OnPoint Customer Service Solutions

e-Book Series

# Service Contracts for Dummies

and the Well Informed

## Service Contract Programs Aren’t for Dummies!

They’re for retailers, original equipment manufacturers and device ODMs, as well as service providers that want to provide added value to their consumers for their product purchases and great post-purchase service experiences.


Developing and launching a warranty program like service contracts is critical for OEMs, retailers and service providers for a variety of reasons. Most programs focus on increasing revenue at the point of sale, but also lend themselves to improved brand loyalty and increased repeat sales based on super service experiences post-sale. So, how does one create an innovative service contract program which is impactful for consumers and that generates revenue now and in the future?

Developing, executing and growing service contract programs must address several key elements including: Product Development, Legal and Compliance, Operations, Consumer Offers and Pricing, Marketing, Reporting and Staffing. In this paper, we’ll discuss what to consider when creating a service contract program.

### Product Development

**First, start with the basics. Define what you're going to offer.**

When developing a service contract program, consider what kinds of service contracts you need to offer to improve your customer’s experience with physical product sales.

For instance, if product sales consist of appliances, POS or extended warranty contracts can lengthen the lifecycle of a washer by repairing breakdowns under coverage. Mobile devices can also benefit from traditional break/fix repair contracts, but accidental damage from handling or ADH coverage can be a better fit, protecting your consumers from accidental damage to devices. Consider whether the buyer can benefit from additional features for high tech products like set up or network configurations, smart home how-to’s, or security audits. Tech support is a valuable contract add-on for some products and consumer segments. Also consider what the manufacturer’s warranty covers and doesn’t cover. If a refrigerator fails, the OEM pays for the repair under manufacturer’s warranty; a service contract can reimburse the consumer for all the food that spoils as a result.

Consider the physical product that you sell or manufacturer and match service contract features to them to drive the greatest benefits for your consumers.

**Don't forget how you sell products.**

If you have a *brick and mortar store*, service contract SKUs should be cross referenced to products in your POS system for which they are eligible, so that they can be offered automatically and correctly at the cash register. Ensure that your systems collect a minimum set of data for each sale, because later your contract administrator will need to know who a consumer is, what product they bought and what contract was sold with it to entitle and set up service. That ensures a smooth service request for your consumer and a full renewal pipeline when the time comes to renew the contract coverage.

And, don't leave consumers whom fail to purchase coverage at the point of a product purchase out of the mix. *POS Miss* is industry jargon for consumers that skip the contract at the point of sale. If you can collect their contact and product purchase details, you can put them in service contract aftermarket campaigns which offer coverage on that same product for a period post-purchase. You can also attempt to cross sell other service contract coverages based on both data sets. If a consumer purchases a washer, it's a safe bet they have a dryer too. Why not attempt to sell a contract on that product as well?

*Ecommerce companies* are similar insomuch as a contract offer still must be appropriately mapped to a product in the shopping cart technology, to a) automatically offer the contract and b) collect data for compliance, renewal and resale purposes. Whereas brick and mortar retailers often have POS materials hanging on end caps or posted on shelves by applicable products, so too must e-tailers consider the digital content needed to drive awareness, offers and attachment rates with no human interaction.

*Manufacturers* can design in-box offers and product registration cards which drive consumers to a site which collects their contact and product details and offer service contracts on that product and other similar existing products in their homes.

## Compliance and Legal

**Next, Address the Legal and Compliance Requirements**

The service contract industry is heavily regulated, at least in some states, depending on the way a service contract program is structured and/or underwritten, and whether the individual state recognizes service contracts or extended warranties as contract or insurance products.

Generally, a service contract or extended warranty is defined as a product which provides consumers whom have purchased a consumer product, like an appliance or mobile device, extended or enhanced [warranty services](), such as repair of mechanical breakdown- for an additional fee- which begins after the expiration of the product warranty. Additional features even cover accidental damage from handling of devices which can be physically handled- think mobile phone, not wall mounted TVs- but not the loss of a mobile device. Power surge repair or replacement as well as food loss reimbursement are also typical service contract features.

An insurance policy is different and is regulated differently. Insurance policies are transacted between an insurer and a policyholder and cover losses caused by perils covered under the policy language for a premium exchanged between the two parties. Most states have a Department of Insurance which regulates insurance providers and require insurers to file policies/terms and conditions and their rates. Some states even require insurers to license specific entities in the insurance ecosystem, such as a Producer or Adjuster.

In order to sell a service contract, the seller must be a licensed reseller in at least 2 states and resell a contract product provided by either an administrator and/or an obligor which can underwrite contracts or insurance for consumer products. Vehicle service contracts and home warranty are different and are regulated differently.

### What Legal Hurdles must Service Contract Resellers Jump Over?

There are three entities which can do some portion of the development, underwriting, sale and/or administration of a service contract program and each is regulated differently.

1. Reseller

To physically sell warranty products like service contracts or extended warranties in some states, the actual seller, such as a retailer or OEM must register with the state in which the contracts are sold. California and Florida are great examples. Each require the reseller to obtain and maintain a reseller license, and in the case of California, also be certified and approved by BEAR, its Bureau of Electronics and Appliances Repair. A reseller would have to necessarily source contract administration and either self-insure or secure an underwriter for the program.

2. Administrator

An administrator is an entity which can both develop and fulfill service contracts or extended warranties. Basically, administrators create programs for resellers, such as retailers, or themselves in a B2C model, and recruit a network to deliver repair and other services. Administrators staff call centers or offer other technology through which consumers can obtain service under contract. Six states in the USA and some provinces in Canada require the administrator go through a somewhat arduous licensing process in which the administrator, *offers its first born and 2 fingers, *just kidding**, through a filing and approval process. The licensing exercise also provides for monetary guarantees in the form of reserved funds in specific amounts or the acquisition of CLIPs (commercial liability insurance policies) from a licensed underwriter.

3. Obligor

An Obligor is different from both a reseller and a third-party service contract administrator, though, sometimes, administrators are the obligor themselves. Obligors provide a guarantee of funds of future repairs under contract through insurance policies which administrators can source from obligors. Administrators take phone calls and dispatch repair companies. Obligors are obligated under the terms and conditions of the contract and write the check for the repair services from insurance reserve accounts. Some states require an even more arduous licensing process for Obligors, including the filing of extensive personal information for company executives, program and rate information and insurance information. Roughly 20 odd states require formal obligor licensing before a service contract can ever be sold, and the process takes months to complete.

In both the administrator and obligor examples above, the reseller is sourcing the service contract program from an underwriting and/or an administrator.

A contract seller can also decide among several other insurance options if it chooses a self-insured strategy

## Underwriting

Underwriting a service contract isn't an option, it's a necessity. However, there are a variety options which can be selected based on the reseller's appetite for risk and financial stability, as well as revenue recognition.

***Fully insured strategy***

In a fully insured model, a reseller can work with an insured service contract administrator or an obligor directly to underwrite its programs. This model offers the least amount of risk with first dollar and default coverage which guarantee appropriate reserves and enable the reseller to immediately recognize revenue at the time the contract is sold. The administrator or insurer set the wholesale cost, while the reseller sets the retail contract price, paying the wholesale to the provider and booking the margin immediately. The insurer is forced to reserve funds for claims and earns the premium over the life of the contract.

***Self-Insured Strategy***

In a self-insured strategy, the reseller can decide between three options, which are defined below. What's most important to note is that the self-insured reseller bears the onus of frequency and severity (rate of product repairs and cost to repair) and must estimate what to reserve to pay for future claims. Talk about managing one's own destiny! In this scenario, like those of an administrator or obligor mentioned earlier, state departments of insurance also require revenue requirements, loss accounts or trusts and annual audits.

1. An independent strategy implies that the reseller holds all risk. There is a requirement to reserve appropriate funding for future claims and maintain net worth minimums to meet those reserves.
2. In a captive environment, a parent group or groups create a licensed insurance company to provide coverage for itself, assuming all risk of the service contract program. Captives offer the reseller a lot of control over coverage, pricing, and cash flow, but carry some of the same sorts of disadvantages as fully self-insured.
3. The stop loss option is basically a reinsurance model where the reseller sources an insurance policy which assumes losses over specified amount. This is a great option if the insurer of the stop loss policy thrives. If they were to shutter their doors, there is no provision for claims to cease. The reseller would bear the brunt of future claims themselves.

In any of these scenarios, revenue recognition is spread over the term of the contract. So, whereas $100 collected today in the full insured model drops immediate to the bottom line, in the self-insured model, that $100 is spread over, for instance, a five-year contract.

All the options above are viable depending on the strategy a reseller opts to pursue.

## Sales and Marketing

**Let's Talk Price.**

Determining what coverage to offer, as we stated earlier, depends upon the physical products being sold, what contract coverage is most valuable to purchasers of those products, and what the manufacturer does or doesn't cover under the product warrant period.

Service contracts also have different benefits and selling points for consumers depending on the goals of the reseller.

Sales channels also impact how and what kind of contract is sold. Consider the following when defining your sales and marketing strategy.

## What's the Goal?

Contracts can be used to achieve several end goals. Define what you're trying to achieve with a program and structure it around achievement of those goals. Consider the following.

- **Drive revenue at the point of sale and beyond through improved repeat sales.** Contracts which are well priced at the point of sale and marketed through highly trained sales people, well designed POS register processes and supported with both in-store and digital awareness campaigns, like online ads and retargeting or IP targeting of store locations, drive additional revenue at product sale.

  POS Miss and renewal campaigns drive revenue post- product purchase through well featured, well priced offers via email, online or through social media targeting.

  Resellers, particularly manufacturers or retailers which offer services post sale, can also offer contracts at downstream touch points, like delivery and installation, product registration, support or repair, driving repeat and ancillary sales.

- **Improve or extend the lifecycle of a product and the customer's experience with your brand.** Contracts offer a dependable source of product repair and even replacement after the initial sale that extends the usability of the product. Great service drives brand loyalty, which drives repeat sales when it's time to replace and end of life product.

In each of the cases above, a well-developed contract program, that's well priced at the point of sale and executed well throughout the term, can drive revenue, brand loyalty and repeat sales.

## Contract Pricing Considerations

When setting the price for your service contracts, consider your costs, how you can potentially offset some claims costs, thereby impacting the premium and wholesale costs of underwritten programs, the value proposition and the competitive sales environment.

1. Contract Costs
   Several factors impact the cost of a service contract program. They generally range from how often a product fails, how much it costs to fix it, to loss ratios, reserves, and loss curves. In a fully underwritten environment, the underwriter or administrator generally calculates costs and provides the retailers with a wholesale price which is marked up and sold at retail. In self-insured scenarios, the reseller or captive underwriting the program must consider costs.

   A typical set of costs to consider include:
   - Frequency – the number of claims as percentage of active contracts
   - Severity – the average cost of a claim which would includes labor, parts, mileage and possibly product replacement cost
   - Loss Cost – frequency times severity
   - Loss Ratio – Percentage of claims dollars paid to earned reserve dollars

- Reserve – account holding funds for claims payment
- Earnings – dollars recognized over term of contract
- Loss Curves – expected timing of claims
- Target Loss Ratio – expected level of loss ratio

A typical example of a cost calculation is below.

| Target LR | Repair Freq | Repair Sev | Replace Freq | Replace Sev | Loss Cost | Reserve | Fees 6% | Premium |
|---|---|---|---|---|---|---|---|---|
| 80% | 10% | $ 100.00 | 2% | $ 500.00 | $ 20.00 | $ 25.00 | $ 1.50 | $ 26.50 |
| 85% | 10% | $ 100.00 | 2% | $ 500.00 | $ 20.00 | $ 23.53 | $ 1.41 | $ 24.94 |
| 90% | 10% | $ 100.00 | 2% | $ 500.00 | $ 20.00 | $ 22.22 | $ 1.33 | $ 23.56 |
| 95% | 10% | $ 100.00 | 2% | $ 500.00 | $ 20.00 | $ 21.05 | $ 1.26 | $ 22.32 |

Understanding your costs, what needs to be reserved and for how long and when you can earn your part is governed by the underwriting strategy you select as much as the frequency and severity of covered products.

2. Claims Offsets

There are some strategies or program features which can impact your costs. For instance, collecting a deductible from the consumer at the first notice of loss, or repair request, directly reduces the severity of the claim. This is common in mobile accidental damage contracts, where the administrator charges, say $200, to the consumer to offset the cost of a replacement mobile device.

Claims limitations or capping the age of covered products can also offset or control claims costs. For instance, a common coverage limit is the total retail value paid for a product. If claims begin to get close to the $2500 paid for a new refrigerator, the next claim that comes in that may push the total claims paid out over that cap results in a buyout of the contract, ending the obligation to service the product.

3. Value proposition
In the service contract world, contract sold within different channels have different pricing strategies.

For instance, in traditional brick and mortar retail, consumer shop for products and view service contracts as a value add, rarely comparing contract pricing among retail alternatives.

In the online world, where an Amazon shopping cart can display a product and multiple service contract SKUs, consumers will absolutely compare prices and buy the cheaper option, once they've decided to buy a contract generally.

In either case, to drive that value-based decision it's important to identify in marketing and sales messaging the value of a service contract for a consumer and do so in a positive way.

Contracts protect consumers from the cost of repairs, for sure. However, they really extend the lifetime of the product by keeping it operational longer. In a B2B environment, a contract might protect against a POS system outage for extended periods of time, or for mobile or computing products, provide for a contracted SLA or replacement/loaner product while a contract is being fixed. High-end product can drive higher service contract retail pricing. The longer the term, the high the price. One could also argue that service contract retail pricing should be drive by actual lost costs, using the frequency and severity to drive lower pricing for more dependable products or brands and higher for less so.

Again, it's important to understand the products you're selling to and whom, so the value position can be defined and communicated most effectively. Some of those value propositions can positively impact your bottom line, driving a premium price for perceived value-added services like tech support or fast SLA response.

4. Competitive sales environment

One other consideration is the competitive landscape. As stated above, consumers buying at brick and mortar retail are shopping products, not contracts. However, a contract priced at a percentage of the product retailer great than 14 to 16% of the product retail can be perceived at too expensive, creating a missed sale.

In the online environment, pricing varies widely and is part of the buying process. In an Amazon environment, contracts from more than one administrator can be presented to the buyer in the same shopping cart, priced widely differently. Consumers will generally opt for the lower price, so technology which can right-price contract offers based on real time competitive

To reiterate, competitive pricing strategies rely heavily on the sales channel.

## New Marketing and Sales Imperatives for the Service Contract Industry

We live in a digital world. Relying on snail mail doesn't cut it anymore. Modern service contract marketers understand how consumers interact with product and services companies, from awareness through purchase, post purchase support and end of life replacement, in person and online and will deploy digital marketing strategies that touch consumers where they're transacting business.


## Operational Administration

**The Buck Stops at the Call Center… or the Webpage or the App. Meet Consumers Where They Are!**

Traditionally, an administrator would get a contract sales file from a retailer or a manufacturer and load it into a CRM, mail out a set of terms and conditions and wait for a phone call.

Millennials don't make phone calls. GenXers and Boomers are more inclined to pick up a phone to ask for service, but they are all connected to service administrators and providers via the internet 24x7. Call centers are still important, but technology and a consumer-first focus are the new norm. Consumer expect to communicate with service contract administrators when they need help the same way the communicate with family and social networks, sometimes over the phone, but more frequently through the web, email, SMS or chat session.

These new communications channels, if deployed correctly, not only improve the customer experience, but reduce overhead and administration costs.

Administering a contract programs requires the following functions complete with process and technology to support each. Whether choosing an external administrator or opting to set up one in house, consider to following:

- Product development
- Compliance and Legal
- Underwriting
- Contract and Offer Management
- CRM and Entitlement
- Service Network Recruiting Management and Dispatching

- Claims Processing
- Reporting

## The Big Take Away

Service Contract programs serve two very real purposes for retailers, manufacturers and service providers. They absolutely can drive increased revenue at the point of product sale by bundling value added services with a product purchase. However, in order to maximize repeat

sales and lifetime consumer value, service contract administrators must deliver contract solutions to their resellers which are innovative, compliant, priced correctly and monitored constantly, in such a way as to deliver awesome service experiences to every consumer which reaches out for repairs. That awesome CX drives the second fundamental purpose of any contract program and that is long term repeat business. If administrators can deliver well and deliver value add to consumers, a contract becomes the rubber band which binds the consumer to the reseller brand, pulling them back over and over to purchase products and services from the brand they come to depend on.

## About OnPoint Warranty Solutions, LLC.

OnPoint was launched by customer experience experts with proven success helping global brands deliver underwriting, service contract and manufacturer's warranty programs, service fulfillment, service administration technology and logistics, to drive the highest levels of consumer experience in the service industry. Building on the foundation of a connected, multinational service network, omni channel customer interactions and consumer-focused technology, OnPoint creates brand loyalty through service contract and service solutions designed to reduce risk, increase efficiency, delight consumers and improve our customer's bottom line. For more information, visit our website: www.onpointwarranty.com.

You can also contact us at help@onpointwarranty.com or dial 877.668.4681 to learn how OnPoint can help your team deliver excellent customer experiences!