

ARE YOU TRANSFORMING YOUR PRODUCT INTO SERVICE?

WHAT STEPS TO TAKE AND HOW TO GET THERE



A recent study performed by Triathlon Group shows that servitization is more important than ever in the Nordic manufacturing industry. Driven by changed customer requirements due to technology usage, higher degree of digitalization and IoT; new possibilities appear. Service has transformed from being a cost item into an opportunity generating additional revenue for both large manufacturers and SMEs.

Servitization for manufacturing companies can involve high focus on selling add-on services; e.g. service contracts including repair and spare parts. Others take servitization to the next level by integrating into their customers' operation through offering advisory services, logistics services and/or financial solutions. 100 % of the manufacturing companies in the study offer several add-on services today, but only a few of them have come to the next level. It is a matter of strategic decision from top management and how the companies are managing the transformation; to innovate and to build new core capabilities.

The motivation behind service sales

Competition has changed; speed, flexibility and adaptation to customer needs are success factors today. Quicker changes require large actors to review their business models e.g. 52% of the fortune 500 firms since 2000 are today replaced.

Servitization: The transformation in which manufacturers are increasingly offering services that are directly coupled to their products

The reasons behind servitization are several, but high competition, high expectations from customers and price pressure on the core product are often the motivating factors. Instead of joining the fierce competition, many manufacturing companies look at other business models that can enhance the product sales. The drivers of servitization are mainly of a financial, marketing or strategic character.

The main financial driver is the potential higher profit margin on services than on the product. Another financial driver is

that services can possibly generate a more stable income over an extended time period than a one time sale of the product.

One marketing driver is the effect that services have on product sales. Customers appreciate customer care, and services are therefore an important evaluation criteria for their initial purchasing decision. It can also create customer loyalty and dependency that bring up-sales opportunities.

The strategic driver is simply to create a competitive advantage and raise the barrier for competitors. The competitive advantage can be related to the increased level of knowledge about customers, but also to the customers' increased dependency to the company.

Making the transformation

While many manufacturing companies have successfully taken the first steps into servitization, research shows that after the initial success there is often a dip. Improving existing services and developing new ones require large investments not only in the service offerings themselves. Investments are also connected to resources to deliver and maintain the services needed e.g. in new employees with additional competences and functions, enhanced knowledge in existing personnel and updated way of working. Depending on strategy for servitization, the transformation and implementation of new offerings will take time. All together endurance from decision makers is crucial to get beyond the dip, see figure 1.

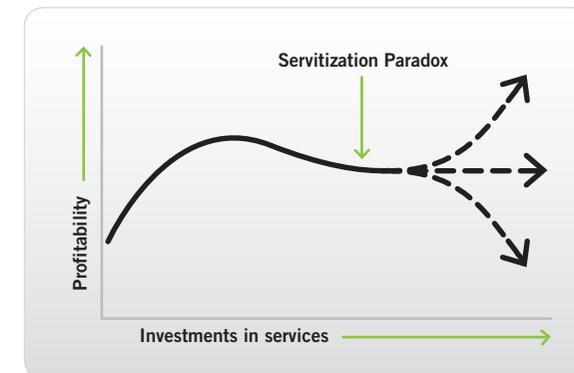


Figure 1. Service paradox and scenarios to get through the dip



BECOMING AN ADVANCED SERVICE PROVIDER

Categories and shifts of servitization

The classification of manufacturers and their level of service sales is commonly divided into four categories;

- Product manufacturer
- Value added manufacturer
- Full service provider
- Integrated solution provider

To succeed in the transformation, the shifts between the categories are crucial to manage. See illustration in figure 2.

1 Reactive to proactive service sales

Add-on services such as service contracts for spare parts and maintenance are common in the first category. Taking one step towards servitization includes shifting from reactive customer offerings to proactive e.g. in delivering maintenance, and looking at a broader scope of the product life cycle.

2 Service sales based on product usage

The second shift towards a *Full service provider* means that the company has developed services based on product information to help the customer to improve the usage of the product.

3 Sell output and product as a service

The shift to an *Integrated solution provider* increases the focus on output and responsibility over entire processes at the customer. It is a facilitator and an enabler for the development of 'pay per use' and 'product as a service' business models.

More and more companies are changing their way of expressing themselves in public, indicating their transformation into becoming service and solution providers. However the study results show that the majority of the companies have started the journey, but to transform and get through the shifts takes time and need substantial investments. Every shift might imply a new dip until the new business models pay off.

What position to take?

There is nothing saying that becoming an integrated service provider is the desired end stage for all companies. What position to take depends on what problems you want to solve for your customers (cost optimization, expertise, financing etc.), your company's capability to deliver services and solutions better than actors doing it today e.g. the customer or other suppliers in the value chain.

Companies with access to capital are more likely to reach the fourth category, whereas SMEs can be more adapted to the first two categories. However, SMEs have the advantage of being more flexible and agile in making organizational changes, in comparison to larger companies.

Regardless of the position and reason for servitization, the decision for a shift must be put on the table and become central throughout the organization and culture of the company to reach its expected potential.

Further utilization of service information

With the development of more advanced services, new information and knowledge can be possessed by companies. Information on product quality, usages, customer operations and behaviors, and end user interaction with the product can be gathered.

New technology enables faster access to data and if utilized efficiently, it can be a crucial differentiator to increase revenues and/or realize potential savings. Benefits of having control over product development and product improvements can be achieved and utilized to maintain a competitive core product. To connect products and machines and gather data on the full life-cycle also open up for developing services in predictive maintenance and advisory services.

Internal usage of services and creation of common business models require cross functional involvement. To succeed in the development companies have to see beyond contradicting KPIs and establish a unified approach and way of working. What is valuable for the company and not for the specific function need to be considered to manage the internal transformation.

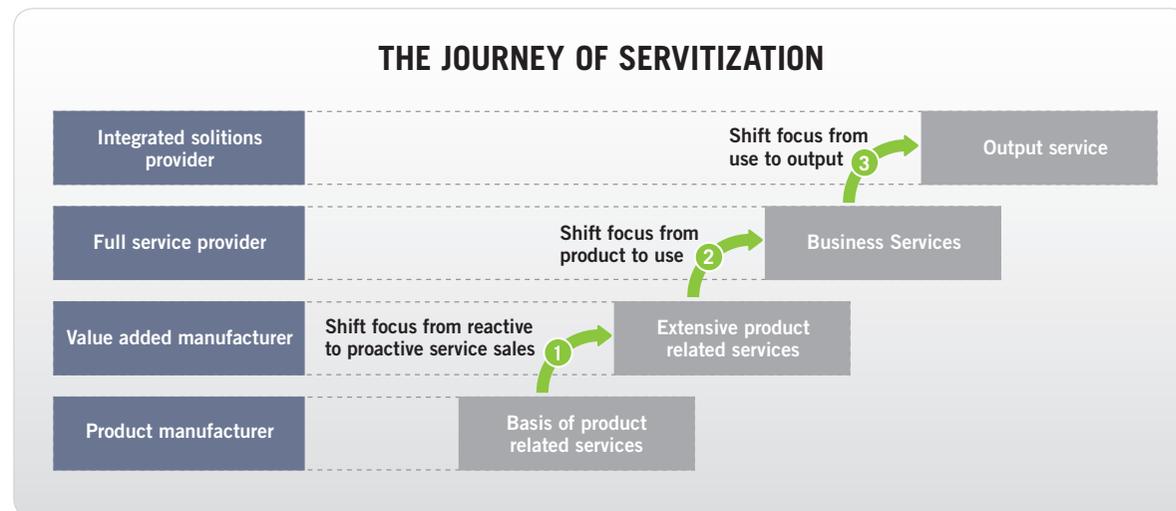


Figure 2. The Journey of Servitization



THE IMPORTANCE OF FINANCING AND OWNERSHIP STRUCTURE TO ENABLE MORE ADVANCED SERVICE SALES

New ownership structures

Having travelled the journey of servitization to the fourth step and using business models based on output, you are also facing new types of challenges. When your customer is paying per use or you have partnership arrangement to share the generated profit, it requires new ownership models. New payment models will result in changing patterns in revenue streams over time, making access to capital crucial.

In more service oriented business models, the physical product has a less important role in the sales situation and the transaction does not necessarily imply a change in ownership of the product. The customer is the user but the manufacturer either maintain the ownership or it is transferred to a third party such as a financial partner. Change of ownership equals a change of responsibility for the risk and the potential profit.

Taking above scenarios into consideration, finance partners but also legal authorities become very important for the manufacturer to be able to deliver on a global arena managing different regulations and laws.

Contract management

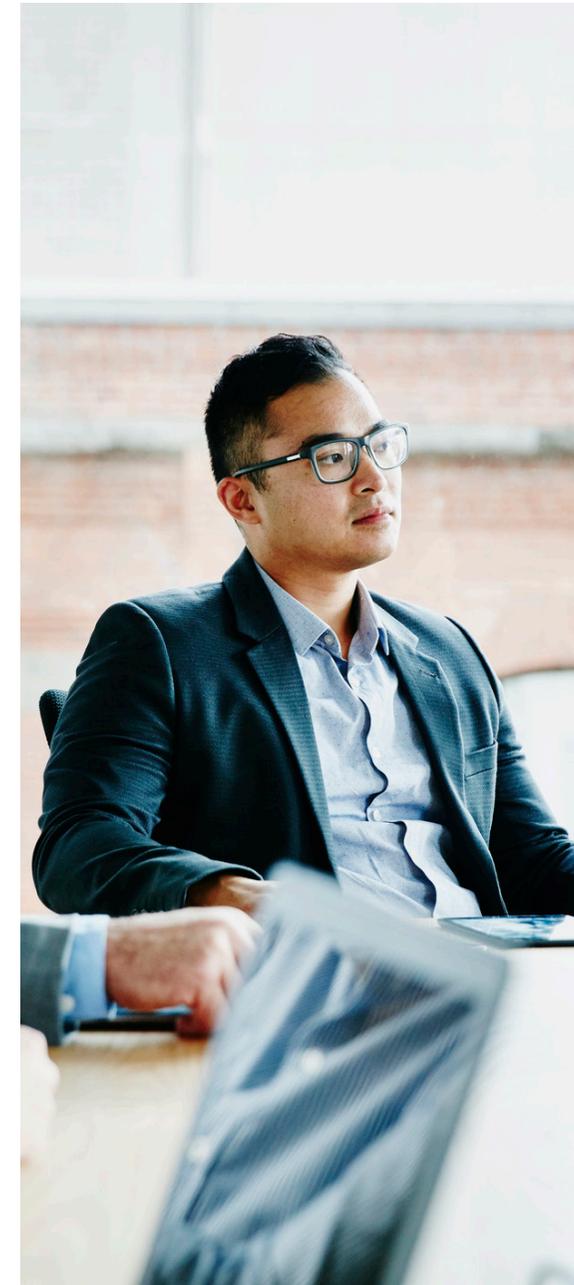
New ownership structures make it more important to maintain a contract management strategy that is in line with the companies' overall strategy. There are many references these days to "partners" rather than suppliers, but is it actually any difference? Working in a partner constellation includes another level of shared risk and reward than in a supplier standardized transaction since set-up is based on terms and conditions for an agreed period of time. The

partnership often yields a competitive advantage, e.g. win-win and potential profit sharing. Even though the business relationship is something in between partnership and traditional customer supplier relation, the importance of clear and efficient contracts is still there, e.g. for considering compensation for transferred risk and to ensure delivery to the customer. 70 % of the companies in the study mention partners as important for the delivery of their services.

Today the availability of software applications designed to address these needs e.g. to improve contractual processes and satisfy increasing compliance, has increased. Contracts need to become an automated standard mean to secure proper solution sales.

Using partners to modernize technology

One dimension of solution sales are the opportunities that the digitalization bring as mentioned earlier. Companies know that they have to be part of digitalization in one way or another, but often the organizations lack competence and knowledge to create a suitable strategy. The number of advisors and suppliers in this area is growing in a tremendous speed and the decision for companies comes down to what to source (or outsource) and what to build, create, develop or establish inhouse. For example, modernizing data architecture, platforms and digital services to the latest technology to make it scalable, secure and cost efficient is often partly a buy decision. Again, make inhouse or buy from supplier becomes a strategic decision and the ownership needs to be defined during development of software, source code or other intellectual assets.



SUCCESS FACTORS

FOR IMPLEMENTING A SERVICE STRATEGY

To successfully progress in servitization it is vital with supporting organizational arrangements next to a well developed technology. The way of preparing for the transformation can be divided into three steps:

- Define and design the service offerings
- Define how to deliver the service
- Define how to govern and follow-up

The first step is obvious but the second two are as important.

Define and design the service offerings

First step is to fully understand your customers' processes and their value chain including end customer interaction. In the design of an offering, new activities need to be defined and key is to ensure better performance in both cost and quality compared to competitive solutions. The design activities also include creating suitable interfaces with the customers. One success criteria is to involve customers in an early stage to ensure that the proposed offer is in line with expressed demands, KPIs, etc. and identify areas where your offering will support your customer with competitive levers.

Define how to deliver the service

Become efficient and successful as a service supplier it is important to secure the way of working and the competitive levers. One part is to establish and build needed competen-

ces in the organization, but also drive change management in your and your customer's organizations. For example develop detailed understanding of how the offering is received; need of training material, on-site support and advice.

Define how to govern and follow-up

Optimization criteria and internal KPIs for the new business model should be established at early stage and linked with a governance model for follow up. With introduced new offerings, customer expectations on additional services are higher and continuous improvement process for developed services is needed to manage a quicker changed demand. New decision models and communication channels internally and with customers are often needed as in many cases additional contact points are developed.

Implementation – How to manage a transition

During the study in servitization and how manufacturing companies make the transition to an increased service business, a framework including six organizational arrang-

ements, that has been found critical to support a successful service strategy implementation, could be confirmed.

The arrangements, as can be seen in the figure below are all essential for successfully implementing a service strategy. However, companies need to balance them, and depending on what transition to make (in the servitization journey) the different areas are of different importance. To establish a service culture is found extra challenging for a traditional manufacturing firm and new means of integrating the service business into the traditional product is crucial. Also changing incentive structures throughout the organization can be needed.

Another important aspect to become successful in a service transition is the managerial motivation in the company. Management has to support the service strategy and invest in needed development. In addition management need to accept the risk and to trust the potential steady revenue streams and return on investment and not fall for the service paradox and get stuck in the dip.

KEY AREAS TO CONSIDER WHEN EXTENDING THE SERVICE BUSINESS

Theoretical framework for organizational arrangements*



*Gebauer, Fleisch, Friedli, (2005)

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