Making Service A Priority

The Long-Term Implications of Putting Customer Retention First

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Contents

Introduction

Among the varying business models and sales approaches we have seen performed by security alarm providers, only a select few outperform the rest. These models vary in how dealers determine the quality of alarm panels they provide, the manner in which they install the devices, the level of service and maintenance provided to existing customers and even how the dealers react when a customer leaves.
This book will focus greatly on the retention of existing customers and understanding the reasons why customers leave. In part, we will analyze the average lifetime value of a security subscriber and identify the exact variables that determine the profitability of a customer. The information in this book is based on research performed in the security space and others.

Introduction

There is an unfortunate stigma that permeates the security industry. According to customer reviews across more than 15 sites, particular security companies are frequently known for their lengthy contracts, cutthroat sales practices and poor customer service. Worst of all, this stigma affects customers throughout the buyer's journey, and even turns people who would be interested away from monitored security altogether. This especially true with the rise of the DIY market and the ability consumers have to monitor their own systems. When customers look through review sites only to find bittered people with negative experiences, they will look to other avenues to fulfill their needs.

Security companies who put customers first, emphasizing quality service and reward programs, are those who retain customers longer. This is important because, as this book will discuss, customers become more profitable over time. Sadly enough, more than 10% of customer defections are because of poor service. Some may scoff at the idea of working to retain only 10% more of their customers, however, a famous Harvard Business Review article argues, "companies can boost profits by almost 100% by retaining just 5% more of their customers."[1]

1 Reichheld, Sasser Jr. (1990)

Why Retention Matters

Retention is more than a matter of boosting profitability. Corporate social responsibility (CSR) is a term making its way into societal expectations. It demands more from companies and changes the way they operate. "CSR is a business approach that contributes to sustainable development by delivering economic, social and environmental benefits for all stakeholders."[2] The beautiful part about CSR, is it creates fertile ground for business to develop, even literally in some cases.

2 Financial Times (2014)

To help visualize CSR in action, let us first consider the tobacco industry. Perhaps one of the most poignant examples of a socially irresponsible product and industry, tobacco fails every point of inspection. First, Tobacco is worth examination because it kills its own consumers, is responsible for 5% of global greenhouse gas production and causes mass deforestation.[3] Worst of all, tobacco keeps lifelong consumers through addiction and imprisonment rather than freedom and satisfaction. Therefore, tobacco fails the CSR model because of its inability to provide pro-social benefits to consumers or the environment it inhabits.

Even if tobacco companies provided amazing benefits packages to their employees or donated money to

3 Novotny, et al. (2015)

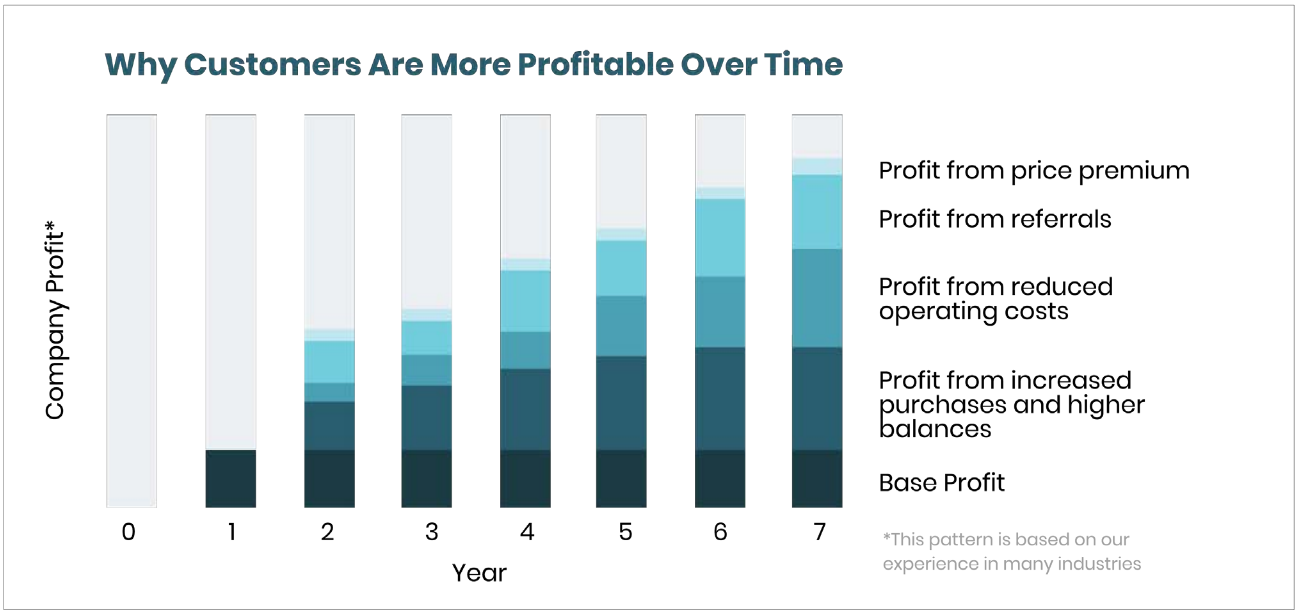
Why Retention Matters

philanthropic endeavors, their good deeds would still be heavily outweighed by how it decimates the quality of life of its customers. While the security industry does not look nearly as grim, business leaders still must consider the long-term repercussions of their strategies. For example, customers who develop an aversion for contracts will eventually boycott monitored security systems entirely. And security systems that are installed sloppily or erroneously will eventually make a lot of noise (literally and figuratively), irritating the customer while creating an undesirable user experience.

As security dealers look to improve their customer retention rates, they must be willing to give up old habits and change the way they do business so customers choose to stay rather than being contractually obligated. "Since companies do not hold customers captive, the only way they can prevent defections is to outperform the competition continually."[4] Dealers exist who offer month-to-month (no contract) monitoring to consumers. They regularly challenge themselves and others to earn RMR every day. Not surprisingly, the attrition rates at these companies is lower than the industry average. Apart from simply removing contracts from the customer experience, the absence seems to have sparked a higher level of service to compensate, and their subscribers have noticed.

4 Reichheld, Sasser Jr. (1990)

The Financial Implications of Good Customer Retention



Graph recreated from the article by Reichheld, Sasser Jr. (1990)

Every business person should know the universal adage that it is ten times more expensive to sign a new customer than it is to retain an existing one. As a single customer does more purchasing with a company, operating costs decline. Checking customers' credit histories and adding them to a database is expensive, but those things only need to be done once. "One small financial consulting business that depends on personal relationships with clients has found that costs drop by two-thirds from the first year to the second because customers know what to expect from the consultant and have fewer questions or problems."[5]

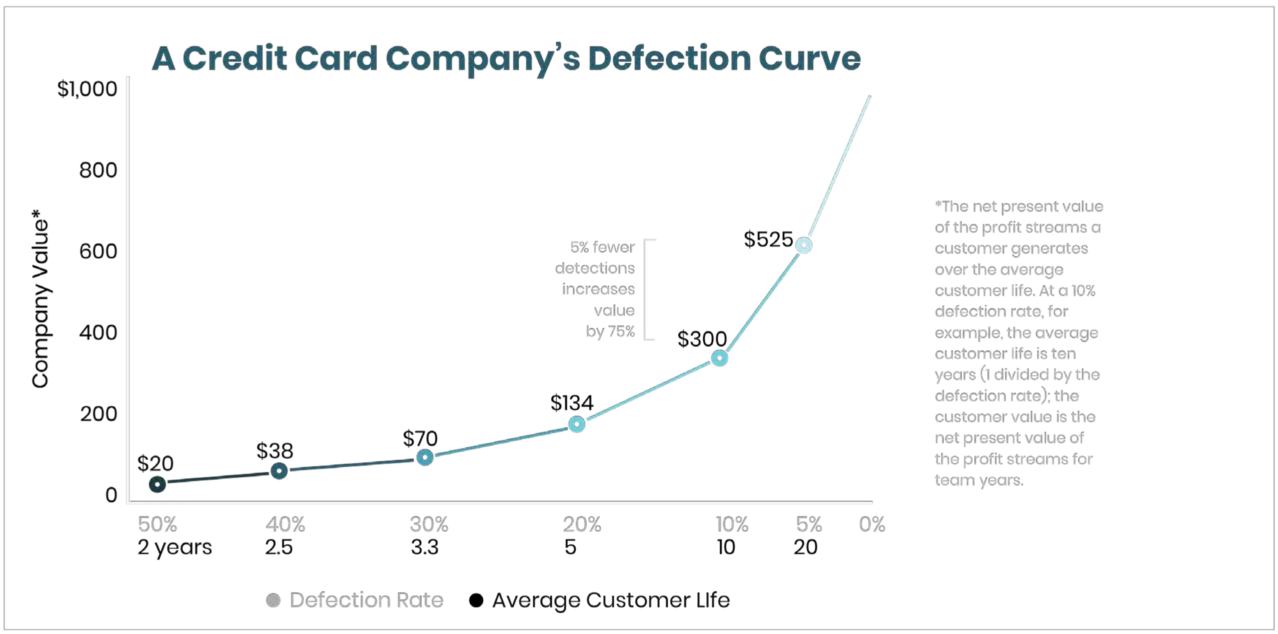
5 Reichheld, Sasser Jr. (1990)

The Financial Implications of Good Customer Retention

When considering the customer lifecycle stages, it is important to recognize that customers must be nurtured, not forced through the funnel. First, they look to solve a problem. Once they have put a name to their problem, they start to consider their options. After shopping, customers make a decision, and if served properly, become advocates of the brand they choose.

To calculate a customer's real worth, a company must take the following projected profit streams into account:

1. Base profit
2. Profit from increased purchases and higher balances
3. Profit from reduced operating costs
4. Profit from referrals
5. Profit from price premium



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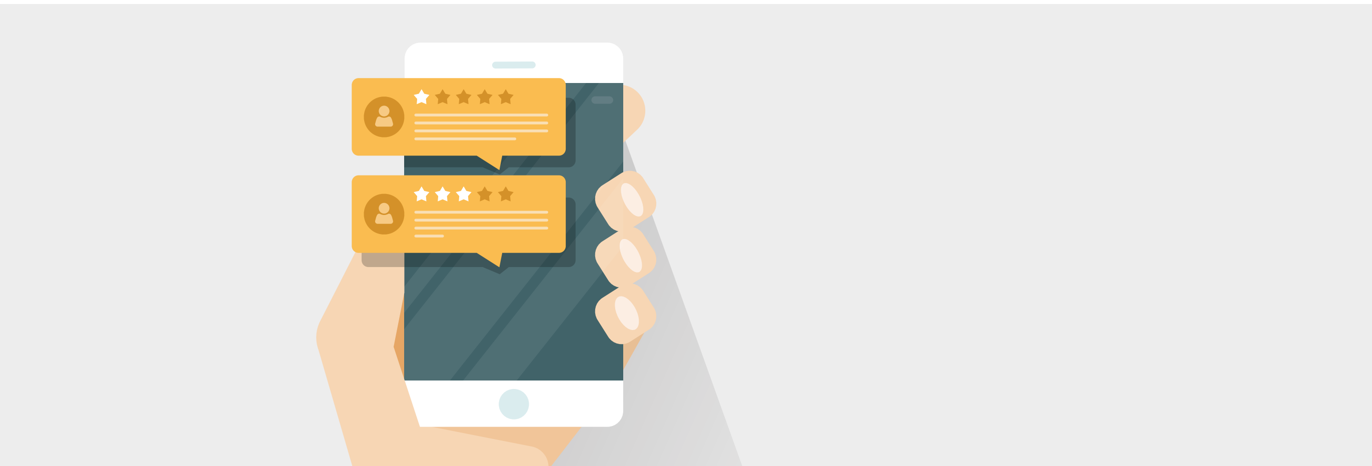
Why Security Subscribers Leave



We performed a qualitative analysis of over 15 user review sites and security/technology blogs. As part of the analysis, we made sure to include the reviews for multiple security companies of varying sizes, and none with less than 1000 accounts.

This helped assure the complaints didn't only account for the door-to-door dealers who make sales and leave. Of the hundreds of complaints we examined, the reasons can be grouped within three categories, ALL service-related.

1- The Cost to Value Ratio

The least common of the three, yet still prominent among complaints was customers felt they were paying much more money than the service deserved. The dissonance between the two seemed to create a sort of resentment as the monitoring bill came through their mail each month. Some customers left because their system didn't have enough features or they simply couldn't justify a $30/month bill for a service that never met any burglars. While these problems don't seem to have clear fixes, dealers can be proactive by educating their customers or rewarding them for achieving such milestones as being with a company for a period of time. Customers who feel disparity in the cost to value ratio deserve reminders, success stories, industry education and product refreshers. The more the customers engage with the products, the more value they will find in what they are paying for. Research has shown a high level of customer satisfaction in the home automation sphere. Integrating security systems with home automation features are another great way to improve the value proposition.

2- Lengthy Contracts

This issue alone may be one of the greatest reasons customers leave for good and new ones never come in. About 25% of the reviews we examined involved customers frustrated with auto-renewing contracts, agreements they couldn't get out of or having to be in a contract at all. This is especially true for new customers who aren't entirely sure they will be satisfied with a security company; one of the ways we suggest combatting this is by offering more options to subscribers. Offer lower prices for contracted services and higher prices for month-to-month accounts. Additionally, be sure to honor the contract terms, and re-nurture customers as their contracts near their ends so they will feel the decision to renew is their own. Nothing seems to irritate customers more than having their contract automatically renewed for another two or three years, only to find they had to pay undesirable fees to escape it.

3- Poor Customer Service

Interestingly enough, the most common complaint that included more than 95% of complaints is the inability to get in contact with the dealer's front office or technician. Most alarmingly, subscribers in this situation needed help fixing sensors or troubleshooting problems with a faulty installation. There are a few ways to solve this problem, and all of them have to do with increasing availability. If providing in-office support is impossible, dealers can hire their monitoring center or answering service to be a sort of front office that communicates with technicians and forwards work requests. This is such a simple fix, and upon implementation, will drastically improve dealers' retention rates.

The Security Customer’s Lifetime Value

You may be wondering now, after reading about the potential lifetime values of customers in other industries, how to calculate your own CLV. Use the following equations to find yours.

Hypothetical Example:

1. Average subscription for security system is $35/mo.
2. The average subscriber stays aproximately six years
3. Therefore, the average lifetime value of a security subscriber can be greater than $2,500

(Use this hypothetical list as a guide for the equations on the next page. Use your own company numbers for greater accuracy.)

Calculate Lifetime Value (LTV)

Constants

s — **Average customer expenditures per week across five customers.** *(e.g. - Divide the $35/mo. subscription by 4 weeks)*

i — **The Rate of Discount.** The "rate of discount" is the interest rate used in discounted cash flow analysis to determine the present value of future cash flows. e.g. - The current rate of discount is 2.25%

r — **Customer Retention Rate.** The percentage of customers who, over a given period of time, repurchase, when compared to an equal and preceding period of time. (e.g. - 75% = 0.75)

c — **Average number of customer visits per week** ("the purchase cycle": In terms of RMR, this number is 4.)

t — **The Average Customer Lifespan** (how long someone remains a customer in years. e.g. 6 years)

m — **Avg. Gross Margin per Customer Lifespan.** Considering your profit margin (p), and the average amount a customer spends during their time as a customer, multiply the two to find your gross margin per customer lifespan. (e.g. 0.4 x (35 x 12 x 6) = $1008)

p — **Profit Margin per Customer.** (e.g. 40% = 0.4)

Different Ways to Calculate LTV

Companies can use several different equations to calculate CLV. We've included three common equations below. These equations can be used to help determine marketing budgets, and, ultimately, the cost of acquisition. The final result is the average of the three.

(Example numbers below come from the hypothetical example on previous page)

Simple LTV Equation

$$52\,(a) \times t$$

Equation Filled

$$52\,(8.75) \times 6$$

Calculated LTV

$2,730

Custom LTV Equation

$$t\,(52 \times a \times c \times p)$$

Equation Filled

$$6\,(52 \times 8.75 \times 4 \times 0.4)$$

Calculated LTV

$4,368

Traditional LTV Equation

$$m\left(\frac{r}{1 + i - r}\right)$$

Equation Filled

$$1008\left(\frac{0.75}{1 + 0.025 - 0.75}\right)$$

Calculated LTV

$2,749

Average LTV

$3,282

By calculating your own CLV, you can begin to estimate the maximum acquisition cost of a new customer and understanding the value of your existing customers. Using the averaged estimate from the three equations will help you know whether or not you are losing money and will help you think of innovative ways to grow your customers' value.

Infographic recreated from Kissmetrics

Conclusion

The purpose of this book was to encourage you to think about innovative ways get customers to *choose* to stay. It is about improving transparency, clarifying important contract details and nurturing customers through the sales funnel. When global entities like Amazon provide two-day shipping, unlimited movie and music streaming, and a myriad of additional included services for only $15 per month, it's no wonder subscribers feel duped when they pay twice that for a service with only one feature. The security market simply has to step up its game in order to keep up with current trends and stay relevant in a connected world.

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