Attrition & Replacing Cancelled Accounts - The Forgotten Factors in today's Acquisitions

It seems today that buyers of alarm companies are paying more attention to a whole list of different factors when assessing an alarm account base- but not as much to two very important markers - the annual attrition rate on the account base or whether the owner is replacing his cancelled accounts. Based on my experience over the last few years, valuations seem to depend more on a) the size of the account base (the larger the base, the higher the multiple), b) the average rate on the accounts (higher rated accounts attract higher valuations),c) the type of panels installed (newer is better) and d) how the accounts are billed (buyers like PAP better than invoices). These factors are important no doubt but so are the attrition rate and whether the owner is able to replace attrition.

Let's look at attrition first. TRG & Associates, US consulting firm with perhaps the most experience on attrition calls attrition **the best barometer an owner can have on how well they are managing their account base.** Attrition is the customer satisfaction score. Well managed companies have low attrition rates. Attrition is particularly important to large companies. ADT in the US is proud these days they have reduced their annual attrition rate to under 13%. Protectron in the years immediately before they were sold in 2014 managed to get their attrition rate down from 12% to about 9.5%. On 375,000 accounts, Protectron lowered their cancellations by almost 10,000 accounts per year. That is 10,000 accounts annually they don't have to put on to maintain their base all at significant cost.

To give readers some targets on attrition, here is what I think different size companies can use as a target on attrition. Larger blocks of accounts tend to have higher rates of attrition:

- Companies with under 500 accounts, 5 % annual attrition is a good target. Really well-run businesses can have lower attrition rates than 5%.
- Between 500-1000 accounts. 6-7% annual attrition is a reasonable target.
- Between 1000-2500 accounts, try to stay around 8% annual attrition .
- As mentioned, large national companies with more than 100,000 accounts can expect to have an attrition rate 10% or slightly more.

Here are some tips of what to do to establish and maintain a low attrition rate:

- **Service your account base well**. This is key. Don't take 2 weeks to handle a service call.
- Track your attrition rate annually *at the very least* and know why accounts are leaving.
- Don't raise the monitoring rate on your accounts too high. $60/mth accounts are likely to get knocked off by another dealer offering lower rates.

- Don’t move the accounts from station to station several times over a short period.
- Charge an install fee when you set the account up. Free accounts cancel more often.
- Try to get your accounts on Pre-Authorized Payment wherever possible.
- Make your accounts “stickier” by adding cell and /or interactive service.
- Know that accounts generated from a dealer programs will almost always have slightly higher attrition rates than organically generated accounts.
- Stay away from accounts generated from high volume door knocking dealers. They almost always produce accounts with high attrition rates.
- Finally pay attention to “moves” in your account base and try to hold onto your customer when they move.

Many dealers I talk to don’t track their attrition at all. Most of the time these same dealers are spending good money to set up new accounts. Why they would not want see what happened to that money beats me. I would have a report done once per month with all the cancelled accounts showing the reason why. This is just part of running a good alarm business.

Having a plan in place to replace your lost accounts is equally important. In today’s market where new alarm accounts are usually put in at a loss, this is tough for a small independent dealer to do financially. Most of the smaller dealers today have gravitated to doing more camera and small access jobs which are more in demand and make them more money. For these dealers then, making sure you hang onto what accounts you have becomes even more important mainly because alarm accounts will likely be the major item of value when the dealer sells. For mid- sized dealers – 2500 accounts or more- it pays to look for and do small acquisitions. But don’t buy accounts with old panels and most importantly pay attention to integrating them into your systems properly which can often be difficult. As for the large national players replacing lost accounts often demands all 3 methods of acquiring new accounts- organic growth through company salesmen, an effective dealer program and most importantly constantly looking for good tuck in acquisitions to do.

I am going to draw your attention to a real-life example of what can happen when owners don’t pay enough attention to attrition and replacing accounts. This concerns an account base that shrank by 38% in a matter of 4.5 years. Interesting enough although this company’s attrition rate was high (11%) during this period it was not totally out of line for the size of the base. *The problem in my opinion was they were not doing enough to replace their attrition.* The major problem was they weren’t doing any small tuck-in acquisitions. Almost every major player in Canada that I have talked to over the last decade or so has told me that they had to do tuck-in acquisitions in order to maintain their account base. The end result for this company mentioned above was a much- reduced purchase price when it came time to sell.

There are many factors to pay attention to maximize the value of your alarm accounts when you sell. Just don’t lose sight of maintaining a low attrition rate and having a plan in place to replace attrition.

Victor Harding
Harding Security Services Inc.
victor@hardingsecurity.ca