

# **ATTRITION**



# **SEEKING A CONSENSUS**

**BY:**  
**TRG ASSOCIATES, INC.**  
**4 POST OFFICE SQUARE**  
**CLINTON, CT 06413**

**JOHN M. BRADY**  
**JAMES LEESE**

## **INTRODUCTION**

## **MEASURING ATTRITION**

**WHAT IS ATTRITION?**

**ALTERNATIVES TO MEASURING ATTRITION**

**THE ATTRITION CALCULATION OF CHOICE**

**THE COST OF ATTRITION**

**WHAT ATTRITION MEASUREMENTS CAN TELL YOU  
ABOUT A BUSINESS**

**TRACKING ATTRITION CAUSES**

**ATTRITION CASE STUDY**

## **CONSENSUS AND ATTRITION MANAGEMENT**

## INTRODUCTION

The electronic security industry continues to prosper because of the increasing value that people place on the protection of their loved ones and their personal/business assets. The industry also continues to attract significant investment capital, management expertise and debt liquidity due to the healthy economic returns that can be created within a liquid market for a predictable cash flow margin enterprise – whose root dynamic is preservation of the customer, the customer's property and the customer's peace of mind through timely provision of services.

The other important characteristic of the electronic security industry is that its growth is often fueled by making an investment in every new customer added. While the “zero or low down, high volume” methods of marketing to increase market penetration had transformed the industry in the early to mid 1990's, the return to sounder “customer value marketing” and the reduction of the “excessive” investment once considered “the only way to grow”, has helped to reduce the necessary investment needed to remain competitive in the marketplace. Despite that recent reversal, we still utilize financial incentives (leasing, customer transfer/takeover, up-sell/high volume) to attract customers. That investment or “Cost to Create a Customer” can range on average (2000-2001 activity) between a 15 to 31 multiple of recurring monthly revenue (RMR). While market values of RMR have decreased since the “altitude ranges” of 48 to 60 times RMR in the late 1990's, they have settled (despite the downward pressure by the most efficient, well financed buyers) into the 30's to mid 40's – a range similar to the late 1980's when the industry also had a similar 12,000 to 13,000 dealer participants as it has today.

The “ease of entry” that the electronic security industry is still characterized by, despite ever increasing licensing and continuing education requirements, continues to work against the normal industry maturity trend of settling in excess of 50% of the marketplace within a single digit number of companies. Customer retention continues to be the single largest management challenge inside a fluid, competitive environment for customers and between alternative providers.

Management's priority is to minimize the investment in customer growth. Some have commented that it is “easy to give security systems away for nothing” but all good dealers agree that it takes an enormous amount of “blocking and tackling” to keep each customer after any sale. So much management effort and organizational focus goes into growing each dealer's customer base while often so little effort or organizational focus goes into keeping those “precious assets”.

Since the late 1980's, when the electronic security industry began to attract significant new equity/debt capital, the industry has continued to improve at gathering and cataloguing industry specific performance parameters – with the SDM 100 and other public/private information sources beginning to keep track of market size, growth dynamics, etc. Despite this new security information age, one continuing enigma of

industry measurement, critical to measuring value created and value lost, that is not well maintained or commonly defined, is the qualitative and quantitative measurement of customer attrition.

The ensuing discussion will focus on what attrition is, how to measure it, its intrinsic cost and how to reduce or limit that basic measurement of “poor service”. This critical measurement needs to be further discussed and gain some consensus both on the definition and it’s utilization within the security industry.

The opportunity at hand is to settle on one or a series of attrition definitions and methods to assist the industry with helping to clarify a vital measurement tool for those who work within the industry and those who seek to understand the industry better.

## WHAT IS ATTRITION?

### Definition

Attrition measures the amount of recurring revenue lost during a particular time frame, expressed on a monthly/annualized basis. Attrition can be measured in many different ways. The nomenclature used to describe the measurement tool and methodology can vary widely. Gross attrition is the absolute of customer losses without the inclusion of any offset or reduction activity such as price increases, acquisition RMR or other “add backs” to the customer base. Net attrition is the result of offsetting “like customer” gains from the gross attrition losses.

Within both residential and commercial markets, there are various types of companies that utilize different marketing strategies, which ultimately tend to yield different “built in” averages of attrition by channel. In the residential market there are the traditional security installation companies versus high-volume companies. As for the commercial market, there is the traditional outright sale versus the leased system. On average, there are industry ranges for net attrition. The following is a breakdown of the ranges that TRG has encountered during its work with a significant cross section of the industry involved in the residential and commercial markets:

Average Net Attrition Ranges			
Market	Type	Low	High
Residential	Traditional Installation Co.	2.5%	7.5%
	High-Volume Co.	8.0%	15.0%
Commercial	Traditional Outright Sales	2.0%	6.0%
	Leased Systems	3.7%	8.7%

Before determining the appropriate method of measuring attrition, we need to know what is “in” and “out” of each company’s calculations. The measuring of customer losses on a gross basis seeks to identify customer losses regardless of what actions caused the loss and what actions were taken to mitigate or reduce those losses. Gross attrition is the purest of the measurement tools, as it doesn’t allow for any qualitative decisions or processes to obfuscate the loss. Net attrition seeks to measure the qualitative impact of management’s effort to control and minimize customer losses. There is a fine philosophical/cost assessment line between including “like customer” re-signs as an offset to gross attrition versus as part of the “cost to create a new customer”. TRG has found that for various reasons, such as the related economics and automation system support to the gathering of data, the newly signed up customer in a “like location” is often best counted as a new customer. This new customer and its related cost to create, in excess of a 6 multiple of RMR (normal costs to program & transfer a system), should be included in the new sale category versus as an offset to gross attrition. The old customer

who moved and whose system was re-installed at a loss may not be used as an offset from gross to net attrition. The “like customer” who was “tracked” in your marketplace and re-signed without an additional investment should be allowed to reduce gross attrition. Similarly, a customer who cancels and was originally included in the gross attrition but subsequently comes back to the company should be used to reduce that gross attrition upon return. The tracking of offsets to gross attrition (or deciding what is “in” or “out”) should be dictated by the following factors:

- Net investment to maintain the same customer (person or location).
- Time frame between the loss and the re-sign (maximum six months).
- Ease of data gathering as to the evolution of a re-signed customer.
- Specific loss/re-sign causes – bad debt cancellation made good should be considered a re-sign.
- Specific departmental responsibility for tracking and effectuating re-signs and related compensation costs.

Regardless of the company’s policies or definitions, consistency in the calculation method and in the definition of what makes up gross and net attrition is critical. The attrition measurement is most important as to what it tells you about a company’s overall performance versus any specific month’s results.



---

Pro's & Con's of Typical Lending Covenant RMR Method

---

<u>Pro's</u>	<u>Con's</u>
Accounts for and weights RMR acquisitions Accounts for timing of acquired RMR Accounts for rapid internal growth Accounts for timing of rapid internal growth Similar to many lending institution calculations	Not the easiest of the calculations

---

**2. Modified Static Pool Method**

$$\frac{\text{Total Attrition for Reporting Period} * 2^a}{\text{RMR Beginning of Reporting Period}} = \text{Annualized Attrition}$$

Calculation Examples:

- No Acquisition:  $(\$3,750 * 2) / \$50,000 = 15.0\% \text{ Attrition}$
- Acquisition:  $(\$3,750 * 2) / \$50,000 = 15.0\% \text{ Attrition}$

---

Pro's & Con's of Modified Static Pool RMR Method

---

<u>Pro's</u>	<u>Con's</u>
Ease of computation Widely used	Does not account for or weight acquired RMR Does not account for or weight rapid internal RMR growth

---

**3. Monthly Attrition Method**

$$\frac{\text{Attrition for Most Current Month} * 12}{\text{Ending RMR of Previous Month}} = \text{Annualized Attrition}$$

Calculation Examples:

- No Acquisition:  $(900 * 12) / 51,100 = 21.1\% \text{ Attrition}$
- Acquisition:  $(900 * 12) / 71,100 = 15.2\% \text{ Attrition}$

---

Pro's & Con's of Monthly Attrition Method

---

<u>Pro's</u>	<u>Con's</u>
Ease of computation	Reporting period not substantial Monthly results can vary greatly Results do not provide a meaningful trend

---

**4. Average RMR Method**

$$\frac{\text{Total Attrition for Reporting Period} * 2^a}{(\text{Beginning RMR} + \text{Ending RMR}) / 2} = \text{Annualized Attrition}$$

Calculation Examples:

- No Acquisition:  $(3,750 * 2) / 50,700 = 14.8\% \text{ Attrition}$
- Acquisition:  $(3,750 * 2) / 60,700 = 12.3\% \text{ Attrition}$

---

Pro's & Con's of Average RMR Method

---

<u>Pro's</u>	<u>Con's</u>
Accounts for RMR acquisitions Accounts for rapid internal growth Ease of computation	Does not account for timing of acquisitions Does not account for timing of growth

---

**5. Roll Forward Method**

$$\frac{\text{Cancelled RMR During the Reporting Period} * 2^a}{\text{Avg. Total of RMR Held During the Reporting Period}} = \text{Annualized Attrition}$$

Calculation Examples:

- No Acquisition:  $(3,750 * 2) / 52,575^1 = 14.3\% \text{ Attrition}$
- Acquisition:  $(3,750 * 2) / 62,575^1 = 11.9\% \text{ Attrition}$

---

<sup>1</sup> (New RMR for the Reporting Period/2) + Beginning RMR

---

---

Pro's & Con's of Roll Forward Method

---

---

<u>Pro</u>	<u>Con</u>
Accounts for RMR acquisitions	Does not account for timing of acquisition
Accounts for rapid internal growth	Does not account for timing of growth
	Complex calculation

---

---

**Summary of Results from the Various Attrition Calculation Methods**

The attrition calculation results obtained from the five methods are summarized in the following table:

---

---

Summary of Attrition Calculations Results		
<u>Calculation Method</u>	<u>No RMR Acquisition</u>	<u>With RMR Acquisition</u>
Lending Covenant Method	14.4%	12.0%
Modified Static Pool Method	15.0%	15.0%
Monthly Attrition Method	21.1%	15.2%
Average RMR Method	14.8%	12.3%
Roll Forward Method	14.3%	11.9%

---

---

The significant variance in the results obtained from the various calculations, as illustrated above, is the main reason for developing a consensus within the industry on the use of one or two primary industry standards for measuring attrition.

## THE ATTRITION CALCULATION OF CHOICE

Based upon our experience in the Security Industry and after encountering the various attrition methods described in the previous section, we feel that the Security Industry should adopt the “Typical Lending Covenant RMR Method” of calculating attrition as the industry standard. This method of calculating attrition best represents a Company’s attrition rate under a variety of different circumstances and situations. In addition to accurately representing attrition for a stable, constant growth Company, this method correctly represents the true attrition rate for Companies experiencing rapid growth and/or doing multiple acquisitions. Due to the “weighting” given to the ending RMR over the six-month reporting period, this attrition method is the most accurate of all methods described and can be used under any situation a company may be experiencing. Because of this, we feel the industry should standardize and use this common measurement of attrition that all Companies can be gauged against knowing that the rate of attrition was calculated in the same manner. The following template can be used to calculate attrition using the Typical Lending Covenant RMR Method:

Lost RMR for the six-month period \$ \_\_\_\_\_(I)

RMR for each of the months ending for the six-month period:

Month one:           \$ \_\_\_\_\_

Month two:           \$ \_\_\_\_\_

Month three:         \$ \_\_\_\_\_

Month four:          \$ \_\_\_\_\_

Month five:          \$ \_\_\_\_\_

Month six:           \$ \_\_\_\_\_

\$ \_\_\_\_\_(II)

RMR monthly attrition is defined as the quotient of \_\_\_\_\_ %  
(I) above *divided by* (II) above, expressed as a percentage

Multiplied by twelve x 12

Actual Annualized RMR Attrition \_\_\_\_\_ %

This method also facilitates rolling the measurement forward as the months (period) progress.

## THE COST OF ATTRITION

If the company and its management spent as much time and economic effort controlling attrition – the loss of customers – as they did trying to find and buy into the next new customer, the net value of the business would be enhanced.

### Example

- \$50,000 RMR Company
- Adding 50 new customers per month at \$30 for monitoring/service per month
- Market Value Assumption – 35 Multiple
- Static Pool Method of Attrition Measurement

### Net Ending RMR

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
6% Annualized Attrition	65,000	77,876	89,984	101,360	112,502
8% Annualized Attrition	64,004	76,880	88,724	99,632	109,664
11% Annualized Attrition	62,504	73,628	83,528	92,336	100,184

### Valuation Difference

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
6 vs. 8% Annualized Attrition	34,860	34,860	44,100	60,480	99,330
8 vs. 11% Annualized Attrition	52,500	113,820	181,860	255,360	331,800
6 vs. 11% Annualized Attrition	87,360	148,680	225,960	315,840	431,130

A 2% attrition difference can make a significant difference in the ultimate value of the entity/customer base. Thus the importance of implementing meaningful and effective management tools such as attrition measurement and attrition cause analysis to help the management team focus on the symptoms of attrition within their organization. The whole management team and work force must be guided and motivated to minimize customer losses.

## **WHAT ATTRITION MEASUREMENTS CAN TELL YOU ABOUT A BUSINESS**

Attrition can indicate direct and indirect conclusions about a business.

Direct Conclusions Possible:

- Indication of a company's ability to set effective priorities
- Indication of the quality of customer care and service
- Indication of a company's operational strengths and weaknesses

Indirect Conclusions Possible:

- Probability of the company retaining remaining customers and to what extent
- Probability of the company attracting new customers and to what extent
- Company's strength in managing their business in a competitive environment

The attrition results can be traced back, in part, to the origin of the new system as marketed or sold. It continues to be supported by the figures that the greater the customer investment in a security system, the more likely that you will experience less attrition or customer losses. The financial community continues to focus on the credit score of a customer as a leading indicator of the likelihood of losses that a low credit score will yield. In the current multi-credit check environment that exists today, access to customer credit history is readily available. This multi-credit check environment has a negative impact on a consumer's credit score through activity, which has nothing to do with increasing credit risk. This "personal attrition characterization" continues to lose some of its newfound validity as a leading indicator of predicting customer's attrition.

## TRACKING ATTRITION CAUSES

Attrition is a measurement of the company's ability to provide timely and competent service, from the installation thru to the termination process (move to a rest home/nursing care). There will be Acts of God (Hurricane Andrew – Homestead, Florida in 1992) and economic downturns (1991 Recession with the Northeast and Southwest United States) that also impact attrition beyond "service" causes. The reasons for the "dissatisfaction measurement" are, for the most part, company caused and the attrition tracking process should be managed to identify and rectify those causes within each organization. Listed below are some of the main reasons why an account cancels its monitoring/maintenance service:

- Poor Service
- Slow Respond to Add, Move and Change
- Lost to Competitor
- Out of Business
- Relocated Out of Market
- Bad Debt
- Monitoring Response Problems
- Billing Problems
- Deceased/Rest Home
- Price Increase
- End of Contract Term

TRG Associates implemented a universal Excel/Lotus attrition tracking system that creates a template by which to measure the causes and amount of attrition. A copy of the template is attached in Exhibit A.

## ATTRITION CASE STUDY

Recently TRG Associates, Inc. (TRG) completed an historical attrition analysis on one of the larger electronic security alarm companies in the industry. The company had accumulated customers through all the varied growth channels, which offered an opportunity to complete an attrition analysis on those different channels. TRG's analysis was designed to segregate the existing customer base by the various types and sources in order to determine which segments of the base were responsible for the majority of the Company's attrition. Clearly, the growth channel analysis that follows demonstrated that the customer origination channel contributed to the attrition characteristic of that segment of the base. The following is an overview of the analysis process and associated results.

### Analysis of RMR

The customer database provided both active and inactive customer RMR, the information also included several identifying codes designed to give company management the ability to track the customer RMR using various criteria. The following tables describe the segregation of the RMR by types and sources included in the data:

---

#### **RMR By Type**

---

Commercial Accounts  
Residential Accounts  
Dealer Program Accounts  
National Accounts  
Wholesale Accounts  
Other Accounts

---

---

#### **RMR by Source**

---

RMR by Acquisition  
RMR by Dealer  
Internally Generated RMR/ Other

---

The annual attrition calculation was based on the RMR at the start of each year plus the RMR added during the year (Modified Static Pool Calculation).

It is important to note that the amount of RMR cancelled in the analysis was in part due to an over 90 day accounts receivable status (120 days for National Accounts) and was not adjusted for slow pay accounts (accounts that pay RMR charges consistently despite maintaining a balance past due 90/120 days or more). All accounts with an over 90/120 status were simply cancelled in this calculation process to yield a "conservative" non-performing account status and thus force the account into a cancelled status.

## **Attrition Results**

Based on the review, TRG compiled a detailed RMR analysis by customer RMR source and type (channel). These calculations reflect the gross attrition levels experienced by the various segments of the customer base, and do not take into consideration any account re-signs or other RMR “Adds, Moves and Changes” that may have coincided with the cancellations. Any account with an over 90 day due status, regardless of extenuating circumstances, was included in the attrition figures at the point the account became 90 days past due. We purposely pushed the attrition back to properly restate the import of non-paying accounts that were still active in the billing system.

**Acquired RMR** The customer base included customer accounts divided almost equally between residential and commercial. It is important to note that the National account RMR and the Wholesale account RMR were analyzed separately, and are not included in this Acquired RMR attrition analysis. The attrition rates for the acquired RMR portion of the base were calculated as follows:

	<b>Acquisition Coded RMR – Gross Attrition Analysis</b>			
	Commercial (No Over 90 RMR Adjustment)	Commercial (Including Over 90 RMR as Attrition)	Residential (No Over 90 RMR Adjustment)	Residential (Including Over 90 RMR as Attrition)
Year 1 Annual	26.57%	26.97%	26.47%	26.56%
Year 2 Annual	16.14%	19.36%	14.99%	16.74%

The early acquisitions suffered from all the “ills” of account assimilation, as the acquisition program remained active during Year 1. As the acquisition pace slowed, the newly acquired RMR of Year 2 cancelled at a slower pace. Also the Year 1 acquired customer bases were predominately residential. The later acquisitions were more focused on the commercial market place.

**Internally Generated RMR** The customer base included customer accounts that were approximately 2/3 residential and 1/3 commercial. The attrition rates for this portion of the base were as follows:

	<b>Internally Generated RMR – Attrition Analysis</b>			
	Commercial (No Over 90 RMR Adjustment)	Commercial (Including Over 90 RMR as Attrition)	Residential (No Over 90 RMR Adjustment)	Residential (Including Over 90 RMR as Attrition)
Year 1 Annual	21.84%	22.45%	24.30%	24.38%
Year 2 Annual	13.88%	18.09%	10.95%	15.22%

Even in the most difficult of operating environments, the internally generated accounts experienced lower attrition characteristics versus the Acquired RMR.

**Dealer Program RMR** The customer base included accounts that were obtained thru a national dealer program. The attrition rates for this portion of the base are as follows:

Dealer RMR – Attrition Analysis		
	Residential (No Over 90 RMR Adjustment)	Residential (Including Over 90 RMR as Attrition)
Year 1 Annual	34.87%	35.55%
Year 2 Annual	13.77%	29.79%

A significant portion of the RMR added in Year 1 and the beginning of Year 2 came from aggressive mass marketing efforts, and as a result the quality of customers added during the period slipped. These efforts were significantly scaled back towards the end of the year 2 and as a result, the attrition levels consistently decreased.

**National Account RMR** The customer base included a substantial amount of actively billed National Account RMR. The attrition rates for this portion of the base were as follows:

National Account RMR - Attrition Analysis		
	(No Over 120 RMR Adjustment)	(Including Over 120 RMR as Attrition)
Year 1 Annual	22.3%	22.3%
Year 2 Annual	22.4%	60.7%

The high levels of attrition experienced in early Year 1 were in part due to the method employed to convert the billing of acquired accounts into the billing software used by the Company. The Company did not eliminate inactive accounts from the acquired databases prior to converting to a new billing system; instead these accounts were transferred into the new system and then eliminated (cancelled).

During the project, TRG worked to remove the impact of some of the data base inaccuracies so as to be dealing only with the customer’s start date, last pay date or cancelled date which ever was earlier. We also worked to transpose the appropriate customer start date versus the acquired date (date of assimilation) as we presented the vintage of the “performing account” base by channel. This analysis led to being able to represent the true length of service that the segments of the performing customer base had been active for – no matter when acquired or internally generated.

## **CONSENSUS AND ATTRITION MANAGEMENT**

While we have discussed multiple methods of calculating attrition and given examples of TRG's clients most frequently used methods; the purpose of this discussion is to generate a conversation/exchange of ideas about these methods to encourage forming a consensus on the measurement methods and definitions for attrition terms. With a common, selected method or methods, the industry can begin to better identify, in a comparable form, the attrition characteristics of a customer base as a whole or within the channels of the customer base as we described in our example.

This dialogue on Attrition is intended to generate an exchange of ideas that will culminate in a special presentation on Attrition in April at the Mid-Year CSAA meeting in Tucson, AZ. As importantly, we will discuss in detail, at that time, the various methods, policies and incentive plans available to minimize attrition – gross and net.