ALARM CAPITAL ALLIANCE

ATTRITION: THE SILENT KILLER

Executive Summary:

Attrition is a key metric in the security industry. Your rate of attrition directly impacts the health, profitability, and ultimate value of your security alarm company. In the alarm industry, revenue is measured in terms of recurring monthly revenue (RMR), therefore your company's gross attrition rate – the percentage of accounts you lose over a set period of time – directly impacts your revenue. As a key value driver, attrition will be a primary focus of potential buyers and will directly influence the price they are willing to pay for your accounts or entire company.

Attrition is also one of the most misunderstood concepts in the alarm industry. Many people don't fully understand how to calculate an accurate attrition rate, what the information really means, or why maintaining an attrition rate at or below industry standards (about 12 percent gross) is so important to achieving both their short- and long-term goals.

This whitepaper explains the fundamentals of this key concept: what attrition is, how to calculate it, and what it means – both to your company and to potential buyers of your accounts. It also provides three key strategies for combating attrition: understanding and addressing the reasons your customers are canceling, focusing on the customer experience as an antidote to attrition, and designing your sales program to minimize attrition from the start.

Attrition: The Essentials

Many alarm business owners are shocked to learn that their attrition rate is much higher than they estimated. This may be because they don't know the essentials of attrition: how to calculate an accurate attrition rate, the important difference between gross and net attrition, and what these rates really mean in terms of revenue and account value in an eventual sale.

Simply defined, **gross attrition** is the total number of subscriber accounts (or amount of RMR) your company loses over a period of time (typically measured in losses over the trailing year) divided by the total number of accounts your company owned over the same period. An accurate attrition calculation also reflects accounts that should be terminated for non-payment, otherwise known as **Rate-at-Risk**. By industry standards, any account more than 90 days past due is considered canceled (regardless of whether notice has been given) and must be factored into your attrition calculation.

A good practice to best determine your attrition rate is to request an online/offline report from your central station(s) and reconcile the deleted accounts with your own billing system.

The alarm industry views both gross attrition and net attrition as important – yet different – metrics. Simply put, gross attrition measures the percentage of accounts that cancel, either outright or are 90-days past due. **Net attrition** incorporates the accounts that a company has gained over the course of a year, which replace those that have canceled; in other words, a new customer that moves into the home of a canceled customer would offset the cancellation.

For potential buyers, gross attrition is the more critical metric, as it represents the actual number of accounts your company has lost over the course of a year, expressed as a percentage of your overall account base.

For potential buyers, it reflects the stability of your account base and provides a metric to predict the potential loss in value, over time, of the assets they are buying – the RMR from your accounts at the time of purchase. In simple terms, buyers use gross attrition to predict the loss of RMR they are likely to incur each year after purchasing your accounts and to estimate the cost of maintaining the same rate of RMR through replacement of those lost accounts.

> Gross attrition factors directly into the multiple that buyers may be willing to pay for your accounts.

SIMPLE EXAMPLES OF BOTH GROSS AND NET ATTRITION.

A – *Accounts lost over the past year*

B – *Accounts over 90 days past due*

C – *Accounts gained, replacing canceled accounts**

D – *Total number of accounts owned over the last 12 months*

GROSS ATTRITION:

$$\frac{A + B}{D}$$

$$\frac{A=10 + B=2}{D=100}$$

Gross attrition is 12%

NET ATTRITION:

$$\frac{A + B - C}{D}$$

$$\frac{A=10 + B=2 - C=10}{D=100}$$

Net attrition is 2%

*For example, a new customer that moves into the home of a canceled customer, directly offsetting the cancellation.

1. TRACKING YOUR ATTRITION

Tracking attrition regularly makes good business sense. It is a fact, generating new customers costs more money (sales and advertising, commissions, equipment, and installation) than retaining existing customers.

Companies with attrition rates at or below industry standards receive higher value for their accounts. Purchase value is most often calculated as a multiple of qualified RMR, and companies with low attrition rates will not only have more qualified RMR to sell but will also, typically, receive a higher multiple. In some circumstances, a buyer will walk away from a potential transaction if the attrition is too high. Having a healthy attrition rate can also reduce the holdback amount in an acquisition. **Holdback** is the specified amount of a transaction that is withheld from the initial funding for an allotted period of time, usually 12 months, to cover the losses relative to a company's attrition in that same time period.

> Profitable alarm companies monitor their attrition rate and take consistent steps to keep it at or below industry standards.

To minimize attrition and maximize revenue and value, companies should monitor both short- and long-term attrition regularly. Calculating your short-term (annual) attrition monthly or quarterly can help you identify current issues before they get out

of hand. Tracking long-term attrition over a three-to-five year period can also help identify trends and issues that may not be evident in short-term attrition numbers.

However, just tracking your attrition with an accurate calculation is not enough. You need to objectively review and evaluate the data and identify changes that need to be implemented throughout the company.

Understand and Address the Reasons Your Customers Cancel

"Ordinary" attrition results from issues outside of your company's control: customer moves outside of your business' footprint, deaths, financial issues (for example, job loss or bankruptcy), and other customer life issues which affect the demand for alarm services. **"Extraordinary" attrition** occurs either when customers cancel accounts for reasons related to your company's performance, or when a competitor is able to win over your accounts with its marketing promotions or sales strategies. Non-payment, whether because of customer service issues or the customer has stopped using the system and doesn't want to pay for it any more, is a good example of "extraordinary" attrition.

You can't combat attrition effectively until you know exactly why your accounts are canceling – whether from internal factors (such as customer service issues) or external factors (such as competition). Just because some attrition is inevitable, doesn't mean you should ignore it. Armed with accurate information about attrition, you can develop procedures to minimize account aging and loss.

The following are ways you can better understand and combat the reasons your customers may be canceling.

Establish procedures to document and track the reasons your customers cancel

Capture the "real" reasons behind every cancellation.

How can you collect the necessary data?

- Establish a uniform set of standardized codes or descriptions for cancellation reasons;
- Create a script of questions for employees to uncover cancellation or non-payment reasons;
- Ensure that the information you're gathering is well documented in the customer's file and keep detailed account records for each customer through the entire lifecycle of the customer relationship.

Detailed information will help you understand why a customer may have stopped paying or canceled. Armed with this information, you can track trends in attrition and identify and manage both internal and external factors that may be contributing to cancellations.

Use different approaches for different cancellation reasons

To effectively drive down attrition, your strategies must address the underlying reasons for cancellation.

Cancellation for company-related reasons can be addressed through internal process changes.

These include providing better resources and employee training to address customer service issues, developing equipment standards to alleviate system issues, and implementing better procedures for your back-office functions.

You can also take steps to combat the drivers of attrition that seem out of your company's control– such as economic factors and competitor-driven cancellations–by making sure you know and understand the threats to your customer base and by providing your employees with the tools–and the authority–to address different cancellation reasons before they occur.

Competitor-driven Cancellations

Information is the key to combating competitor-driven cancellations. You need market intelligence, a good understanding of your competitors and what they offer, and what, ultimately, differentiates you from them. A special subset of competitor cancellations consists of customers who are switching to either DIY systems, or services offered by telecommunications or cable companies as part of a bundled package. Once you know the reasons behind the competitor-driven cancellations, you can decide what measures to take to combat them.

Are your service offerings competitive? Actively market service and technology upgrades. Don't wait for your customers to call you for upgrades or new technology. If you wait, your competitor may come knocking on your customer's door and offer to install a new system for free.

Relocation

While one of the most common causes of cancellations is customer relocation, customer moves can actually present business owners with the opportunity not only to retain a customer (the departing homeowner), but also to get a referral to a new one (the incoming homeowner). Consider creating a move or relocation program that gives the outgoing customer, moving locally, the ability to transfer their services to their new home and incentivize the new, incoming homeowner.

System Non-use

Customers often state the reason for their cancellation is because "they don't use their system anymore."

Whether the result of an old or outdated system, changes in customer needs, or the sale and installation of the wrong system for the customer in the first place, system non-use is a major factor driving both customer-initiated cancellations and cancellations for non-payment. Mitigate this attrition cause by communicating regularly with customers about the value of owning and using a security system, as well as explaining the specific services your company provides, including basic services and new technologies. Use e-mail, newsletters, bill inserts, website blogs, and other communications as touch points with customers. Highlight other services you offer–such as monitored smoke detectors, carbon monoxide monitoring, and water detection monitoring–to communicate that the system provides always-active services and value, even if they don't use the intrusion portion of the alarm.
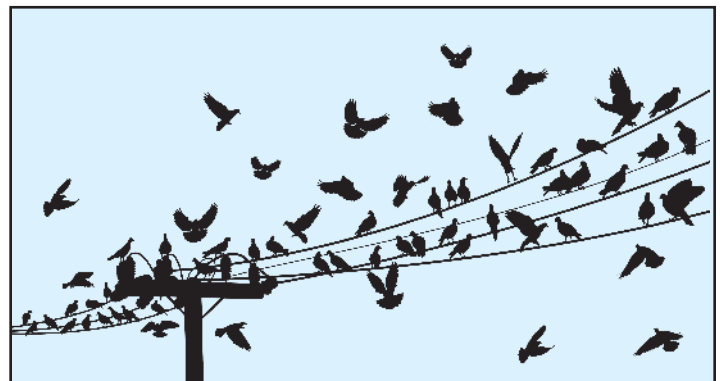
Non-paying Customers

While they may not have actively canceled, non-paying customers–those whose accounts are 90 days or more past due–are considered to be canceled accounts. Like many other reasons for cancellation, combating attrition due to non-payment requires understanding and addressing the underlying reasons for non-payment. You can reduce the number of aging accounts by implementing consistent billing and collections processes. In addition, if you know that consistency in billing and collections is a challenge for your company, consider outsourcing this function to one of the companies in the industry that offer billing and collection services.

> **Develop appropriate messaging for each cancellation reason and empower your employees to solve customer problems to reduce attrition.**

2. THE CUSTOMER EXPERIENCE AS AN ANTIDOTE

When your employees interact with your customers, they become "brand ambassadors."

It's a fact: the longer a customer stays with your company, the more profitable the relationship becomes. A good customer retention program not only protects your customer base and your RMR, it directly and positively impacts your net revenue and value.

How do you retain customers and get them to promote you? *Give your customers exactly what you promised.* Go beyond just fulfilling your brand's promise and providing them with the best customer experience possible to ensure that they become avid promoters.

While it seems obvious that providing an excellent customer experience can help minimize attrition, attaining this goal is challenging. It requires management buy-in, implementing good policies and procedures, and continual employee training.

Here are some steps to help you provide your customers with a best-in-class experience.

Implement the Highest Standards

Some of the key hallmarks of a best-in-class customer experience for your customers include: positive call center touches; prompt phone service, flexible times for installation, testing and maintenance, or repairs; the right equipment installed correctly the first time; and knowledgeable and friendly staff in all departments.

View Your Employees as Brand Ambassadors

In the eyes of your customers, every employee and independent contractor is a brand ambassador for your company. Every interaction, whether over the phone, online, by e-mail or regular mail, or in-person, presents another opportunity to provide that customer with an excellent experience. Invest in your employees and give them the tools, training, resources, and authority to provide an excellent customer experience.

Add Value – for Free

Every interaction with a customer is another chance to earn that customer's loyalty. One way to enhance the experience of dealing with your company is to provide something of value – at no cost. Proactively providing relevant, timely information (via e-mails, newsletters, bill inserts and on your website and social media) that is designed to inform rather than sell, is one way to provide added value.

Get Feedback

Knowing how your customers truly feel about your company and your services is invaluable in preventing cancellations before they happen.

Give all employees who consistently interact with customers the direction to ask not only about the specific interaction but about other issues as well. Asking two or three brief questions at the end of a customer service call can give you invaluable information. Keep questions brief and limited in number, and acknowledge that you know that the customer's time is valuable. Don't forget, social media can also be a wealth of real-time information from customers.

Customer satisfaction surveys are also an effective way to gather information from your customers. Again, make the questions simple and limited in number, and include a mix of yes/no, rating (1-10), and open-ended questions to get the best and most complete information. Consider offering a bonus or reward to those customers that agree to take the survey.

In addition to, or as part of, your customer satisfaction survey, consider using a simple Net Promoter Score® survey. The Net Promoter Score (NPS) measures customer loyalty, and is derived from asking the likelihood, on a scale of zero to 10, of whether a customer would recommend the company's products or services to a colleague, friend, or family member.

See Complaints as a Gift

In her book, *A Complaint is a Gift*, Dr. Janelle Barlow, the President of TMI US (the global consulting and training firm) suggests that customer complaints should be treated as gifts of information, opportunities to make customers happy, and ideas on how to improve products and services. Of course, this mindset is hard for you and your employees to maintain in the face of complaining customers and product or service problems. Nonetheless, remember to value the information you glean from customer complaints. Use the information not only to solve the individual customer's problem (and hopefully retain that customer), but also to identify company-wide issues that need to be addressed.

> All the information you gather from your customers is useless if you don't actually do anything with it.

Work the Customer Feedback Loop

The customer feedback loop helps you take the information that you've collected and use it to make changes to address issues and combat attrition.

After **collecting** the information, whether from customer service calls, complaints, or surveys, **acknowledge** the customer for providing the information. **Evaluate** the data to identify issues

that need to be addressed and **act** to implement policies, processes, or procedures to address those issues. Don't stop there! Once the changes have been implemented, **communicate** with all of your customers to let them know the changes and improvements you've made to benefit them.

Let Go with Grace and Goodwill

Providing an excellent customer experience requires good customer care at every stage of the customer lifecycle, up to and including cancellation. Even loyal, satisfied customers sometimes cancel. Once you've done everything you can to retain the customer, including addressing any underlying service problems, make the cancellation experience the best it can be by letting the customer leave easily and with positive feelings. Not only does a positive cancellation experience leave the door open for customers to return to your company, but it increases the chances that they will be willing to act as a promoter and a referral source for you in the future.

3. SALES PRACTICES TO PREVENT ATTRITION

Minimizing customer cancellations requires effort at every stage of the customer lifecycle – and that begins with the sales process. Depending on the sales model you have in place, certain sales approaches lend themselves toward a higher attrition rate.

In-person sales calls, where the consumer is approached with no advance warning, and is not actively looking to purchase an alarm system, coupled with persuasive or high-pressure sales tactics, can lead to a contractual commitment that the customer may come to later regret. **This type of an account is far more likely to cancel or stop paying.** Potential buyers often see accounts that are the result of fast-pitch or high-pressure sales tactics as a riskier purchase because these accounts typically have a higher attrition rate.

In contrast, well-prepared customers, those who are looking to purchase a system and who are able to make an informed buying decision, are usually better customers. Better sales techniques yield a more stable customer base, which translates directly into higher revenue.

A better strategy for attracting loyal customers is the development of a sales program that focuses on qualified leads for quality customers. Here are some steps to building a best-in-class sales program.

Take Control of Your Sales Program and Align it With Your Business Objectives

Before putting any sales program in place, or changing the one you have, you must determine your business objectives, beyond adding more customers and increasing RMR. **What is your brand proposition?** What kind of customer best fits your services? What are the challenges you need to overcome in your market to build a profitable alarm company and how can you tailor your sales program to meet those challenges?

Implement Standard Processes and Procedures

No matter what sales method you decide is best for your company, you will need to develop and implement standard sales processes and procedures, as well as personnel policies and a code of conduct. Standard sales procedures give your sales team appropriate and effective selling methods, communicate your expectations and establish a baseline. They provide you with information about your sales methods, sales team, and market that you can use to make changes to your selling program to respond to market challenges as they develop.

While every employee serves as a brand ambassador for your company, this is especially true of your sales team.

Build a Great Sales Team

While a great sales team starts with the hiring process, regular training and consistent supervision are also critical to your team's success. The development of a new-hire on-boarding and training process, and continual employee education will yield optimal sales results and business performance.

Focus on the Customer

One of the keys to attracting "sticky" or loyal customers is focusing your sales program and your sales team on the customer, rather than on the contract or the sale. Developing and implementing sales methods that educate, inform, and respect the customer will not only result in more sales, but more loyal customers and fewer cancellations.

A "get 'em and forget 'em" sales mentality may result in higher attrition. A sales program that includes customer quality assurance provides a better customer experience. Encourage communication between your sales team and the customer throughout the installation process to ensure the customer knows what they're purchasing and how to use it.

Focus on Qualified Leads and Referrals

Identifying and pursuing qualified leads, potential customers who have expressed an interest in your company by making an inquiry by phone or e-mail, visiting your website or blog, or signing up for your newsletter or social media posts, is an excellent and cost-effective way of acquiring the right kind of new customers.

Implement a program to collect qualified leads and assign follow-up to your sales team. Train your sales team to seek referrals before the end of successful sales calls. Incentivize your existing customers to refer family and friends through referral programs that offer rewards for successful referrals.

Implementing Your Strategies to Minimize Attrition

Now that you understand what attrition is and how to calculate, manage, and prevent it, you are armed with the information and tools to build and maintain a profitable alarm company.

Remember these key strategies:

- Track Your Attrition
- The Customer Experience as an Antidote
- Sales Practices to Prevent Attrition