The rapidly increasing amount of connected products in combination with the long-known trend of servitization is currently accelerating digital servitization. A recent Triathlon study shows that many manufacturing companies sense an urge to follow this development and are struggling to capture the expected values to secure profitability. This newsletter will present further findings from the study, including identified key success factors for how to manage this transition.

A common perception is that being in the forefront of digitalization and digital servitization is a prerequisite to stay competitive. Similarly, most companies included in the Triathlon study expect that they must start, or continue, their digital servitization journey to protect and strengthen their market position. This is reflected in that the investment is commonly initiated to either meet customer request, keep up with competition or to increase differentiation, as seen in the initiators table.

Even though the companies experience a pressure to develop digital services, they have identified large potentials for value creation and increased profitability through digital servitization. The companies expect to realize these values through a combination of revenue from digital services, internal savings and increased product sales. Profitability is however rarely seen as the main objective for the investment, but rather as a result of the strategic objective to strengthen competitiveness. Securing profitability has also proven to be challenging for many companies.

“I do not think we are profitable, but it is not really the main objective. This is rather something we have to provide to our customers.”

To develop and start offering digital services, which often includes moving from a product centric offering towards a service centric customer offering, puts new requirements on an organization. Among other things, organizations must increase customer attention and proximity as well as become more data driven to develop and continuously improve competitive digital services. Operating and maintaining the quality of digital services often requires formation of new cross-functional teams and processes. In addition to the required organizational transformations, digital servitization is subject to both one-time investments to acquire software and hardware, as well as runtime costs to operate the services.

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**INIZITATORS**

The most common initiators to start developing digital services, according to the studied companies.

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<thead>
<tr>
<th>Increase Profitability*</th>
<th>Strengthen Market Position</th>
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<tbody>
<tr>
<td>Increased Product Sales 71%</td>
<td>Customer Request 42%</td>
</tr>
<tr>
<td>Profitable Digital Services 57%</td>
<td>Keep Up With Competition 29%</td>
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<tr>
<td>Internal Savings 29%</td>
<td>Increased Differentiation 29%</td>
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* Some companies gave more than one initiator

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**Triathlon study: How to Manage Digital Servitization Successfully?**
**Purpose:** To increase the understanding of how manufacturing companies can pursue digital servitization
**Industries:** OEMs in the agriculture, forest and mining industry. All producing heavy, mobile machines
**Performed:** Q2-Q4 2019

**Digital Services:** Services delivered using digital technologies. Also commonly called connected services or IoT (Internet of Things) services
**Servitization:** The transition from a product-centric to a service-centric offering
**Digital Servitization:** The transformation in which manufacturers are increasingly offering services that are using digital technologies, i.e. digital services
WHERE IS THE VALUE?

To secure payback on the investment and running costs to offer digital services, all companies in the study succeed in realizing internal cost savings, but many struggle to generate revenue.

To generate revenue, value for the customers must be created. Examples from the study show that the customers can decrease costs by an improved proactivity and safety, and they can increase revenue through a higher productivity and machine uptime. For the manufacturing companies, these values are expected to translate into revenue from sales of the digital services or increase the revenue from product sales, as a result of an improved customer offering.

"Everyone understands the value, it is easy to demonstrate. If we can increase efficiency in a mine, it is a huge saving for our customers. The questions however remain, how to charge? How to invoice?"

The digital services revenue is by all studied companies based on subscriptions, where both price model and price level is the result of benchmarks across industries. Charging for the services is however perceived to be very difficult and many companies instead expect to increase revenue by selling more machines or increasing the margin for the machines.

The companies that best succeed in charging for digital services have experienced high customer demand and have through co-development secured that services are value-adding for their customers. Other companies are caught in a "charging paradox". As many customers require to test run a service and experience the value before committing to it, free trial periods are commonly applied. For many companies it is perceived to be the only option, especially if they have failed in creating or communicating enough customer value. As the free trial period is running out, there is a risk that customers are not willing to pay for something they are used to access for free, unless they are convinced that the service generates value for them. For example, companies in the study have recently extended their free periods with several years, as they did not retain enough paying customers.

The internal cost savings for the manufacturing companies are generated as a result of increased information and data generated from product usage. Succeeding to extract actionable insights from the data can for example improve the customer segmentation, product development and service market operations. By increasing the predictability, efficiency of maintenance and quality of the products, large savings from reduced number of service occasions, quality repairs and customer visits can be realized for the aftermarket business.

The share of realized cost savings and revenue differs between the industries. The differences depend partly on that mining companies to a larger extent have been able to charge for their services, given that they are realizing tangible customer value. Companies in the forest industry, on the other hand, have realized large internal savings by increased efficiency in aftermarket operations. The companies in the agriculture industry are still struggling to charge for the services and are mainly focusing on internal cost savings.

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HOW DO YOU KNOW THAT YOU ARE PROFITABLE?

The study shows that companies see a great potential for value generation and have entered digital servitization with a belief that they will become profitable. The results are however not as convincing, and most companies are struggling to follow-up on progress and to secure profitability.

The majority of the companies in the study state that they prior to their investments have identified profitable business cases, which were based on digital services revenue, internal savings and increased product sales. The business case calculations were characterized by many estimations and assumptions, which make them unreliable. Nevertheless, the companies refer to an overall understanding that offering digital services will generate value in the long run even though they fail in creating convincing business cases.

Given the difficulties to find solid business cases, the digital servitization initiative in many companies lack support and understanding from the organization. Consequently, several companies are to a large extent relying on ad-hoc solutions as teams developing digital services are not part of any formal processes or governance structures, and much-needed cross-functional collaborations are not properly established.

40% of the companies in the study claim to have made the investment into digital servitization profitable but also reveal that the follow-up has, similar to the business case calculations, been tricky and that they have been forced to simplify and estimate. The difficulties are mainly related to follow-up on increased product sales and internal savings. For example, even though improvements have occurred it is still difficult to prove a correlation with the introduction of digital services.

The other 60% of the studied companies either admit that they are fighting to become profitable or do not know if they are, as they lack proper follow-up in terms of KPIs and other measurements. Even though many companies are unsure about the financial status of their investment, they plan to continue their current strategies as they assess it to be of importance to strengthen their market position and that it will pay off in the long term.

What differentiates the profitable companies are that they have a more efficient governance setup and a more structured follow-up to track value generation. This includes KPIs for internal efficiencies, with a historic baseline, and indicators such as sales growth and customer satisfaction to better understand the impact on product sales. They also have offered digital services for a longer time than the companies that are not profitable.
Becoming a digital service provider comes with a need to broaden capabilities, knowledge and access to data. Many actors enter partnerships to overcome these challenges. Two key forms of partnerships can be identified for the development of digital services, serving different purposes and putting different requirements on the partnership.

**Partnering to gain access to competence**
A partnership is entered to access the latest technology, a platform or simply to get access to expertise. Enables to broaden capabilities while keeping core strengths, can be a strategy to adapt services to local needs. The partnerships often include actors from different value chains.

**Challenge:** The chosen partner’s capabilities will heavily impact the qualities of your services. Secure way of working for continuous improvements.

**Partnering to share data and business**
A partnership entered to share data and/or co-developing services, often between two actors in the same value chain. Enables overlapping of information gaps and create new insights for customers by combining and analyzing data.

**Challenge:** Data is a key asset in the digital world, sharing data is to share business. Many actors are trying to take a strong position and partnerships can be challenging to achieve as it is difficult to agree on how to share the data.

Triathlon has identified some key considerations for successful partnerships:

1. **Set a clear strategy:** What is core for you, and what can partners support with?
2. **Prepare for sharing:** A successful partnership requires openness and trust. Be open to change and seek to complement each others’ weaknesses and strengths.
3. **Risk management:** Entering a partnership requires a thorough risk assessment with identified mitigation measures from both parties.
4. **Prepare for new business models:** As partnerships assume a win-win situation, they often require new business models that are better fit for revenue sharing.
5. **Know what you need:** Different needs call for different type of partnerships and level of engagement. Set realistic expectations and define supporting incentive structures in each specific case.

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**You are selling a service, not a technology!**
Stay focused on the service and the customer offering by devoting resources for service and business model development. New technology is exciting and bring a lot of potential, but you are in the service business now, right?

Cross-functional collaboration between product development, business development, IT resources and the marketing and sales departments early in the development process secures a balance between technology and business focus and prepares the organization for a new type of sales.

**Utilize collaborations for value creation**
Enter close collaboration with customers before, during and after development to gain in-depth insights into their operations and how they use your products and services. Identify innovative and cooperative customers to approach, it can certainly become a win-win situation as you and your customer will gain invaluable insights.

**Secure governance and measure over time**
All evidence points in the direction that we have only seen the start of this transition, and that we are all in it for the long run. Experience must be gained, and the real values will be generated once you succeed to penetrate large parts of your installed base. Set the strategy and put in the hard work. It will take time!

Keep track of your internal activities and identify some key KPIs to start measuring already before implementing your new digital services – how else will you be able to track progress?

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Everyone do not have the competences, resources or aspiration to be in the digital forefront and decide to wait. The chosen position will heavily impact the risk and reward structure moving forward.

**Do you know were you stand and were you will move next?**
Triathlon Group

Triathlon Group is a professional service firm and a leading actor in Performance Improvement. We serve large, multinational, Nordic clients internationally. We engage in client assignments to deliver lasting improvements in organizations, based on our areas of specific expertise.

By combining innovation and best practice, we develop substantial value to our clients through long-term relationship and genuine understanding of business needs in the industries we operate within. Triathlon’s core business is our clients’ ‘out of the ordinary’ operational management issues.

Need a success story of your own?
– Triathlon develops your business

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<thead>
<tr>
<th>Strategy</th>
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<th>Finance</th>
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<td>Improving operations by combining innovation and best practice</td>
<td>Setting up business structure and control to support strategy and operations</td>
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