extended coverage for their equipment. You just need to be sure your price reflects whatever risk you assume. Your ultimate goal in any agreement is to get the future replacement sale.
7. Anytime you have a service technician performing a service agreement work order; there are more costs associated with this than just the raw labor. Remember that if the technician is performing an SA, then they are not performing a demand service call. During peak periods, this has an impact on your service department. This is one consideration financially why a PTU specialist may be in your best interest. The technician can have the option of performing the work during slower periods, and the PTU specialist performs the work during peak periods.

Step-by-Step to Implementation of a Service Agreement Culture

1. Define your overall culture – Do you want to have service agreements become a part of how you conduct business? If so, what do you expect?
2. Write-out your philosophy for service agreements so you can internalize the philosophy and begin to communicate it to your employees.
3. Involve your key company personnel in the challenge of developing a dynamic service agreement approach.
4. Develop a strategy for how you plan to go to market with your company service agreements. The strategy is going to dictate the operational tactics and processes that need put into place.
5. Make the lists of benefits to the customer, the employee, and the company and have the key employees define these as they work on the challenge of implementing service agreements.
6. Price the Service Agreements based on your choice of strategy. Use the pricing templates. Be sure to choose a strategy that works for your company.
7. Print the service agreement forms and consider having a referral for your service agreements tied into your demand service invoices.
8. Design compensation and reward system for the sale of service agreements, and the renewal of agreements.
9. Decide how you want to operate. Do you want to tie a discount into your demand service for service agreements? Your operational practices need to match-up with your goals for service agreements, and of course how you intend to market them.
10. Train the service/maintenance technicians on your service agreements approach. Now that you have your program in place, you can communicate and answer questions that are bound to come-up!
11. Begin to track and measure your performance.
12. Celebrate and discuss your success, talk about your program weekly. You should plan to make adjustments and anticipate the fact that it will NOT start perfectly.

Why is this Critical to Your Success?

- Service agreements are good for your customers – if they are happy and have peace of mind – what is that worth? Many customers want this security we just have to offer it to them.
- Service Agreements are excellent for your employees – providing a work routine for service departments when business seasonality slows the labor demand.
- Service agreements allow a proven training ground for new or prospective service technicians. It allows them to see and work in and around many pieces of equipment concurrent with training.
- Service agreements allow you to lock in your existing customer base so a competitor does not come and take your customers from you, and the very same competitor may show up on replacement leads to bid against you more often if you DO NOT have service agreements.
- Service agreements allow a company to create marketing offers to existing customers through technicians that are completing the service agreement work, resulting in additional accessory sales, and even equipment leads that resulted from the technician being IN THE HOME!
- **A well-designed service agreement program will add PROFIT to your business!**