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JUNE 22, 2009 STRATEGY

Beyond Products

More manufacturers are branching out into the service business. Here's how to make the move successfully.

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By **STEPHEN W. BROWN, ANDERS GUSTAFSSON** And **LARS WITELL**

For many manufacturers looking to boost their business, simply selling products doesn't cut it anymore.

The Journal Report

See the complete **Business Insight** report.

Companies in a range of fields—from pulp and paper to telecommunications—have decided that they have to branch out into services to stay competitive. Some truck manufacturers, for instance, don't just offer vehicles; they sell maintenance and service packages, as well as driver-training programs. In some cases, they even sell services that go well beyond caring for trucks, such as advising clients about improving their logistics operation.

Why the push into services? In part, necessity. In the fiercely competitive global market, companies must do whatever they can to stand out. But companies that have successfully made the move say there are substantial benefits, too.

For one thing, unlike products, services often deliver a regular stream of income. They also require a lower fixed capital investment, and frequently bring higher margins, than products do. What's more, they can be tougher for rivals to copy—which can bring big competitive advantages.

Then there's marketing. Companies say they can build on their existing products, brand image and customer base when pitching a line of services. And when an existing customer buys services as well as products, it builds loyalty, since the two companies work together much more closely.



For all of that promise, though, making services work isn't easy, and success is far from assured. Many companies are unprepared when they make the move into new territory, and fall into a number of traps, such as introducing services the wrong way and focusing on the wrong points when pitching them to customers.

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Wesley Bedrosian

To learn the best way to do things, we surveyed hundreds of business-to-business manufacturers in a range of industries,

interviewed many executives and developed several in-depth case studies. We looked at what made the unsuccessful firms stumble—and what helped the successful firms rise to the top. Here's what we found, starting with what can go wrong.

A Host of Hurdles

Many manufacturers in our research moved into the new territory without any clear strategy. For many years, they offered discounted or even free services to secure sales for their products, such as maintenance plans or training courses for the people who would be using the products. But later, when the companies tried to start charging for those services, they found that customers often weren't prepared to pay for something they used to get free.

Many companies also met internal resistance to their service plans. Sales forces were a particular challenge. For instance, sales teams often had incentive programs tied to meeting targets for product sales, and it was hard to incorporate services into that structure.

What's more, selling services is often more challenging than selling products. Aside from the fact that customers sometimes were used to getting the services free, it was much harder to show the value of an intangible offering and figure out how to price it. And when the price finally got hammered out, it often led to disappointment. For people who are used to selling million-dollar equipment, it's tough to get excited about selling \$50,000 maintenance contracts, even if they represent a recurring stream of income.

Challenges and Payoffs

How surveyed manufacturing companies rated the severity of the hurdles to overcome in expanding their profitable service offerings (7=most severe, 0=not severe)

Organization not ready	4.2
Lack of experience	4.1
Pricing	4.0
Resistance from customers	4.0
Resistance from sales force	3.8
Lack of channels	3.6
Services are a cost driver	3.6
Economic potential	3.5

How the companies rated the benefits of making the transition to services (7=high, 0=low)

Improved customer relationships	6.6
Capturing a large share of the value life cycle	5.8
Meet the needs of customers to outsource	5.6
Response to changing customer needs	5.4
Achievement of competitive differentiation	5.0
Greater income stability	5.0
Profit margin for services	4.7
Response to decreased profit margin for hardware	4.3

Source: Stephen W. Brown, Anders Gustafsson and Lars Witell

Meanwhile, moving into services often meant building up new sales

connections within the customer's organization, often higher up the decision-making chain—and far removed from anyone who would actually be using the service.

The sales-force problem was just part of a larger issue: Many companies attempted to market new services the same way they sold new products—by giving employees new responsibilities while keeping the current structures, practices and incentives in place.

But people who have been focused on developing and selling products usually don't have the deep knowledge of a customer's operation they need to create and market services. To come up with an idea for a new product, for instance, you might only need to have a general knowledge of the industry and the problems that companies often face. But if you're trying to, say, take over a customer's maintenance operation or offer advice on improving logistics, you must know specifics about how companies do their job.

That wasn't the only big organizational mistake. Some manufacturers tried to get their whole operation behind the service effort, letting every department help in developing and delivering the new offerings. It seemed to be the best way to use the company's limited resources and ensure that products and services worked well together.

But this approach leads to lots of practical

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Better Served

The Big Step: Many manufacturers are starting to offer for-pay services in an effort to stand out in a competitive market and open up new streams of revenue.

The Pitfalls: For all the promise that services hold, success is far from assured. Companies can fall into plenty of traps when entering this new territory—such as thinking the same strategies that worked for introducing new products will work for services.

The Road Map: Successful companies use a number of common strategies, such as creating a separate division to handle services and devising generic service packages that customers can modify.

But this approach leads to lots of practical problems. When multiple departments are responsible for delivering services, it's tough to ensure a consistent level of quality—which could potentially lead to lots of grumbling from customers. It also can be tough to get managers from across the company to agree on standards for pricing and other factors.

The result of all this? Manufacturing employees often ended up focusing on developing new products—and then rushing out new services to complement them almost as an afterthought.

Keep Services Separate

Many of the successful companies in our study addressed these issues by taking one big step: They kept services separate from the rest of the operation, creating separate units to develop and deliver their new offerings.

Telecom giant Telefon AB L.M. Ericsson, for instance, gathered its various service businesses into a single unit, Global Services. The division, which now accounts for nearly a third of the total employees at Ericsson, offers services such as managing the networks that mobile-phone companies use. Some companies took the idea of a separate services unit a step further, partnering with outside firms to help them develop and deliver services.

Why wall off services this way? Culture. As we've seen, in a manufacturing company, all of the processes and habits are geared toward making and selling physical goods. Changing the focus of an entire organization is extremely difficult—and usually only marginally successful. As a senior executive at Ericsson observed: "Culture wins over strategy each time."

Consider how much has to change to make services work. One auto executive described how his company added services to the mix:

"If you go back to even a very short while ago, our whole idea of a customer was that we would wholesale a car to a dealer, the dealer would then sell the car to the customer, and we hoped we never heard from the customer—because if we did, it meant something was wrong. Today, we want to establish a dialogue with the customer throughout the entire ownership experience. We want to talk to and touch our customers at every step of the way. We want to be a consumer-products and services company that just happens to be in the automotive business."

Not many companies can pull off that kind of a makeover—retraining hosts of employees and getting them not only to learn new skills but also to change the way they approach their job. So, it's usually easier to build a service operation from the ground up, one that works far more closely with customers than the rest of the business does, and charge it with creating and executing the strategy.

For Further Reading

See these related articles from MIT Sloan Management Review

Creating Growth With Services

Mohanbir Sawhney, Sridhar Balasubramanian and Vish V. Krishnan (Winter 2004)

In a world of commoditized products, companies are turning to service offerings for growth. The key to success involves redefining markets in terms of customer activities and outcomes, not products and services.
<http://sloanreview.mit.edu/x/4528>

Global Sustainability and The Creative Destruction of Industries

Stuart L. Hart and Mark B. Milstein (Fall 1999)

When they are evaluating new business opportunities, managers should consider three economies—consumer, emerging, and survival.

Beyond that, we found that successful companies tended to use similar strategies in developing and marketing their services.

Standardize—and Customize

Many companies often plunged into services by closely tailoring their offerings to each customer. Companies would come up with plans that fit the particulars of a customer's processes but couldn't be easily applied to another customer. And those kinds of services took a great deal of effort and significant costs to develop.

The more successful firms moved beyond this initial strategy and came up with generic

<http://sloanreview.mit.edu/x/4112>

Creating New Markets Through Service Innovation

Leonard L. Berry, Venkatesh Shankar, Janet Turner Parish, Susan Cadwallader and Thomas Dotzel (Winter 2006)

Many companies make incremental improvements to their service offerings, but few succeed in creating service innovations that generate new markets or reshape existing ones. To move in that direction, executives must understand the different types of market-creating service innovations as well as the nine factors that enable these innovations.

<http://sloanreview.mit.edu/x/47213>

Sustainability Through Servicizing

Sandra Rothenberg (Winter 2007)

In a world that's increasingly environmentally conscious and cost-conscious, suppliers can make their business both more sustainable and more profitable by focusing on services that extend the efficiency and value of their products.

<http://sloanreview.mit.edu/x/48216>

Growing Negative Services

Ivor Morgan and Jay Rao (Spring 2006)

Negative services—those that are needed in emergencies, when problems arise or to ensure against unwanted outcomes—are part of most businesses and are central to many. But their very nature presents some unique growth challenges.

<http://sloanreview.mit.edu/x/47313>

service packages. These deals offer a standard set of services that clients can customize by adding or removing options. This lets the manufacturers balance customization and standardization—and keep costs down.

For instance, one truck maker offers a maintenance and repair package with standardized prices for spare parts and scheduling for service. But let's say a customer wants to use another company's replacement parts in the trucks. The service plan would let the client customize the plan by dropping the replacement-parts feature.

Look Beyond Costs

The successful firms in our research used another key strategy in crafting their services: They focused on more than helping customers cut costs.

Many companies in our work took a basic approach, pitching their services simply as a way for customers to save money. They might argue, for instance, that customers could lower overhead by outsourcing their

maintenance operation.

The more successful companies found they did better by adding another dimension to their offerings. They looked for services that would help their customers provide benefits to their own customers—and thus boost business.

One truck company, for instance, sells its customers fleet-management services, such as monitoring fuel consumption and teaching drivers how to drive more fuel-efficiently. This, in turn, helps the company's customers sell themselves as environmentally friendly to potential clients. And that's often a crucial factor for many clients, such as government agencies.

Or consider Ericsson. When one of its phone-company clients wants to offer a new option to its subscribers—such as Internet connectivity over mobile phones—Ericsson can help develop the program and provide behind-the-scenes support.

--Dr. Brown is the Edward M. Carson chair in services marketing and executive director of the Center for Services Leadership at Arizona State University's W.P. Carey School of Business. Dr. Gustafsson is a professor of business administration at Karlstad University's Service Research Center in Karlstad, Sweden. Dr. Witell is an associate professor of marketing at the Karlstad Service Research Center. They can be reached at reports@wsj.com.

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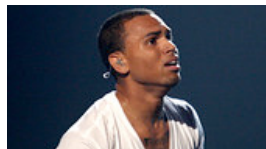
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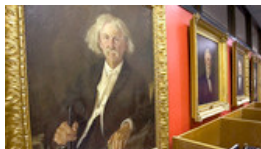
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Noble Buys FDR for \$2.16 Billion

Noble agreed to acquire closely-held drilling company FDR Holdings for \$2.16 billion, and it disclosed the signing of related contracts with Royal Dutch Shell.

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