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## Cover Story

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### Magnifying the Path to Residential Success

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As the U.S. economy struggles amid the subprime mortgage debacle and a housing downturn, the residential security marketplace has been set adrift into uncertain times.

The once white-hot builders market has all but flamed out across most of the country, leaving security dealers and integrators scrambling to adjust their business models. Revenues, already under pressure from price wars in some regions and mass-marketed systems, are suffering further erosion as consumer pessimism continues to mount.

Moreover, a crush of economic statistical data released by the government and forecast projections by security industry experts suggest the precipitous fall may not abate until sometime in 2009.

Security Sales & Integration spoke with more than a dozen industry professionals from across the country to gauge the current pulse of the residential market and identify new trends and opportunities. SSI found an industry and its players hard at work strategizing how best to cope with adverse effects from the economic storm that has befallen the market. But there is more at play in the residential space than gloom and doom; there is justification to be bullish when looking forward as well.

For instance, new products and services, powered by broadband and network connectivity, promise to satiate the appetites of new generations of tech-savvy end users, while creating new streams of recurring monthly revenue (RMR). The retrofit market is being looked to as greener pastures where many millions of single-family households and multiunit dwellings remain an untapped source in which to sell new security, fire/life-safety and home automation controls, as well as other interactive systems and services.

Significantly, several manufacturers have engineered their go-to-market strategies to include intensive interaction with dealers and end users in order to expeditiously provide the marketplace with sought-after products and services. Despite increased competition, price point pressure and other hurdles created by the current economic morass, SSI's 2008 Residential Market Report shows there are profits to be made



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### Housing Slump Continues to Be Harbinger of Residential Woes

The latest housing market statistics released by the U.S. Commerce Department only provide insult to injury for security professionals positioned on the frontlines of the builder market.

The number of housing starts fell 3.7 percent in November from a month earlier, to a 1.19 million annual pace — marking a 24-percent slide from November 2006. Total housing starts are now 48.2 percent below their peak in January 2006.

In a troublesome sign for future activity, building permits dropped for the sixth straight month, shedding 1.5 percent to a seasonally adjusted annual rate of 1.15 million units, the slowest pace for building permits since June 1993.

"That is a scary thing. That means eight months from now there is not going to be that new inventory we need to sell into," says Frank Benna, sales manager, Supreme Security Systems Inc. of Union, N.J. "Existing home sales continue to drop as well at a huge rate. That churn we need is not occurring."

Also glaring, single-family home starts declined 5.4 percent from October to an annual pace of 829,000, the lowest level since 1991. Benna, who teaches economics at two New Jersey junior colleges, projects the situation could worsen.

"Credit is still tight even at the current low rates. If there is no credit that means there is no money to be had to buy new homes," he says. "That is the engine that drives the housing starts and the building permits. But that engine is not in place and as a result, everything is stagnant."

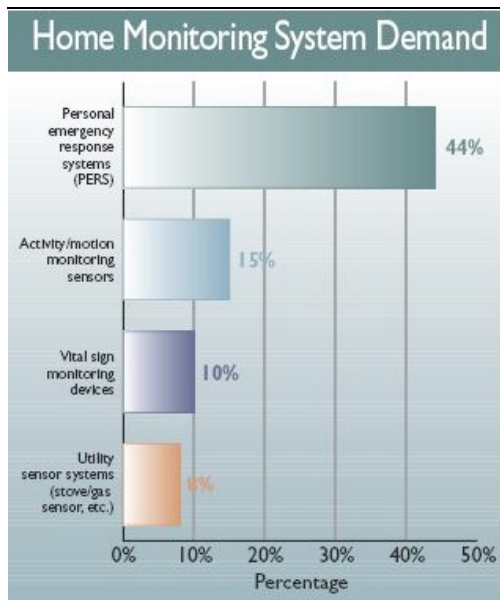
In fact, multifamily housing starts continue to hold firm, according to the U.S. Commerce Department. Groundbreakings for apartment buildings and condominiums ticked up in November, keeping pace with a 22-percent rise during the past 12 months. The report reflects a shift toward multifamily structures as builders forecast more families will have difficulty obtaining mortgages in the months ahead.

"About six months ago (the housing data) was showing that in the second half of 2008 there would be some improvement," says Randy Marquardt, vice president, residential, Schlage, an Ingersoll Rand Security Technologies company. "But over the last three or four months that has eroded. So now the general consensus is that 2008 will be a difficult year for everybody all the way through. Certainly any recovery looks like it will be pushed out until 2009."

### Competition, Opportunity on the Rise in Retrofit Market

As the builder market boom began to plummet in early 2006, residential security contractors have been forced to transition to alternate revenue streams. One market sector in the crosshairs of many security professionals is retrofit projects. A stampede to the retrofit market can't simply be explained by a mass exodus from the troubled housing market. Savvy companies have recognized that remodel and retrofit projects are a safe haven from razor-thin (or less) profit margins forced onto dealers by hardnosed builders.

Technology advances make retrofits more practical to a broader market as an ever-increasing number of homeowners upgrade their security, entertainment, home control and other systems, says Bill Ablondi, director of home systems research at Dallas-based Parks Associates.



Parks Associates recently asked residential security contractors to rate the intensity of customer demand for

Before the housing market began to slump, about 1.5 to 2 million new homes were built annually. "Now," says Ablondi, "we are well down below the million mark. But the existing home stock is 100 times that."

The promise of retrofit solutions nowadays, he says, centers on affordability and advancements in technology.

"The technology is well enough along that power line and wireless control and content distribution is a reality," adds Ablondi. "There is opportunity for security dealers to go beyond their current offerings and look at retrofit solutions that fit the market they are serving."

Parks Associates released a white paper in 2007 titled "Home Controls: Trends and Opportunities." The research projected the widespread implementation of broadband Internet access and the consumption of digital media is creating a market environment that will stimulate adoption of home controls. "When consumers acquire one system in a home, whether a security system, home theater or multiroom audio installation, they are often prompted to install other systems as well," the

**the above home monitoring systems. A scale of 1-7 was used, with 1 being little or no demand. Personal emergency response systems (PERS) outpaced the nearest category by nearly 30 percentage points.**

Source: Parks Associates

report states.

Parks Associates projected the market for home control hardware and software would climb from \$3.5 billion in 2007 to \$6 billion by 2012.

Intelligent controls (excluding security controllers) was forecast to grow from just less

than \$600 million in 2007 to \$1.5 billion by 2012 led by rapid growth of advanced entertainment controllers.

"When I think of security dealers, I think they are more likely to be involved in retrofit jobs than CEDIA-type (Custom Electronic Design & Installation Association) dealers," Ablondi says. "They've got the knowledge of how to run a business and roll a truck; install the equipment and leave. The question is what skill sets they chose to develop and perhaps partner in some cases if it involves working with an electrical contractor."

### **Industry Looks to Expanded RMR to Advance Market Penetration**

The percentage of alarm system penetration in all U.S. homes is commonly thought to hover somewhere between the mid-20s to low-30s. The total monitored population is estimated at 32.3 million, according to J.P. Freeman Co. Inc. Of that penetration, 23 percent of the homes in the U.S. are monitored, according to GE Security's Kirk MacDowell, residential marketing leader, Americas.

"It has been that way for the last six to seven years. Not much additional penetration is happening in the alarm market," MacDowell says. "It's frustrating for large dealers and certainly frustrating for manufacturers. We are constantly looking for ways to penetrate and expand the market."

Despite all the ballyhooed talk about the opportunity for new types of services creating new revenue streams for security dealers, industry professionals interviewed for this story resoundingly agreed that security remains the utmost important driver in the residential market, notwithstanding the stubbornly persistent degree of market penetration.

"Even today it is surprising the number of homeowners — regardless of the price point or economic background of the homeowner — who do not have a security system," says Jim Callahan, vice president of sales for Atlanta-based Ackerman Security.

However, Callahan expects a growing awareness about security — particularly due to a rise in the incidence of home invasions — will likely further propel alarm system penetration.

"I think you will see those numbers ratcheting up rather quickly. We are seeing much more complete systems being installed," he says. "People who used to consider maybe just doing a couple of doors and motion are insisting upon perimeter protection, contacts on all the accessible doors and windows, because they want early detection."

According to *SSI's Annual Installation Business Report*, the average total sales price that security companies charged in 2007 for a residential alarm system was \$1,520. The 2006 average price was nearly the same.

However, recent research by Parks Associates indicates that number is expected to trend upward, supporting the expectation that expanding systems and services are on the rise. According to Parks Associates, total residential security market revenues are forecast to climb more than 40 percent to \$12.5 billion in 2012 from \$8.2 billion in 2006 (see *chart*).

MacDowell points to the 23 percent of monitored alarms as an entry point to expand market penetration, thanks to the widespread adoption of high-speed Internet access. "Eighty percent of the monitored homes have broadband installed in the home," he says. "This is one reason we are so bullish on the interactive services market."

GE Security has aligned with iControl, a provider of mass-market Web-based solutions, and Alarm.com, a provider of wireless interactive security and monitoring system technology, to connect subscribers to the home. The services allow mobile access to security systems, cameras and home devices, plus remote home monitoring and home control functionality.

"The retrofit guys are saying, 'We want to increase RMR, we want to increase RPU (revenue per unit) — what are you going to do to help us?' We now have a solution," MacDowell says.

### **Underserved PERS Market Growth Is Trending Upward**

Demand for home health monitoring solutions, such as a personal emergency response system (PERS), is expected by some in the industry to also be on the rise and offer increased RMR.

"We have devoted much of our last three to four years on PER systems," says Chuck Stevens, vice president of marketing for Carlsbad, Calif.-based Linear, a provider of low-voltage wiring systems and wireless components. "My growth rate in PERS has been over 20 percent a year for the last four years."

According to Parks Associates, the intensity of demand for PERS compared to other home health monitoring systems — including motion monitoring sensors, vital sign devices and utility sensors — is by far the greatest (see *chart*). Stevens says there are more than 5 million people who are in need of a PERS, which consists of a small two-way radio transmitter or "help button" carried or worn by the user, a console connected to the user's telephone, and an emergency

response center that monitors calls. Users include disabled or elderly persons living alone who can summon help in an emergency. Consumer prices range from \$125 to \$1,500 or more for a system; there is also an installation fee and a monthly monitoring charge up to \$30.

Stevens says a dearth of PERS specialists across the country, in part, explains why the market is underserved. "The best data I have says there is maybe 1.4 to 1.5 million of those individuals that are being served today," he says.

**Industry Growth in Cameras Expected to Spread to Home** According to SSI's Annual Installation Business Report, dealers/integrators say the residential market on average provided 9 percent of their video surveillance sales revenue in 2007. While that number may not appear significant now, security installers across the country are beginning to ramp up for wider adoption of video services and monitoring in the home.

"We are now spending more time looking at and deploying and installing video in the residential marketplace," Callahan says. "It's been talked about for a number of years, but the technology and price points are such that it is [now] affordable for the average homeowner."

Residential video surveillance historically has been a higher end installation, but newer IP-based products and services have made it possible to penetrate a wider audience.

For instance, NAPCO's recently introduced iSee Video™ solution enables security systems to integrate with video, putting homeowner residences online via Web-enabled devices, including cell phones and PDAs. The solution offers dealers an easy source of incremental RMR for new and retrofit installations, says Judy Jones, NAPCO's vice president of marketing.

"Alarm events can trigger video clips to be automatically sent to both the end users for instant information and to the central stations for alarm verification," she says.

Joe Freeman, founder and president of J.P. Freeman Co. Inc., noted for its security market reports, says the ability to verify an alarm will help drive video in the residential space.

"One of the things video can contribute is to explain a false alarm before law enforcement is dispatched. That's one of the advantages being used in sales pitches is the false alarm control issue," he says.

Freeman says intelligent video has not touched the residential market space — but it will in the next five to 10 years as the price of software and IP cameras decreases. Security dealers with thoughts of competing in the residential market had best start honing their networking skills, he says, or be shut out of the market.

"With the entry of the IT-savvy home automation dealer into the residential security market, what you've got is a much better, far more amplified and understandable explanation of the possibility of video monitoring," Freeman says. Game planning for future trends is vital for any creditable business model, but there are still rough waters ahead to navigate to ensure a company's survivability and growth.

Holmes Electric Security Systems in Fayetteville, N.C., illustrates how successful companies are weathering the storm. Prior to the subprime and builder calamities, Holmes Electric derived its revenues from 70 percent residential, 30 percent commercial. That ratio has changed quickly to 40 residential, 60 commercial, according to company president Stephen Wheeler. Wheeler looks in-house when pondering how to replace his losses in a moribund housing market.

"We're tapping into our base to make sure our existing customers are updated with some simple additions, like a carbon monoxide detector to back up radio monitoring," Wheeler says. "There are still lots of accounts out there that need new or upgraded alarm systems. That is what we are going to focus on in the coming year."

## Dealers, Customers Are Key to New Product Offerings



The slick new products and technologies now being sold to the residential market aren't just the brainchild of a manufacturer's R&D department. The marketplace can thank dealers and integrators, and their customers, for helping incubate the very idea of some the products and services now available in the home.

It is the fruition of manufacturers' go-to-market strategies that include intensive interaction with dealers and end users in order to expeditiously provide the marketplace with desirable products and services.

"I would say that today more than at any other time manufacturers are bringing product to the market to meet consumer request/demand faster than they ever have in the 26 years I have been doing this," says Jim Callahan, vice president of sales for Atlanta-based Ackerman Security. "It is my opinion that the manufacturers are doing an excellent job — better than they have ever done — in understanding what homeowners are looking for and quickly bringing that to market to satisfy that need."

In prior years, manufacturers often displayed more of an aloof disposition toward independent security dealers and integrators than a forthcoming partnership with an open-door policy.

It is now common for manufacturers to actively conference with dealers to better understand what end users want and expect from their security systems and services.

What was the incentive for manufacturers to do an about-face? Flat residential sales proved a supreme motivator. Manufacturers realized the way to grow bottom line profits was to provide a larger breadth of quality products and satisfy what consumers are willing to pay for.

There is still work to be done on the manufacturers' part in communicating the reality of security system cost to the homeowner, says Stephen Wheeler, president of Fayetteville, N.C.-based Holmes Electric Security Systems.

"Our salespeople are answering phone calls constantly from residential people who want to go to the next level, 'I want to see my child when they come in the door after school.' Well, yes, the technology is there, but the cost for that supersedes what the average person thinks it is going to cost," Wheeler says. How can that be fixed?

"The manufacturers need to help the dealers educate the public that it's not as cheap as they think it is. It's nice to watch the TV and think I can watch my business from home, but the customer forgets the cost of the equipment to do that."



Although Bosch's name is quite familiar to those in the security industry, his previous experience has been in daily newspaper journalism. Prior to joining *Security Sales & Integration* in 2006, he spent 15 years with the Los Angeles Times, where he performed a wide assortment of editorial responsibilities, including feature and metro department assignments as well as content producing for latimes.com. Bosch is a graduate of California State University, Fresno with a degree in Mass Communication & Journalism. In 2007, he successfully completed the National Burglar and Fire Alarm Association's National Training School coursework to become a Certified Level I Alarm Technician.

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