Making the Shift to Service Management

This paper identifies the strategic and operational adjustments that high tech and industrial products manufacturers need to apply while shifting their business model to service management.

> "You need to come up with a service brand, 'Excel' for instance, showing that it is separate from your product. You can then actually sell 'Excel' on top of your product."
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> **Managing Director, global manufacturing company**

Although not a new concept, service management is a powerful option for manufacturers seeking an alternative revenue channel in today's highly competitive marketplace. Many business experts believe that companies should seriously consider adding services to their traditional manufacturing portfolio to diversify their income streams and increase repeat business with existing clients.

Customers are not only looking for quality products for the right price, but increasingly they need aftersales service and support for the entire lifetime of the product. Furthermore, they wish to minimize the risk of product failure and are willing to pay a premium for peace of mind in the event their equipment breaks down.

Manufacturers can certainly reap the rewards of offering service management to their customers. According to some estimates, leading service-led product makers derive more than 50% of their revenues and 60% of their margin from services as opposed to product sales. In addition, businesses employing the strategy can increase customer intimacy and gain a deeper understanding of consumers' needs and demands.

But how do manufacturers shift their business models, strategies, and operations to be able to both sell products and manage services? The report titled "The strategic and operational

About the Research

The research published in "The strategic and operational adjustments that high tech and industrial products manufacturers need to apply while shifting their business model to service management" is the result of a dissertation by Nader Padidar, an MBA student from the University of Edinburgh Business School, which he conducted in cooperation with Capgemini. The dissertation can be ordered from Capgemini (contact details on back).

"There is a limit to offer services and that limit should be aligned with both strategy and operational capabilities."

Managing Director, global manufacturing company

adjustments that high tech and industrial products manufacturers need to apply while shifting their business model to service management" (see sidebar) provides a broad overview of service management and gives an insight into the strategic and operational adjustments made while shifting the product-centric business model to service management. It reveals that failures are not due to a lack of technical knowledge or investment, but often simply because managers try to apply the same manufacturing models to their service business. This paper provides a summary of the report's findings.

Based on the analysis of the empirical data, this report reveals three key findings:

- **Five major factors are driving manufacturers' transition to service management.**
  1. The need to remain competitive and beat global competition.
  2. Increasing customer demands and financial restraints.
  3. The need to improve their positioning to generate greater revenue.
  4. The potential for higher profits associated with services compared to products.
  5. To bring cash streams into the final stages of the product's lifecycle.
- **Manufacturers, regardless of industry, products and customers, experience similar patterns in the shift to services.**
  - ***Finding the right services:*** Considering product proliferation and commoditization and the desire not to acquire new technologies, manufacturers are adding innovative service designs to their products such as one-stop services, embedded services and bundled product-service packages.
  - ***Adjustments to the business model:*** For nearly all manufacturers studied the transformation requires business model adjustments at a strategic level. These include adapting internal processes and IT infrastructure focused on the installed-base concept; looking at the service business as a single consolidated unit with a separate P&L; creating funding mechanisms to help customers with capital-intensive products; and focusing on the product's lifecycle, especially the stages of maturity and decline, to further stretch service revenue and profits.
- **The business model adjustments directly affect the organization and its operational structure and infrastructure.**
  - ***Rethink the organizational structure:*** Top management should put services at the center of attention by restructuring the hierarchy of the organization.
  - ***Focus on developing customer alliances:*** The idea of customer alliance is particularly important in services as there is usually close and direct contact between the service provider and the customer.
  - ***Understand the role of IT in a service-led organization:*** The right IT infrastructure is essential in order to manage a service-led organization. Implementing a robust, harmonized and flexible

IT landscape supporting service businesses involves extensive customization, optimization, harmonization and data collection.

- ***Emphasize capabilities and development:*** Acquiring and developing new capabilities should be the highest priority considering the operational adjustments, to be followed by ongoing professional training. In addition to product and market knowledge, resources should possess commercial and financial acumen as well as business consulting and IT savvy.
- ***Change the mindset:*** Perhaps the most important lesson of all is that manufacturers need to embrace and master a service mentality – without this they risk failing regardless of their level of investment and capabilities.

The rules of the game are changing fast. Economic pressures and customer trends are pressing industrial manufacturers and high tech firms to create innovative solutions to gain or maintain their competitive edge. Today, service management is redefining services in such a way that they are no longer just an add-on to the product but a separate brand offering. However, the key question is whether service management is the right solution for all manufacturers. The answer is: it depends. The classic management statement perfectly applies here that "one size does not fit all."

Six criteria are considered in the report to address this question more deeply, and to help managers with their decision and increase their awareness about the inherent challenges, issues, and complications in shifting to service management:

- Managers need to review where their business makes its money, in product or service, and to what extent in each.
- Service management makes more business sense for companies in the automotive, industrial and high tech industries producing capital-intensive products. And here the shift also becomes much easier if the product is among the top three brands. But for firms producing commodities where for customers the price is the only priority the lower rate of return is not worth the switch.
- The stronger the product commoditization trend, the more attractive it becomes to shift to service management. In markets such as domestic electrical goods, companies can increase brand recognition by adding services.

A View of What Service Management Can Look Like

Imagine an engine manufacturer, selling five-year contracts for its capital-intensive engines. In the contract the engine is offered for free and guarantees no down times and/or malfunctions within the usage period. In addition, service maintenance, replenishments, upgrades, continual training, and additional services are included. The customer, in return, commits to frequent transactions (paid per usage) for the whole service package including the asset.

Its technically advanced system allows an on-line diagnosis of technical failures, trouble-shooting, self-optimization, and upgrades to avoid any down times. Oil and parts are repaired, refurbished, or changed on time without customers noticing it. In case of any failures the remote technical service team responds immediately regardless of the geographical location. If needed, the engine is replaced with a new one. The information is gathered in a reliable central database enabling the engine manufacturer to offer additional services, such as managing customer's spare parts inventory, location mapping and logistics, connectivity and coordination with several other devices, providing reports, and consulting, thereby reducing costs (e.g., fuel consumption and waste).

Finally, at the end of the contract (or lifecycle of the machine), the customer has the choice to replace the engine or give it back to the manufacturer and receive the residual value of the asset. The manufacturer will do this through disposing the machine by renting it to other customers at a lower price, selling it to other markets, or recycling it for further usage. The total product support illustrated above represents a whole new level of value creation for customers. Same analogy can be used for any other capital-intensive goods. It is a new journey for manufacturers, the journey towards "service management".

- Based on the decisions above, managers need to identify their target market, understand customer needs, and define their unique selling proposition, and, if possible, differentiate their services.
- Moving to service management does require rethinking the organizational structure and operations because a service company does not operate like a traditional product-centric company.
- Completing the paradigm shift is a journey that takes an enormous amount of time, investment, energy, and commitment. It not only requires organizational readiness and maturity, but a new mindset.

Service management also requires new organizational principles, structures, and processes, all of which are often at first challenging to manufacturers. They can find many good reasons for staying as they are and continuing to focus on what they do best. Their decision should be based on rational judgment rather than to follow the pack. But, however difficult the transition, the rewards are worthwhile. Several best-in-class high tech and industrial manufacturers have already grasped the importance and value of offering innovative services. They have made the leap and are now shaping the market. For others, now is the time to take the first step into service management and gain a foothold in immature and potentially rewarding markets.

"It is the mindset that needs to change, and that will not happen without rigorous trainings and reinforcements."

Managing Director, global manufacturing company

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MRD2011-02-ST-SSC