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Service Contracts: 9 Top Reasons for Non-Renewal

What to Do to Preserve Your Revenue Stream

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Ever wonder why people fail to renew an existing contract, agreement, plan, or program? Looking for the right actions to take to preserve and grow your revenue stream? Then you've come to the right place, as we'll explore these in detail right here in this article.

One requisite for selling contracts is that it must offer *value for money*. If there is insufficient perceived value, it will not be purchased. There are several reasons that people buy contracts:

- **To reduce hassle.** "One call, and the service organization owns the problem."
- **To maximize equipment uptime.** "The service organization keeps my purchase operational and available.'
- **Predictable expenses**. "I will never exceed my budget with your service organization."
- **Peace of mind.** "The service organization has my back covered."

Why Do People *Not* Renew a Contract?
It seems rational to assume that failure to deliver on one or more promises would be the cause of non-renewal. While this is quite true, there are additional reasons why people do not renew. The three reasons for **failure to renew** beyond the service provider's control include:

1. **Going out of business.** If your front-line support is in contact with your customers, then this should not come as a surprise. Internal customer employees know when workloads and equipment utilization are decreasing. They are very good at reading the tealeaves and assessing the situation. This does not have to be a loss, but it can generate additional business. If a customer is forced to liquidate, there is a good possibility that the equipment will be sold.

   Make sure you have equipment history records, keep track of the purchaser, and offer to de-install the equipment (if appropriate), move it to the new location, reinstall it, train the new operators, and place it under contract. If you are managing a single territory or country, you may lose the service revenue. If you do your job well, someone in your company will enjoy the long-term benefits.

2. **Downsizing or closing the operation or project.** Perhaps this is a result of mothballing or selling the equipment. This is very similar to "going out of business," except the company is still obligated to fulfill its contracts.

   If your equipment is taken out of service, make a relationship-vs.-money decision. Do you want to void the contract and earn goodwill with the business? You may also make some form of pro-rata adjustment for the balance due, or you can take a hard line and demand full payment for the term balance. This last action helps your financial results for the short term and may earn you internal respect for your business acumen, but it may turn the company or its employees against you. There is no correct answer. It depends on the factors involved. Remember, if you work in a limited marketplace, the people you are working with may relocate and become your customer again.

3. **Corporate mandate goes into effect to cancel service contracts.** This is a typical cost-cutting, knee-jerk reaction, along with travel and wage freezes, reducing employee education, and other measures.

This situation is possibly the most difficult to navigate. If your customer believes the situation is "temporary," you must decide what benefits of the contract you will pass along while they are on a pay-as-you-go scheme. You want to demonstrate continuing support, but you do not want to deliver such a high level of service that the customer does not reinstate the contract when the corporate mandate is lifted. And of course you have to make the same decision when the customer downsizes. Do you suspend the contract, prorate it, cancel it (with or without penalties), or negotiate an extended or deferred payment scheme?

There are also six reasons why you **lose contract renewals**:

4. **You fail to deliver on your value proposition.** This frequently happens with very reliable equipment coupled with few, if any, value-added services. The contract is perceived as an insurance policy with a low likelihood of being cashed in. We hear comments like, "If I would have known the equipment was so reliable, I would never have purchased the contract."

   To avoid this situation, make sure your contract is valuable, especially if the equipment is very reliable. There are two ways you can do so:

   1. ***Make sure your contract marketing documentation includes all services provided.*** *For instance, if you offer free telephone support, make sure this is clearly stated. The same with any other services.*
   2. ***Include services available only to contract customers or to non-customers at a premium cost.*** *For example, include priority telephone response with the contract and sell the enhanced response for a higher price to increase the value of the contract. Same thing with priority parts availability, rapid on-site response, and so forth.*

5. **Competition offers a similar contract at a lower price.** You are not consistently exceeding your customer's expectations or building loyalty. When a company experience meets expectations, they purchase on price. But when their expectations are exceeded, they purchase on value. You should be continually demonstrating value to protect your business.

   To avoid this dilemma, monitor two factors:

   1. ***How your customers rate your business.*** *What is important to them, and how successful are you in delivering against their expectations? Focus on key drivers to impact current service business, and future sales. This is a big deal! Without this, you are vulnerable to the customer changing.*
   2. ***Your competitive landscape.*** *Are your competitors offering multi-vendor service (very common in the healthcare, instrumentation, and data communications industries)? Are other software providers moving to the services as a business (SaaS) model? You must strengthen your delivery processes and evaluate the opportunity to enter the multi-vendor service or SaaS arena. This is not a decision to be taken lightly, but nor should it be the result of a multi-year study. Evaluate, make a business case, and decide quickly but thoughtfully.*

6. **Too much hassle.** Customers want their service provider to take full responsibility for quickly solving their problem. For them, managing the resolution process is a real hassle. Forcing customers to do what they perceive as your job equates to low performance against expectations.

   You can find out if your processes and people are letting your customers down through transaction surveys. You will quickly learn if they are happy or if you need to redesign processes, retrain or replace people, or both.

7. **Uptime fails to meet expectations.** Frequently when people recommend the purchase of capital equipment (hardware and/or software), they feel as though they are playing a game of "You Bet Your Job." If their recommendation is accepted and the equipment fails expectations, then at best, they used bad judgment and could lose their job. Customers protect themselves by purchasing a contract. If you do not help them meet the CapEx assumptions, they have choices:
   1. Self-maintenance.
   2. Third party.
   3. Time and materials.
   4. Scrap the product (the most drastic and least likely choice—barring the semiconductor

industry.)

Your contract should include an uptime expectation. Every service organization should be monitoring their contract customer's uptime. If there is unreasonable downtime, take the responsibility to identify the root cause for a solution. We know of one company that actually replaced a piece of equipment worth several hundred thousand dollars because it was unreliable. It was returned and completely diagnosed. The outcome was:

- *A delighted customer.*
- *An opportunity to identify and repair the root cause of the failure.*
- *A great story to use with prospects.*
- *A demonstration of contract commitment.*
- *An opportunity to educate and motivate employees.*

A special case of uptime and service contracts is the service level agreement (SLA). While some purchasers and suppliers like the SLA, many do not, since it places the parties into a confrontational mode instead of a partnership. What is an SLA? According to Wikipedia, *"The SLA records a common understanding about services, priorities, responsibilities, guarantees, and warranties."* Each area of service scope should have the "level of service" defined. The level of service also can be specified as "target" and "minimum," which allows customers to be informed as to what to expect (the minimum), while providing a measurable (average) target value that shows the level of organization performance. In some contracts, penalties may be agreed upon in the case of non-compliance of the SLA.

So, when you are putting together the terms, conditions, and deliverables of the agreement with your customers, keep in mind that success is measured by meeting or exceeding these. On average, only about 60 percent of companies today are capable of performing at the SLA level (a little over 80 percent for best-in-class). You have to be prepared to measure and deliver. Do not over-promise. It is better to consider what you can deliver, and then exceed those expectations.

8. **Your service contract requires unplanned (and unbudgeted) expenditures.** Contracts may not cover *all* possible expenses. And the buyer of the contract may not always be aware of certain limitations (who really reads all the fine print?).

   Here's a true story: An associate of ours purchased a two-year service contract on her car when the factory warranty expired. She expected it to cover all repairs and scheduled services. She further expected that her only expense would be a $50 per-visit deductible. Within a few months, she had an engine leak. For whatever reason, that repair was not covered. Our friend was not happy. But the service advisor had a "bag of tricks up his sleeve" and was able to make her feel better by offering her a branded keychain and a baseball cap. Not an equal exchange, but the bag of tricks worked to turn around the situation. What could have been a very unhappy customer turned into a happy one.

   When designing service contracts, carefully evaluate the value proposition and any deviations that will adversely affect the customer. Make sure that the cost/benefits of exclusions exceed the emotional downsides of your decision. Any exclusion must be clearly articulated. You must be able to do this, and they must "pass the smell test."

9. **You dropped the ball and did not deliver peace of mind.** Your customer lost confidence in your ability to fulfill the terms (both written and implied) of the contract.

   This is an emotional situation that's difficult to rectify. When it happens, it is critical that all efforts be made to correct the situation. Unless the organization learns where and why it dropped the ball, it will continue, and like a stone rolling downhill, it will accelerate with time, since it is the beginning of a downward spiral: lose revenue à cut costs (people) à lose more revenue.

Conclusion
In the long run, it is the responsibility of the service organization's management team to make sure that it is doing everything it can to prevent losing customers. It is a shame to lose the contract because the organization did not execute the plan.

Finally, if the organization drops the ball, then treat the customer as you would want to be treated. Do what's right. It may not always save the customer, but it will send a message to the organization that its promises matter.

About the Authors…

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About Middlesex Consulting Group and Sam Klaidman

Middlesex Consulting Group specializes in:
•Service Strategy
•Services Marketing
•Identifying and commercializing value-added services
•Go to market assessments
•Creating and retaining customers
•Operational improvements

Sam Klaidman is the Principal Adviser at the Middlesex Consulting Group. A thought leader in service excellence, Sam is an experienced executive with a deep and varied background that spans nearly 45 years. During that time, Sam led several world-class service delivery organizations and has more than 20 years of service and support experience. He is an accomplished speaker on Service Strategy and Marketing and has published numerous articles on Services Marketing and Services revenue.

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