



Nash Networks Inc
IT Consulting

Serious about technology. Serious about your business.

Extended Warranties: Sensible Insurance or Waste of Money?

"Making every IT dollar count!"

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Contents

Executive Summary	3
It's Hard to Argue With a Billion Dollars.....	4
Overview	4
What Do (Should) Warranties Cost?.....	5
Who Benefits?	5
Insurance: Back to Basics.....	6
Betting Against the House: The Case Against Extended Warranties.....	7
Peace of Mind: The Case in Favour	8
How to Get the Best Value from a Warranty	9
Sources	10
About Nash Networks	12

NOTE: This white paper focuses on desktops and laptop computers. Some of the information also applies to other hardware and peripherals, but they aren't specifically addressed.

Executive Summary

Overview

- An extended warranty is a guarantee of a product under conditions of ordinary use, and covers a period after the standard, free warranty expires.
- Extended warranties are usually highly profitable for retailers and a waste of money for consumers.

Main Cons

- Extended warranties are expensive, at approximately 10% of the purchase price per year of cover. Repairs typically cost about the same as the warranty.
- Covered parts seldom break within the extended warranty window. Most faults occur within the first year, which is covered anyway.
- For most businesses, keeping a couple of spare laptops in the office will cover the business continuity side of laptop or desktop failures.

Main Pros

- If warranties offer a true business continuity advantage – not just replacement parts – at a fair price, and uptime is critical, then they are worth considering.
- If you can negotiate a great price, or the warranty really offers a good deal, go with it. Features to look for are on-site service, guaranteed response times and advance replacement.
- Laptops that travel a lot and certain PCs might be worth covering, but laptops are likely to need additional accident cover.

If You Buy: How to Get the Best Value

- Negotiate on price and shop around. Consider third-party warranties.
- Don't pay more than 10% of the purchase price per year of warranty.
- Make sure the extended warranty doesn't overlap with the 1-year manufacturer's warranty, effectively providing a year less cover.

It's Hard to Argue With a Billion Dollars

Paul Champagne, computer engineer, worked as contractor to the Canadian Department of National Defence for more than 10 years.

Champagne was recently featured in Maclean's magazine. Here's the interesting part:

"At the time [that he started], DND was spending around \$227 million a year on more than 2,000 separate [IT] contracts. Champagne's big innovation was to declare that DND would henceforth pay to fix only systems and equipment that were broken. **Essentially, he was ripping up a couple thousand extended warranties**, and betting that the government would save a bundle. He was right. Maintenance costs soon fell by more than three-quarters, to about \$50 million per year."

All up, the savings added up to **over a billion dollars**.

Unfortunately, Champagne pocketed \$10 million per year of the \$157 million he saved the government – a kind of unauthorized commission that the Crown did not appreciate. He's currently serving time in the Pittsburgh minimum-security prison near Kingston.

The Champagne story was so compelling that we decided to take a look at whether extended warranties make sense for small businesses.

Overview

What Is An Extended Warranty?

An extended warranty is a guarantee of a product under conditions of ordinary use, and covers a period after the standard, free warranty expires.

If the product malfunctions during the warranty period, the manufacturer or distributor typically undertakes to provide a replacement, repair, or refund.

What's Covered?

Extended warranties generally cover mechanical failure incurred with normal personal usage. Coverage can include parts and/or services such as technical support, rapid response, and on-site repair visits.

What Isn't Covered?

Typically, extended warranties don't cover accidental damage, peripheral items, normal maintenance, and damage by computer viruses. Consumer-grade warranties may not cover commercial use.

How Well Do They Sell?

Consumers seem more than happy to buy extended warranties. About 50% of the computers in a 2008 Consumer Reports survey had purchased a service-upgrade plan.

In a PC World survey, almost two-thirds of consumers had bought extended warranties and 80% of those who used them said they were happy with the outcome.

What Do (Should) Warranties Cost?

Extended warranties are usually calculated as a percentage of the item's retail price. Consumer Reports recommend that buyers should pay **no more than 10% of the purchase price per year of coverage**.

Prices for the same warranty can vary dramatically between retailers. Generally, if the product is sold at a discount, the warranty is too.

Who Benefits?

We'll explore in just a minute whether or not the buyer benefits from extended warranties. What's clear is that the seller is almost certainly the major beneficiary.

Profit margins on extended warranties are huge. While retail profit margins on hardware are tiny, margins on warranties are 50% or higher. Knowing the impact of extended warranties on company profits makes it easier to understand why these products are pushed so hard.

- In late 2005, extended service contracts accounted for 45% of Best Buy's operating profits and 100% of Circuit City's. Without extended warranties, Circuit City would have reported a loss for the 2003-2004 fiscal year.
- About a quarter of Dell's net income in the first quarter of 2003 came from extended warranty sales; in the fourth quarter of 2005, that had grown to 37%.

Hence the hard sell, and the extension of warranties from big ticket items to just about anything.

Insurance: Back to Basics

Insurance was designed to protect from catastrophic losses from which businesses or individuals could not otherwise recover. It wasn't intended as a little bet between the customer and the retailer over a \$200 computer repair.

And that, ladies and gentlemen, is the simple crux of this issue.

Cost-Benefit Doesn't Add Up For Consumers

For most consumers, extended warranties are simply not worth buying. The limited benefits don't justify the cost of the insurance.

But What About Businesses?

For businesses, though, a failed computer or system can have financial implications that go far beyond the cost of the parts and labour. Downtime and lost productivity add significantly to direct losses.

When considering an extended warranty, business owners should assess whether it will allow the business to recover faster – if not, it probably isn't worth paying for. Features to look for:

- **Same-day or next-day on-site repairs.**
- **Technically competent repair and support technicians.** In a recent Consumer Reports survey, consumers were most satisfied with Apple tech support, followed by Lenovo, Dell, Toshiba, Gateway, Sony and HP.

The “Self-Insurance” Option

Given that the most compelling reason to buy extended cover is the risk of prolonged downtime, there are a couple of things that businesses can easily do to minimize that risk at no, or low, cost:

- **Keep retired computers as spares.** If upgrading computers, keep a couple of old ones to use if a current machine needs repairs. Extra cost, zero.
- **Buy a spare computer.** For an environment with fifteen computers valued at \$1,000 each, extended coverage for 3 years would cost \$4,500. For \$1,000 to \$2,000, including hardware, installation and software, the business could buy a spare machine. That’s a savings of \$3,000, and a material asset rather than an insurance expense that might never be called in.

Betting Against the House: The Case Against Extended Warranties

The buyer of an extended warranty is betting that the device will break during the extended warranty period, and that the value of the repairs will justify the cost of the warranty. The seller is betting that defects will show up within the first year, while the product is covered anyway, and that any problems after year one won’t be covered or will cost less than the extended warranty.

As the high profit margins on extended warranties demonstrate, the seller is winning this bet overall.

Here’s why Consumer Reports, and others, maintain that extended warranties are a bad deal for the customer:

- **Typical repairs cost the same as extended warranties.** You’re better off saving the warranty money and using it to fix your system if and when it breaks, instead of buying a warranty you may never use.
- **Covered parts seldom break within the extended-warranty window.** Failures of covered parts usually occur within the first year, when they are covered anyway.
- **Computers are pretty reliable.** It’s true that computers have a high rate of repairs over their lifetimes (31% for desktops and 43% for laptops in 2006), but that still means that most won’t ever need any repairs; and many of the repairs wouldn’t be covered by standard warranties anyway.

- **Warranties are limited.** Warranties only cover some of the many things that can go wrong. Also, the first claim on a warranty may void subsequent claims, unless a new warranty is purchased.
- **Third-party technical support is more efficient.** According to Consumer Reports, independent third-party providers, such as the local computer repair shop, provide technical support more efficiently. Technical support from some manufacturers or retailers can chew up inordinate amounts of time without solving the problem, and at worst can result in permanent loss of data.
- **Credit card companies might provide free extra cover.** Paying by credit card can double to manufacturer's warranty period in some cases – at no extra cost.
- **You're insuring a rapidly-depreciating asset.** Computers drop in value very rapidly. The \$300 you spend on an extended warranty today may seem reasonable compared to the cost of a \$1,000 PC, but in two or three years, the same computer will probably cost \$500.
- **The warranty is only as good as the warrantor.** If the company goes bankrupt, the warranty might vanish too.

Peace of Mind: The Case in Favour

Here are some reasons to go ahead and buy the warranties anyway:

- **Business continuity.** If warranties offer business continuity – not just replacement parts – at a fair price, and uptime is critical, then they are well worth considering.
- **Very small businesses.** In businesses with only a couple of computers, where self-insurance in the form of spare computers isn't feasible, extended warranties might be a reasonable option if they will limit downtime.
- **Laptops - maybe.** Laptops have the highest repair rates, and are expensive, so it might be worth insuring laptops that travel a lot – but that means paying extra to add accidental damage. It might be more cost-effective to maintain a spare laptop as suggested above.
- **Dell or Gateway PCs if you need the tech support.** Problem-solving by techs from these companies is significantly better for those with paid plans, so if you anticipate that you'll need hand-holding after the first year, an extended warranty might be a good idea.

- **Refurbished computers.** Consumer Reports recommends extending the warranty to a year for refurbs, if they come with anything less. Do the math first, though.
- **Great deals.** If you can negotiate a great price, or if the warranty really offers a good deal, go with it. Features to look for are on-site service, guaranteed response times and advance replacement.
- **Poor initial warranty.** In some cases, labour is only covered 90 days instead of a year, even though parts are free – that makes repairs expensive and might tip the balance in favour of a good extended warranty.
- **Peaceful sleep.** Despite the poor value that most extended warranties offer, huge droves of consumers buy them and report that they are happy with the purchase. That's largely because of the emotional comfort of the warranty, rather than the economic reality.
- **Projection TVs and digital cameras.** Consumer Union recommends extended warranty protection specifically for these products, because they require repairs frequently and are expensive to repair.

How to Get the Best Value From a Warranty

- **Negotiate on price and shop around.** Warranty prices vary as much as purchase prices. Be aware that discount stores also sell discount warranties.
- **Remember the 10% rule.** The maximum you should pay is 10% of the purchase price per year of warranty.
- **Consider third-party warranties.** You don't have to buy the warranty from the manufacturer or retailer. They might be considerably cheaper, or offer better value.
- **Be careful you don't lose a year.** An extended warranty usually begins the day you purchase a product, so it overlaps with the standard warranty for a year - so a three-year policy gives you only two years of additional coverage.
- **Ask about free cover.** Some retailers, such as Costco, might extend a warranty at no extra cost. Buying by credit card can extend the warranty by up to a year.

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About Nash Networks

What we do

We manage and maintain IT networks for small businesses.

Philosophy

We understand that every business is unique, with unique technology needs. We provide and support the mix of technology that's right for each client.

We aren't a one-solution shop. There's no such thing as one-size-fits-all in technology (or socks).

Skills

We know a lot about a lot: Windows, Unix, Macintosh, programming, connectivity, VoIP, virtualization, security, disaster prevention ... and much more.

People

Our consultants are all university-educated, experienced, highly skilled and excellent problem-solvers.

Vendors & subcontractors

We recommend and use only quality vendors whom we know and trust.

Technology

We use state-of-the-art monitoring, remote support and backup tools.

We constantly update and upgrade our tools and capabilities - but where it makes sense, we continue to use tried and trusted, older technologies. We're not driven by fads.

Core Team

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