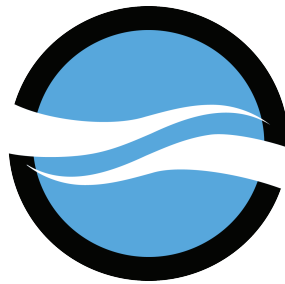


# What Your Service Business May Be Missing

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***“Flat rate pricing doesn’t allow a company to bill every hour that each service technician works, but it allows for labor rates high enough to compensate for those hours that cannot be billed.”***

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The statement above is taken from my eBook, “It’s All Up from Here!”\* It sums up in a single sentence the real significance of moving away from time and materials pricing to flat rate. Implied in that statement is the overriding advantage that flat rate pricing allows service companies to raise labor rates without a negative reaction from customers. That is only true because flat rate pricing creates a blended price for repairs that includes both parts and labor. It takes the customer focus away from hourly rates, yet it is fair because it levels out repair fees from technician to technician and customer to customer. Unlike time and materials pricing, customers never pay a higher fee for repairwork performed by an inexperienced technician running up both time and labor charges on the job because of their inexperience. Flat rate also allows for labor rates high enough to cover direct, indirect and overhead expenses. At the same time flat rate addresses the profit-killing impact of unapplied or non-billable time that permeates the workday of every service technician.

## 30+ Years of Proven Success

Through the years the most successful companies in the service trades have been those that adopted flat rate pricing and made it a constant in their company with a continuous commitment to keeping their pricing up to date and relevant to their operation. The reasons are many, but paramount is that flat rate for service is the only proven method to overcome customer objections about perceived high labor rates and subsequent labor fees charged when a repair is completed. Flat rate can assuage customers concerns and avoid the built-in confrontation that can occur between technicians and customers when time and materials repairs are charged and presented.

However, the value of flat rate for service is not limited to an improved pricing system to generate more revenue and improved customer relations. Flat rate also delivers to company management the formula to determine the appropriate price for every repair, thereby taking pricing decisions out of the technician's hands.

Although that sounds harsh, when using time and materials pricing, service companies often defer to the intentions, feelings and attitudes of the technicians when it comes to pricing repairs. Often service fees are reduced by technicians seeking to avoid confrontation, wanting to be a good guy, or charging for their work with their heart instead of their head. All at the company owner's expense.

## Time and Materials Pricing is Outdated and Subject to Undue Customer Scrutiny

1. There are two basic reasons why service companies use time and materials pricing to charge for service.
  - A. **Doubt.** The company believes it controls the unknowns on a repair with time and materials pricing. Service companies go out each day believing that because they have not yet diagnosed the problem(s) on the service calls to which they respond, they don't know what to charge for each individual repair. That's because they have never cataloged repairs by tracking the parts used and the labor time on each repair. Also, they fail to recognize that the tasks are the same, only the condition of the equipment and the working conditions change. So they split parts and labor into two separate fees. Time on the job multiplied by an hourly rate provides one portion of the fee and the part cost multiplied by the part markup provides the other fee to be collected. Each shows as separate line item on an invoice. That makes the company feel "safe."
  - B. **Habit.** The company has always charged for repairs using time and materials pricing and consequently doesn't know how to price repairs differently or they simply don't want to change because change is difficult.

So they continue on believing they are making things easier. However, there is an old saying, "The easy road gets hard and the hard road gets easy."

2. Easy isn't necessarily better. In the case of service pricing, the company using time and materials pricing becomes the customer's target and the company gives their customers a box of ammunition to shoot, reload and shoot again. If they don't kill you with a complaint about the labor fee or time on the job, they'll kill you with a complaint about the part fee. And they'll keep shooting until they get you. That's because of three factors:

- A. **Hourly-Rate Threshold.** Most customers have an hourly rate in mind that they are willing to pay for service. It may be different for each customer, but it is generally agreed that a labor rate of \$100 per hour is at the top end that most customers are willing to pay. Above \$100 per hour customers become uneasy. The big question every service company needs to consider is, “Is my hourly rate high enough to cover all my costs, including unapplied technician time and still turn a profit?”
  
- B. **Time on the Job.** Repair time comes into question when a customer perceives a repair is taking too long. That’s because when using time and materials pricing more time means a higher labor charge. Conversely, customers also become anxious when they are paying a one-hour minimum and the only problem is a switch “turned off” or a blown fuse. While those repairs solve the problem they do little to instill “value” in the mind of the customer.
  
- C. **Internet Search for Parts Costs.** The internet is where customers turn to find part information when they are charged a part fee. The reason? To see if the service company is offering a fair price for the parts they are installing. However, what customers fail to realize is that the internet is not a reliable source for parts pricing. That’s because one may not know who is posting the price, or their motivation for doing so. Also, when searching the internet, customers cannot tell whether the part price is wholesale, retail or somewhere in between.

## **Your Hourly Rates - Why You Should Raise Your Rates**

Most service businesses are crushed by unapplied (non-billable) time and many service business owners take it in stride and accept it as part of doing business. However, if the business owner were to focus on the impact on the company, that laissez faire attitude would likely change.

Consider a normal 2080 hour work year for every service person. If all hours were billed at \$100 the revenue generated would be \$208,000.00 for the year per technician.

$$2,080 \text{ hours} \times \$100.00 = \$208,000.00$$

However, most service companies only bill 4 to 5 hours per day per service person, or 1000 hours per year.

$$4 \text{ hours} \times 250 \text{ work days} = 1,000$$

At 1,000 hours billed at \$100.00 per hour, the revenue generated is \$100,000.00.

$$1,000 \text{ hours} \times \$100.00 = \$100,000.00$$

Of course, the service tech is paid for all 8 hours, totaling 2080 hours in the year. If the technician's pay including benefits is \$35 per hour, the cost to the company is \$72,800.00.

$$2,080 \text{ hours} \times \$35.00 = \$72,800.00$$

Now, don't forget about overhead expense. If the company overhead expense is running at 30%, the overhead cost on \$100,000.00 in revenue is \$30,000.00.

$$\$100,000.00 \times .30 = \$30,000.00$$

The direct and indirect costs, that is tech pay \$72,800.00 and overhead \$30,000.00 cost the company \$102,800.00.

$$\$72,800.00 \text{ tech pay} + \$30,000.00 \text{ overhead} = \$102,800.00$$

Yet, the company only generated \$100,000.00 in labor revenue. **Obviously, the company didn't break even on billing labor at \$100.00 per hour!**

And, more doesn't make it any better. It doesn't matter if a company employs one, ten or a hundred technicians. The numbers don't work!

But the discussion doesn't stop here. There are some other painful factors to consider; callbacks and ten-year warranties.

A reliable source has told me that 5 percent of service calls result in a callback. If a technician clears 900 calls per year, or 18 calls per week and 5 percent result in a callback, that is 45 calls per year, nearly one call per week, that goes unbilled. At \$100 per hour that's \$4,500.00. The amount takes into account lost opportunity to serve another customer.

$$45 \text{ callbacks} \times \$100.00 \text{ lost revenue per hour} = \$4,500.00$$

Now let's factor that number into the formula.

$$\begin{aligned} & \$100,000.00 \text{ revenue} - \$4,500.00 \text{ callbacks} = \$95,500.00 \\ & \$95,500.00 \text{ realized revenue} - \$102,800.00 \text{ tech pay} + \text{overhead} \\ & = (\$7,300.00) \text{ loss} \end{aligned}$$

**And, in the above example the \$7,300.00 loss is then multiplied by every technician employed.**

That places the company at a significant operating loss for the year.

If the company employs three technicians the loss is (\$21,900.00).

$$(\$7,300.00) \times 3 = (\$21,900.00)$$

Can the loss be made up on volume or warranty work? Obviously, not.

So how can a company overcome the loss created by unapplied time and callbacks? The answer is flat rate pricing.

## **Why Flat Rate Works So Well**

It is nearly impossible to overcome the challenges discussed above by remaining on a time and materials pricing system for service.

Here are a few reasons why flat rate works much better than time and materials pricing.

- A. It moves customer focus away from the hourly rate, time on the job and the part fee and places their attention on fixing the problem and bringing the customer to a decision about the needed repair.
- B. It gives the customer information that allows a decision as to whether to repair or replace the failed product. Consequently, it is a much friendlier way of doing business because quoting a flat fee for repair upfront not only informs the customer about the needed repair and the associated fee, but gives the customer a choice.
- C. Perhaps most importantly, it overcomes unapplied time. Overhead expense on service, due to unapplied time, increases to about fifty to fifty-five percent of each service sale. "Unapplied," means there is no job to charge labor against, so the time went un-billed. A ten percent net profit in a service division would require a sixty to sixty-five percent gross profit margin on every repair.

Interestingly, when using flat rate pricing, a customer may be paying more for a flat rate repair than they would for the same repair on time and materials pricing, but they are generally more accepting and relaxed because they know in advance what the final repair fee will be.

## **What is the Impact on the Bottom Line?**

The impact on company profit can be significant. Using all the same information as before, and raising rates from \$100.00 to \$130.00 per hour has a measurable positive impact.

The 1000 billed hours at the new rate yields \$130,000.00.

$$1000 \text{ hours} \times \$130.00 \text{ per hour} = \$130,000.00$$

The forty-five callbacks at \$130.00 per hour costs the company \$5,850.00. However, the starting point has moved up favorably from \$100,000.00 to \$130,000.00, moving the company bottom line into the black.

$$\begin{aligned} & \$130,000.00 \text{ revenue} - \$5,850.00 \text{ (45 @\$130) callbacks} = \$124,150.00 \\ & \$124,150.00 \text{ realized revenue} - \$102,800.00 \text{ tech pay + overhead} \\ & = \$21,350.00 \text{ profit per technician.} \end{aligned}$$

So, how good is that? Obviously, very good when multiplied by the number of techs on staff.

## How to Decide on the Correct Rate Increase

Service companies will often use a trial-and-error method for setting **service rates** when converting from time and materials pricing to flat rate. That can work, but it is likely that the rates selected will not be as accurate as they should be.

The best way to make a determination about service rates is to first departmentalize the company income statement. Separating income and expense by service and installation work provides insight into the rates that should be charged to cover direct and indirect costs. It will also show if a division is making or losing money. As discussed above, unapplied time will have significant impact on a service division and much less impact on an installation division. Breaking out income and expense by type of work will allow the company to determine the rates that will carry each division and help turn a profit. Using only one billing rate based on man hours regardless of type of work and associated expense may cause the company to under charge on service and over charge on installation work.

**A more competitive hourly rate on installation may mean significantly more new equipment sales, while a more realistic hourly rate on service may turn a service division into a profit center. Without departmentalization a company cannot recognize growth opportunities or where cash is being drained.**

## **Answering Customers Top Two Questions**

When a customer is faced with a needed repair it can be stressful. A too-cold or too-hot home, a clogged drain, or tripped circuit breaker creates anxiety for the customer. That's because it can be both uncomfortable and costly.

When customers call for service and a company responds, some of the customer's anxiety is alleviated because they have shifted their anxiousness to the company and the service person. However, their anxiety builds again when the technician diagnoses the problem and begins repairwork especially if there has been no discussion about "what's wrong and how much?" which are the only two questions the customer wants answered.

Time and materials pricing does nothing to answer those questions effectively. Often technicians will provide a low to high price range. The low price is quoted so as not to frighten the customer, the high price is quoted to cover the technician's hide just in case he runs into problems.

A verbal quote is nothing more than a technician's opinion. And, when a low to high price range is quoted, the technician unwittingly just became a party to an activity known as price anchoring.

## What is Price Anchoring?

Price anchoring happens frequently when companies charge for service on a time and materials basis, without the participants even realizing it's happening. Here's how it works. A technician responds to a customer request for service. After diagnosing the problem the customer asks, "What's wrong and how much?" The technician has a fairly good idea about the parts needed and about how long the repair should take.

However, most technicians don't want to "paint themselves into a corner" when it comes to labor time because unknown issues often pop up. So, as mentioned above, the technician quotes a price range for the repair.

The tech says something like, "Well, you need this part and that's \$47 on my price list. It should take me about an hour, give or take to complete the repair. Our labor rate is \$95 an hour. It will probably be around \$142 to \$190 for the repair."

As innocent as that sounds, the price was just anchored at \$142. If the job runs to one and a half hours, the charge balloons to \$189.50 or \$47.50 more than the lowest price quoted. The customer is not happy because not only did their system break down but the customer now believes that the technician was not totally upfront about how long the repair should take.

A customer's comment like, "You told me it should be around \$142," followed by a technician's response, "Yes, but I also said it could be about \$190," does nothing to foster good customer relations.

Such a discussion may result in the technician adjusting the labor fee downward. Considering how difficult it is to turn a profit in service, any downward adjustment to the bill will likely result in a loss on that particular service call.

Conversely, flat rate pricing provides a firm price upfront for repairwork. The labor times are set to allow an average or good technician to complete repairs in the allotted time or even beat the time allowed in eight out of ten calls. The result is a much better customer experience, a big reduction in customer complaints, and many fewer adjustments to repair fees.

## **Important Takeaways**

1. A well-designed, well thought-out flat rate pricing system based on income and expense is the only way that will consistently deliver the appropriate desired net profit every service company needs to stay in business. That's because discretionary pricing is removed from the purview of the technician.
2. Regardless of the cost of a repair, it's far better to discuss the cost prior to turning the wrenches on the system. After the work is completed is not the time to discuss what repairs were completed and at what cost. Such discussions in advance of repair draw customers into important dialog about repair versus replacement. Price anchoring is also eliminated. Keep in mind, customers want to do business with a service company that is professional, honest and upfront. Flat rate pricing promotes price and repair discussions up front. Professionals need to act the part, every day on every call. Flat rate pricing underscores professionalism.
3. It all starts with how the initial phone call from your customer is handled. Office staff should tell the customer about the service call or diagnostic fee to cover travel to the job and to determine what repairs are needed.
4. Once the needed repairs have been determined, inform the customer that the technician will quote the repair before completing the work. That places the customer in a position to make a buying decision about the repair. A customer faced with an expensive repair on an old system, may decide to replace rather than repair. If the customer is unsure about what to do, the technician can give advice.

5. Keep in mind that customers have confidence in the technician working on their system, much more so than in a sales or office person. If a customer is not satisfied with the repair quote and wants to shop your price, you should then simply collect for your service call or diagnostic fee. Explain that if the customer calls back for the repair within a week, you will not charge another service call or diagnostic fee. That's only fair.
6. Time and materials pricing gives the customer more information than they need. In using this pricing method, the clock becomes their measuring stick against your hourly rate. And when they get to the end of that stick, that is, the length of time that they believe is reasonable, they beat your technicians with it to work faster by saying things like, 'Hey, how much longer is this going to take?'. Or, they poke and prod them with that stick and refuse to pay the bill unless the tech makes a fee adjustment. Or worse yet, your technician, in an effort to avoid the beating in advance, just doesn't bill all the time on the job. Maybe you've noticed your technicians are always more willing to argue with you than the customer. That's because they can't always justify why a repair took so long to the customer, but they can always justify saving the customer to you.
7. **Flat rate pricing doesn't allow a company to bill every hour that each service technician works, but it allows for labor rates high enough to compensate for those hours that cannot be billed.** It has been said, "Money doesn't solve all problems, but it makes all problems solvable." Life can be lived without money, but it can be more fun when you have money. So, money is a good start to solving your problems.

## Specific Benefits

Why it's better for the customer

- First, it keeps the customer informed and addresses the two important questions, 'what's wrong and how much?'

- Second, flat rate allows the customer to make informed decisions in advance of repair about repair versus replacement of their equipment.
- Third, it allows customers to relax about repair fees. Flat rate pricing is not an open-ended arrangement. More time on the job will not cost more money.
- Fourth, there are no surprises after the work is performed. The repair that has been recommended and approved is the work that is completed.
- Fifth, the customer never pays for education of apprentice and journey man technicians. If your tech takes longer because of his lack of skill, the customer doesn't incur that expense. Of course, that places the expense of educating and training your technicians on your shoulders. But, certainly we all agree, it's the service company's responsibility to send competent technicians out into the field.

#### Why it's better for the technician

- First, the technician can relax knowing the repair has been approved before the work begins.
- Second, technicians can be more thorough because they don't have to rush to keep repair fees low.
- Third, techs can complete thorough diagnostics because the customer has been informed up front, by the office staff, about the service call or diagnostic fee.
- Fourth, it eliminates guessing as to how much time it will take and multiplying that time by the hourly rate to answer the customer's question "How much?"
- Fifth, once the problem is diagnosed, technicians quote a total fee for the repair right from their pricing guide and ask for customer approval to complete the repair. That process makes the technician more professional and keeps the technician in control of the process.
- Sixth, upon approval, customers generally allow the technician to do his job without interruption.

- Seventh, upon completion, the technician completes the invoice for the appropriate service call fee and repair fee without concern the customer will press him for a lower price.
- Eighth, because the technician is no longer adjusting repair fees downward to satisfy the customer, lengthy explanations to the boss as to why he didn't charge for all the labor on the repair simply go away. All of the reasons I just mentioned give validation to the technician and his role with the company, thereby promoting greater job satisfaction for the tech.

#### Why it's better for office staff

- First, the process promotes better communication from the staff to the customer about the service call or diagnostic fee. The office staff should also communicate that the technician will quote the repair fee up front. Those talking points eliminate complaints both on the job and after the fact.
- Second, fewer complaints about pricing allows the office staff to remain more relaxed and focused on important tasks.
- Third, your company will experience lower call volume as a result of fewer questions or complaints about pricing. That allows everyone, especially service managers, to deal with customer needs rather than revisiting past customer invoices.

#### Why it's better for the company

- First, flat rate generates more money than time and materials pricing, thereby improving margins and increasing cash flow.
- Second, flat rate allows the technician to complete repair billing with fewer math errors.
- Third, a good flat rate system will display maintenance agreement discounts, thereby giving technicians an easy way to offer and sell maintenance agreements.  
return on investment.
- Fourth, because there are fewer complaints, the entire staff has a better attitude day in and day out.
- Fifth, with increased rates and higher margins, the owners gain a better return on investment.







Service businesses looking to grow revenue, improve customer relations, and receive a greater return on investment should consider converting to flat rate pricing. After 30 years or more it remains the best way to build profit and wealth in a service business.

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