



# Servitization strategy and cost management

## Session 13

Prof.ssa Lucrezia Songini

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Lucrezia Songini

# Agenda

- Servitization strategy
- The contribute of services to firm profitability
- From products to services and solutions
- The transition towards servitization
- Types of servitization strategies
- Determinants of servitization
- Critical issues

# Servitization strategy

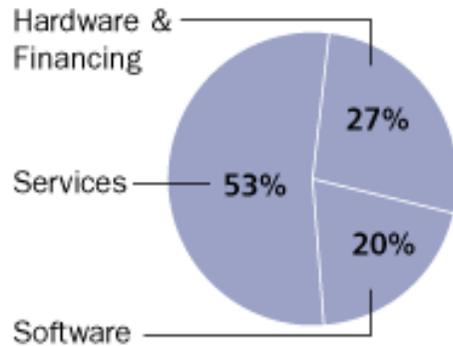
«The attention paid by a manufacturing company to an enlargement of its offering through services is, in broad terms, called servitization».

Different meanings and extensions of this concept:

- A bundle of product and services launched occasionally on the market
- A new business model
- A completely different value proposition
- ...

# The contribute of services to firm revenues: the case of after sales

## Revenue Mix

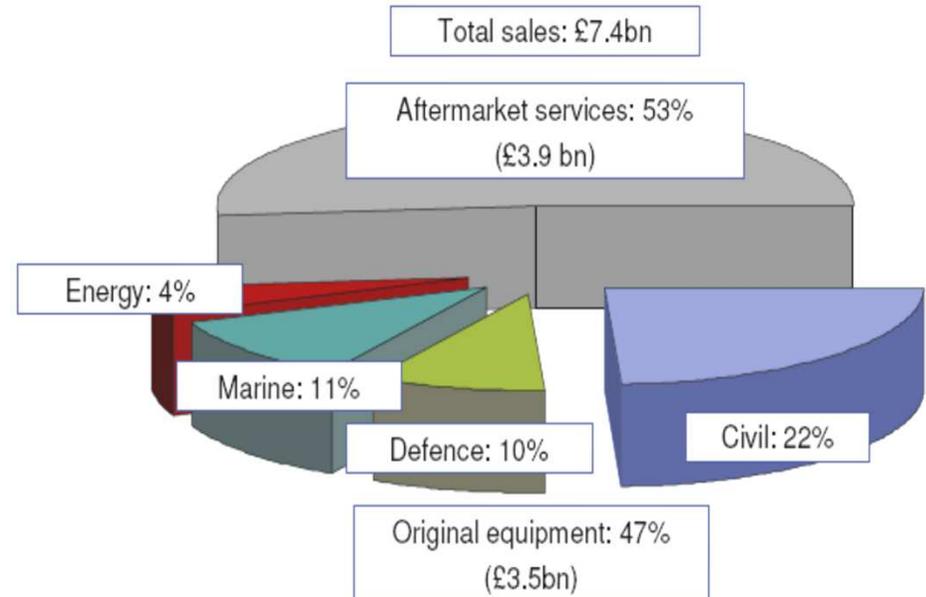


## Revenue Stream



Approximately 28% of our revenue comes from equipment sales, from either lease arrangements that qualify as sales for accounting purposes, or outright cash sales.

The remaining 72% of our revenue, "Post sale and financing," includes annuity-based revenue from maintenance, services, supplies, and financing, as well as revenue from rentals or operating lease arrangements.



# The contribute of services to firm performance: the case of after sales

**After sales margins:  
data from different industries**

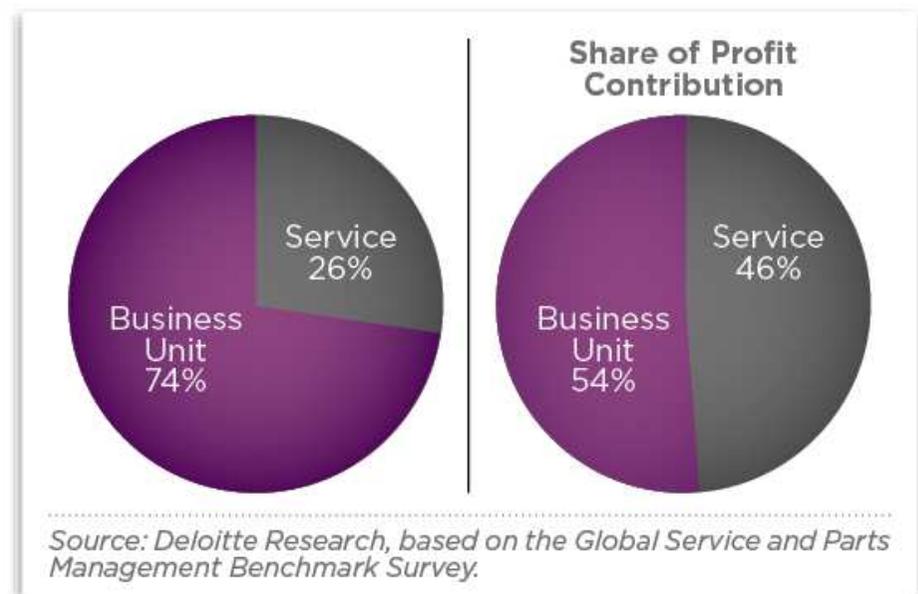
INDUSTRY	MARGIN IN OEM BUSINESS	MARGIN IN SERVICE	MARGIN LEVERAGE <sup>1</sup>
Paper Machines	1-3%	10-15%	5
Power Equipment	2-5%	15-20%	4
Metallurgy Equipment	-3 - +6%	15-20%	4
Rail Vehicles	3-6%	8-10%	2
Machine Tools	1-12%	5-15%	2

Note: 1 Margin Leverage = Margin in Service / Margin in OEM-Business

Source: Annual Reports, Expert Interviews, Monitor Analysis

**Product versus  
servicess sales**

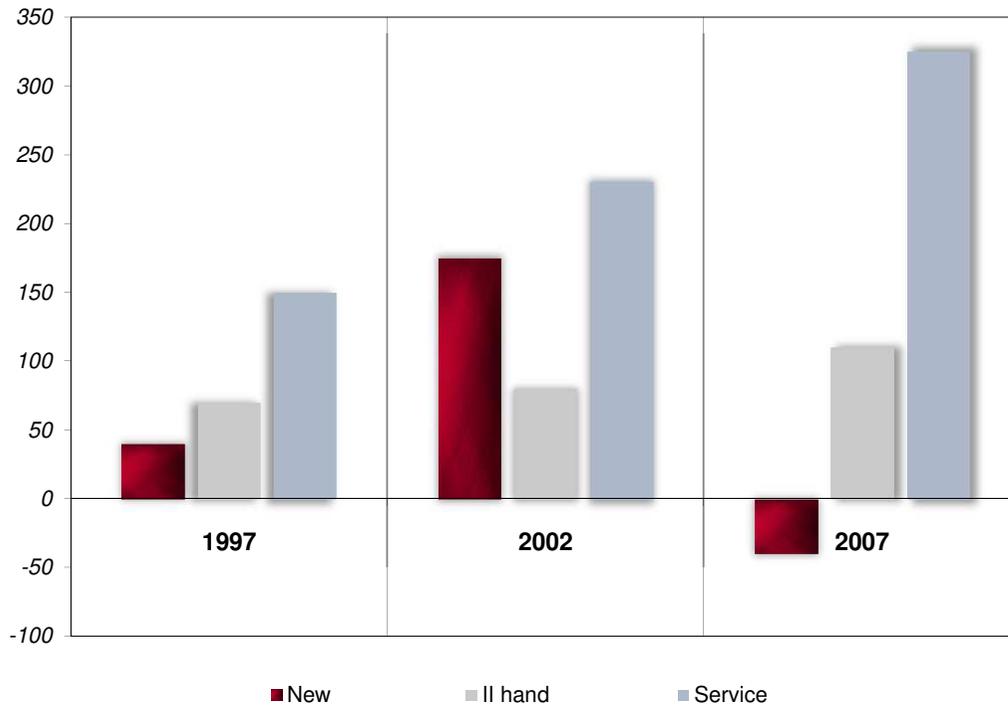
**Contribution to  
profitability**



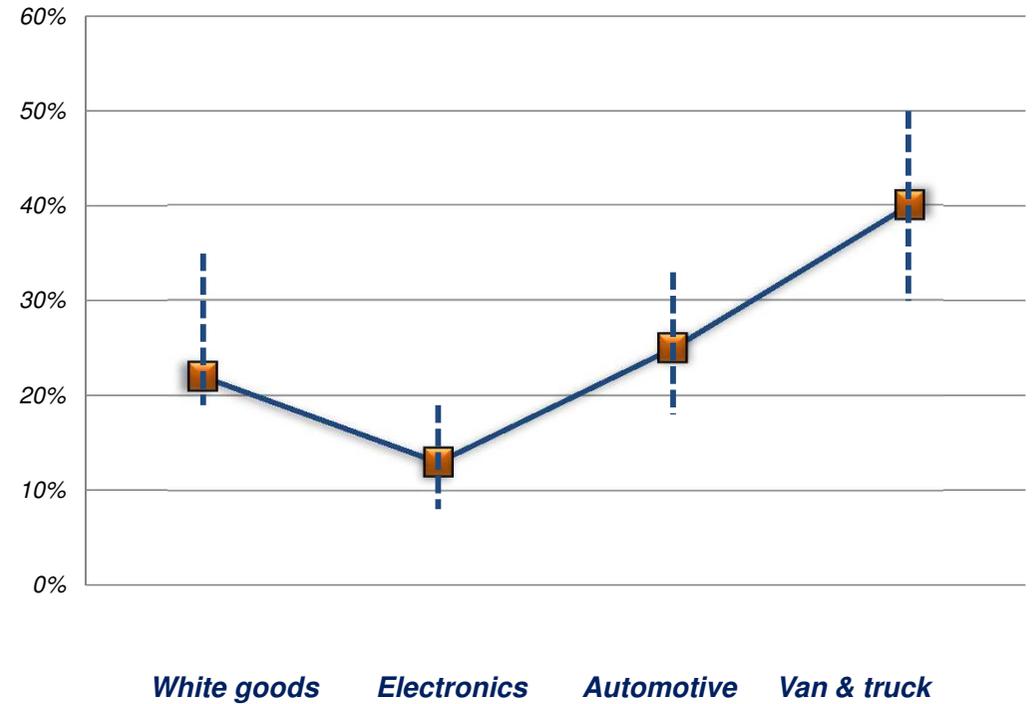
After sales generates higher margins than product sales

# The contribute of services to firm profitability: the case of after sales

*Net profit in automotive industry in USA (kUSD)*



*Return on Sale (ROS)*



# The contribute of services to firm profitability: the case of after sales

*Aftermarket is a \$400 billion business .... many of those in the Fortune 100 rely on the aftermarket for up to **40 percent** of their profits.*

*McKinsey (2005)*

*GM shareholder value reveals that \$9 billion in after-sale revenue produced **\$2 billion in profits (22%)**. Profits from the company's \$150 billion in car sales were relatively lower.*

*Accenture (2003)*

*After sales activities in the PC sector account for 24% of revenues and **45% of profits** of OEMs.*

*AMR Research (2003)*

*Trucks may provide revenue **four times bigger than their purchase price** through financing, insurance policies, service contracts, and the sale of parts and accessories.*

*Whitney (2002)*

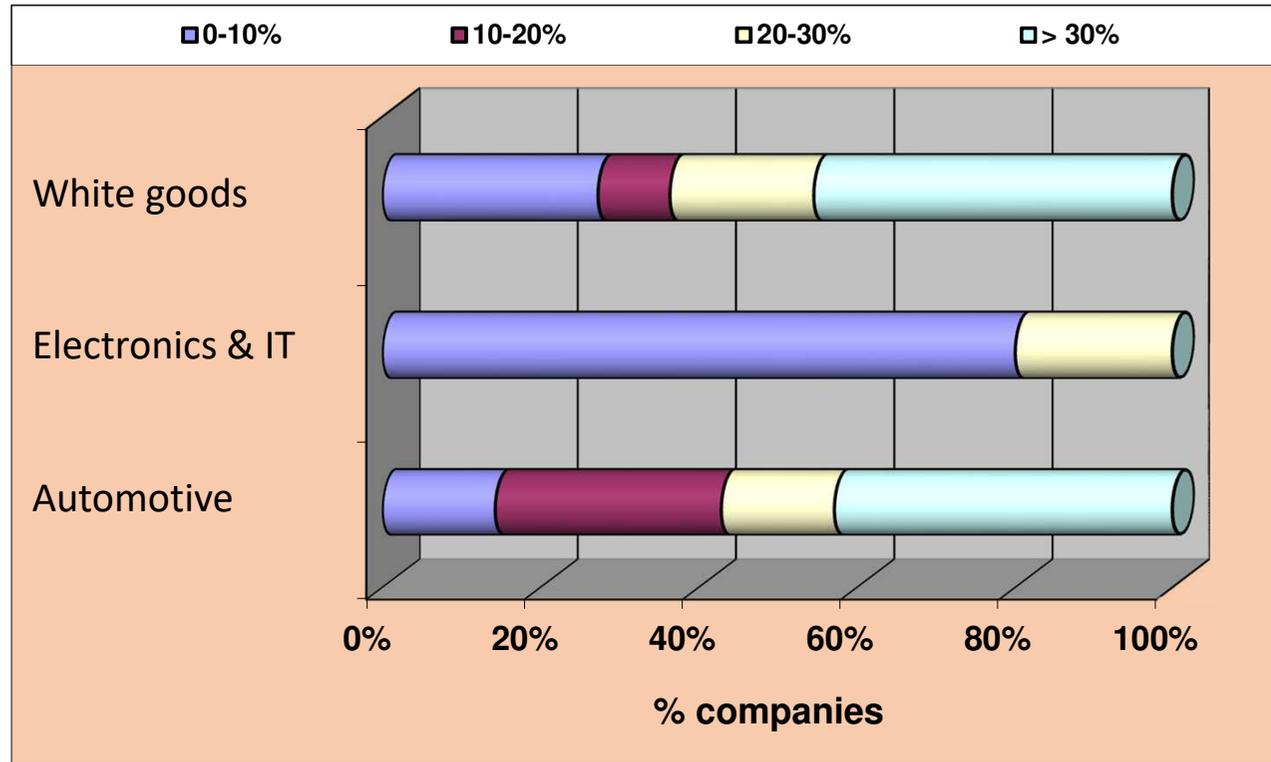
*In the EU automotive industry, AS spare parts generate a turnover of €63 billions with an operating profit of **20 to 25%**.*

*In the U.S. AS service and parts account for **more than 50 percent** of the average dealer profit.*

*ASAP SMF (2004)*

# The contribute of services to firm profitability: the case of after sales

Profitability



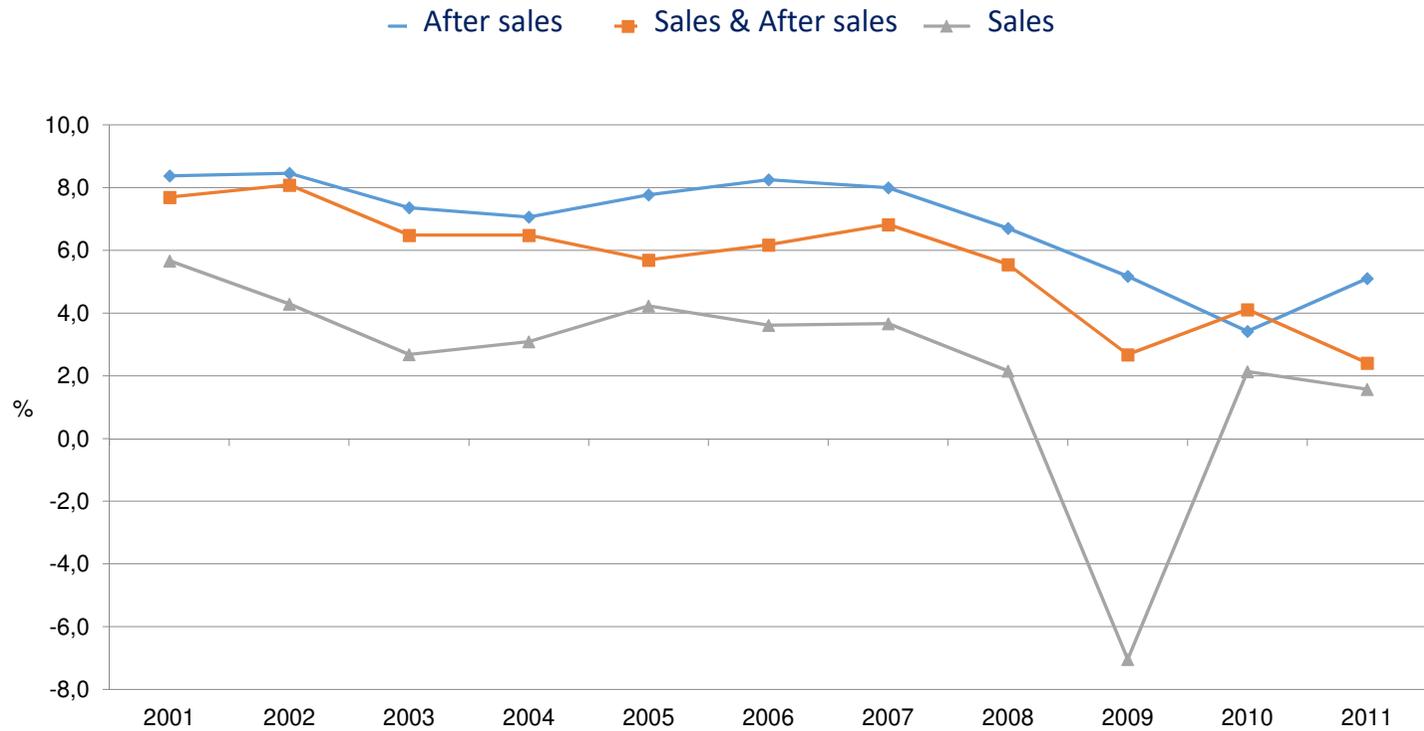
% of companies	Profitability
44%	0 % - 10 %
26%	10% - 30 %
30%	more than 30 %

Source: ASAP SMF

# The contribute of services to firm profitability: the case of after sales

ROI = Return on investment

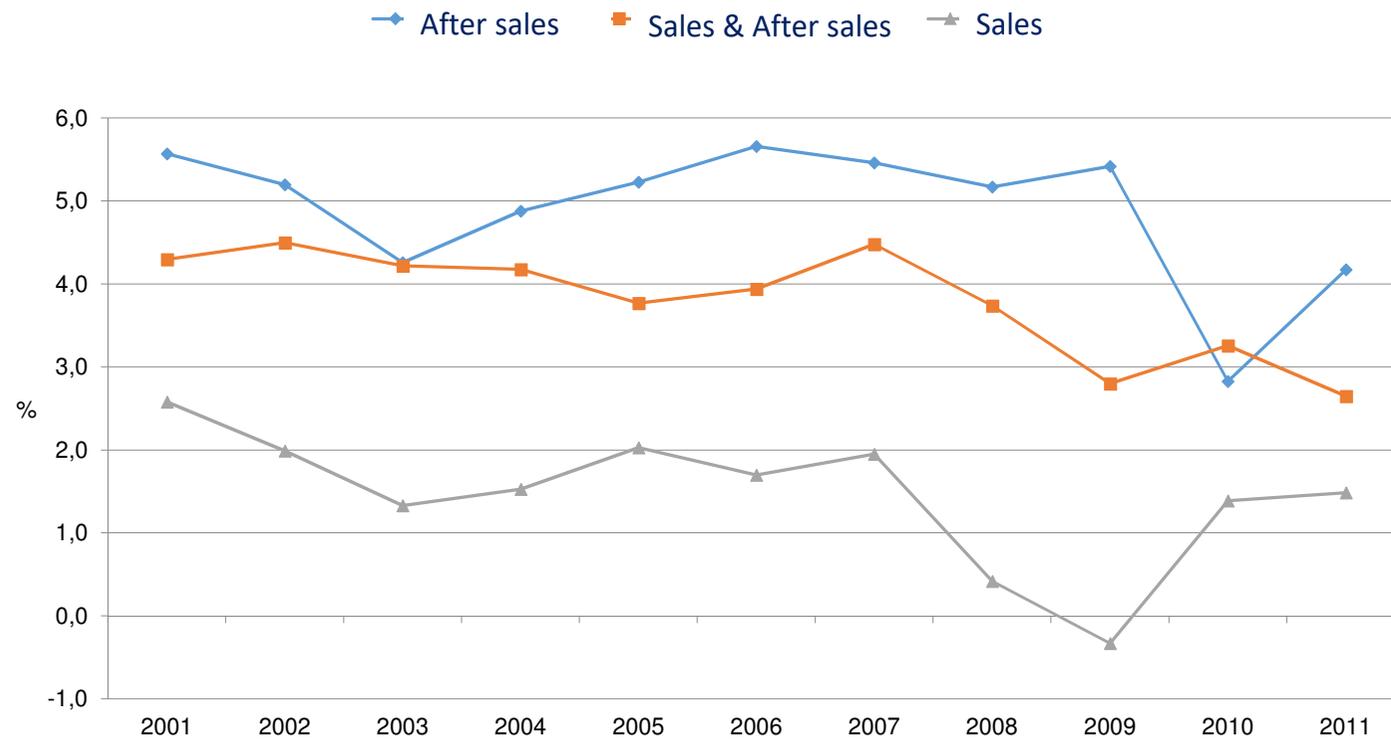
Italian automotive dealers and workshops



# The contribute of services to firm profitability: the case of after sales

ROS = Return on sales

Italian automotive dealers and workshops



A strong transformation: from product selling ...



... to services



# The manufacturing world has changed



From  
*Selling a single machine*



To  
*Copy services*



From  
*Harvester*



To  
*Services of plowing,  
sowing and harvesting*



From  
*Selling a turbine*



To  
*Selling engine power*



# The service offerings significantly increases

 <p>Riparazione e manutenzione</p>	 <p>Cataloghi</p>	 <p>Contratti di manutenzione</p>	The service offerings significantly increases			
 <p>Parti di ricambio</p>	 <p>Consegna a domicilio</p>	 <p>Un'assistenza vantaggiosa? Ci pensiamo noi.</p> <p>Finanziamento al dopo vendita</p>				
 <p>Installazione</p>	 <p>Pit-Stop</p>	 <p>Formazione sulla manutenzione</p>	 <p>Outsourcing</p>	 <p>ORICA MINING SERVICES</p> <p>"paghi al risultato"</p>	 <p>ROLLS ROYCE</p>	
 <p>BEFORE</p>	 <p>Diagnosi in remoto</p>	 <p>5 10 15 25</p> <p>Garanzie estese</p>	 <p>Custodia del prodotto</p>	 <p>Sharing</p>	 <p>Pooling</p>	
 <p>AFTER</p> <p>Riammodernamento</p>	 <p>Gestione del magazzino</p>	 <p>GELATO UNIVERSITY CARPIGIANI</p>	 <p>Consulenza di processo</p>	 <p>Paghi all'uso</p>	 <p>Documentazione digitale</p>	
 <p>Dismissione</p>	 <p>xerox</p> <p>Consulenza sullo sviluppo del business</p>	 <p>CANON SCHOOL</p> <p>Formazione sul business</p>	 <p>Through the Eyes of a Pro</p> <p>Formazione sul prodotto</p>	 <p>Soluzioni verdi</p> <p>Green Solution</p>	 <p>Esperienza di marchio</p>	

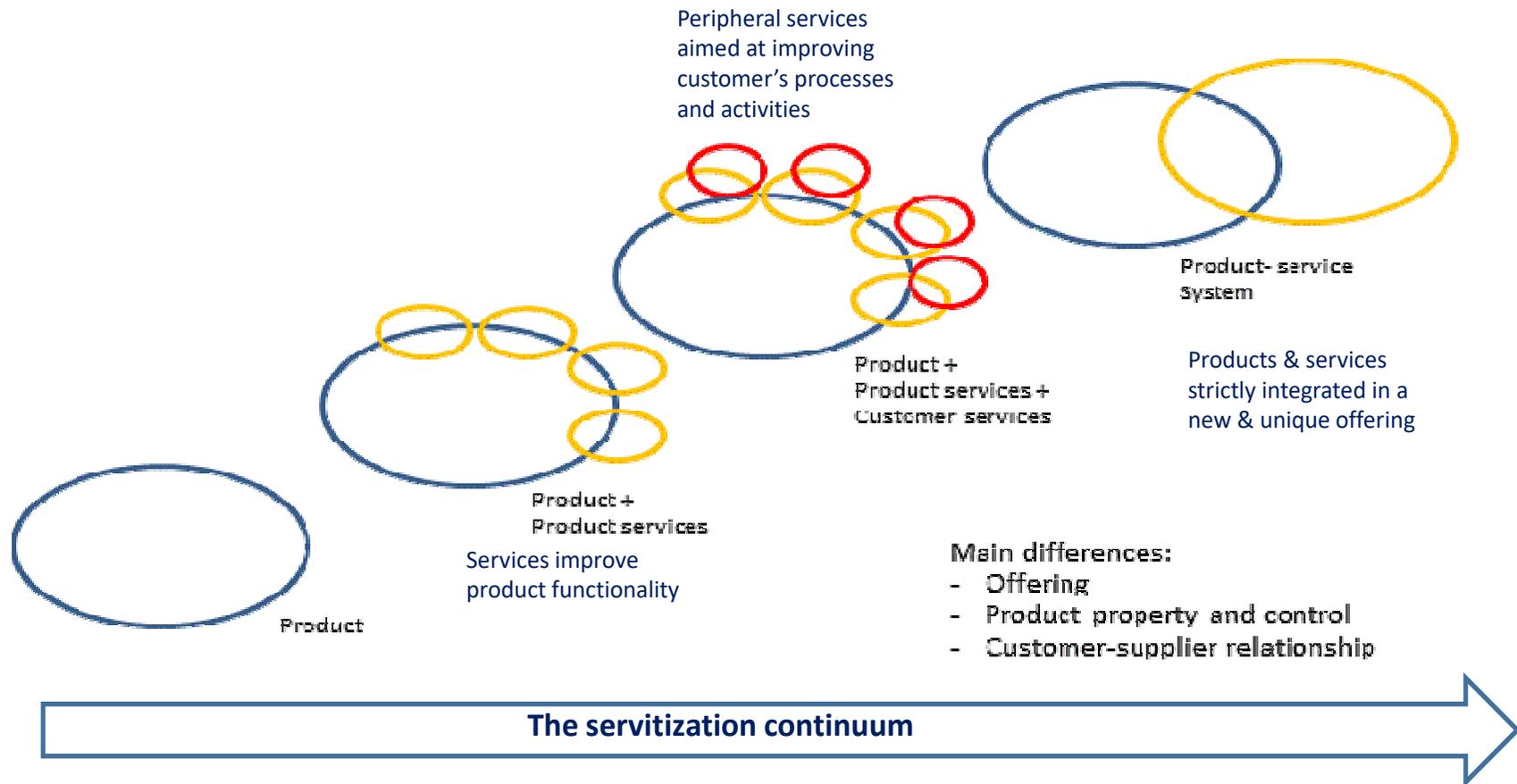
# From product to solution



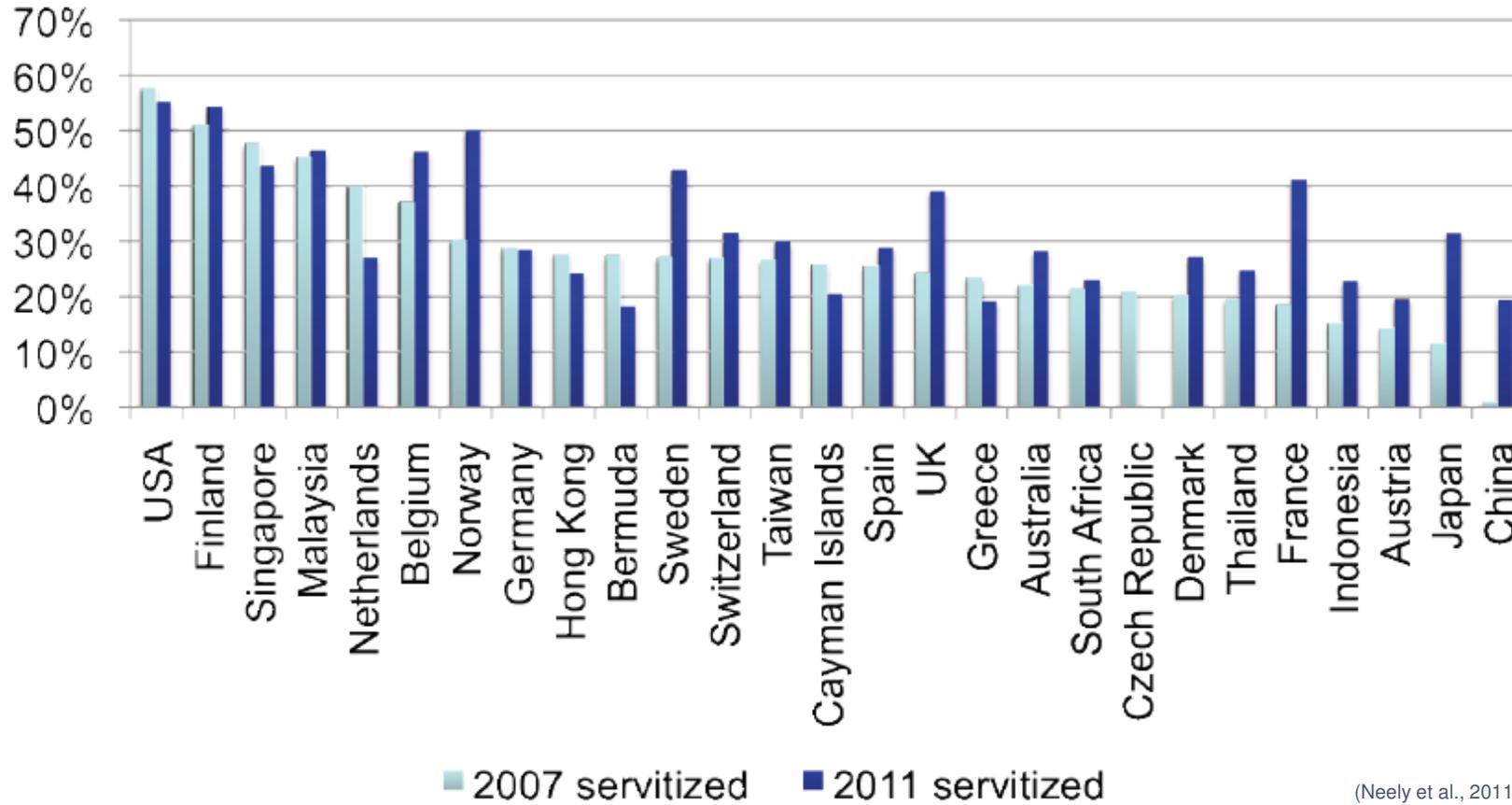
<b>Extended time service</b>  TOYOTA	<b>Fly &amp; Fit</b>  ALFA ROMEO	<b>Digital documentation</b>  mazda	<b>Eco-driving</b>  Ford	<b>Driving courses</b>  MERCEDES
<b>Express service</b>  CITROËN	<b>Home delivery</b>  LEXUS	<b>Porsche Club</b>  PORSCHE	<b>Mobility</b>  PEUGEOT	<b>Experience</b>  MASERATI

(Cavalieri, 2014)

# Servitization evolution

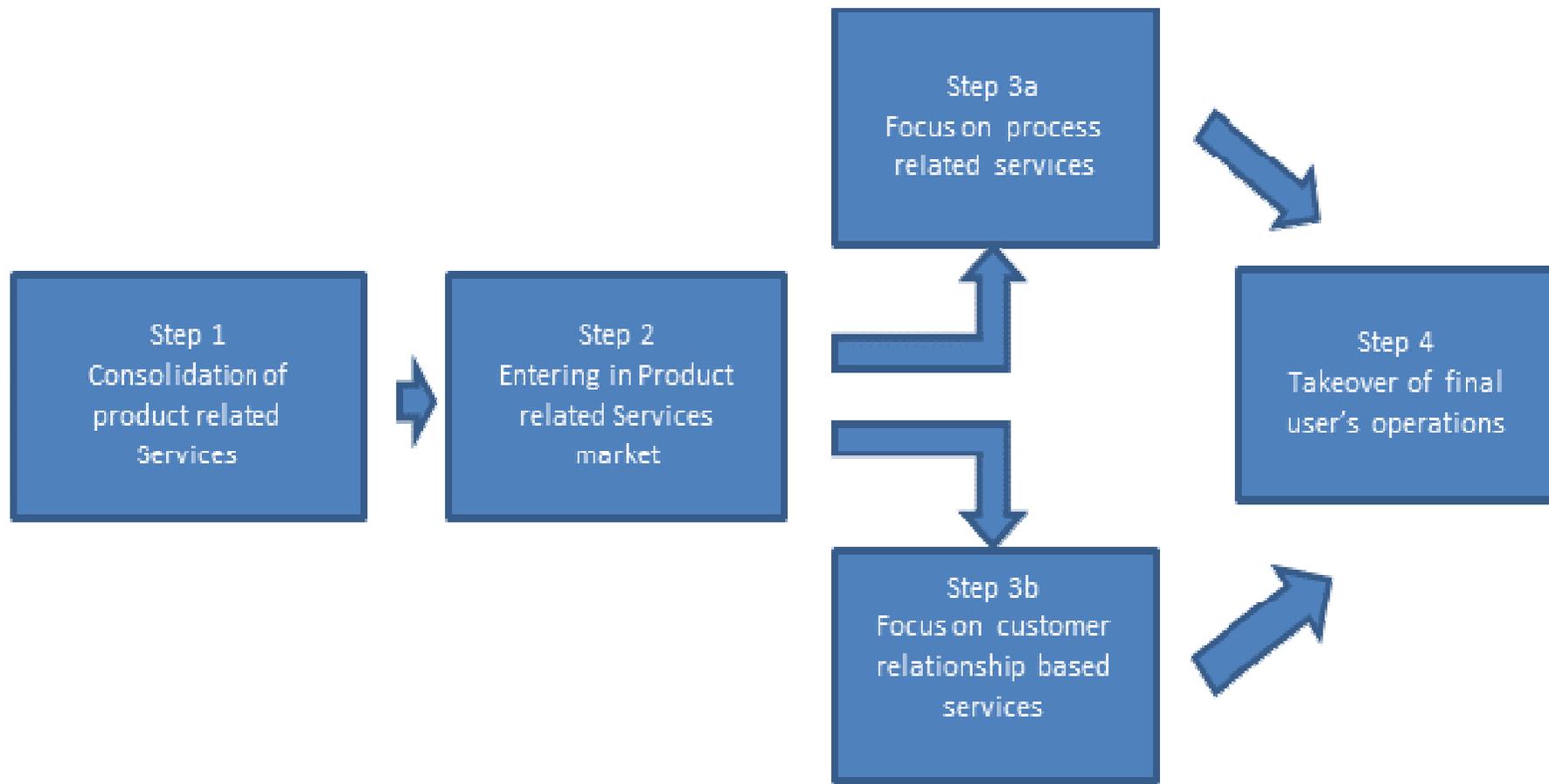


# The trend of servitization



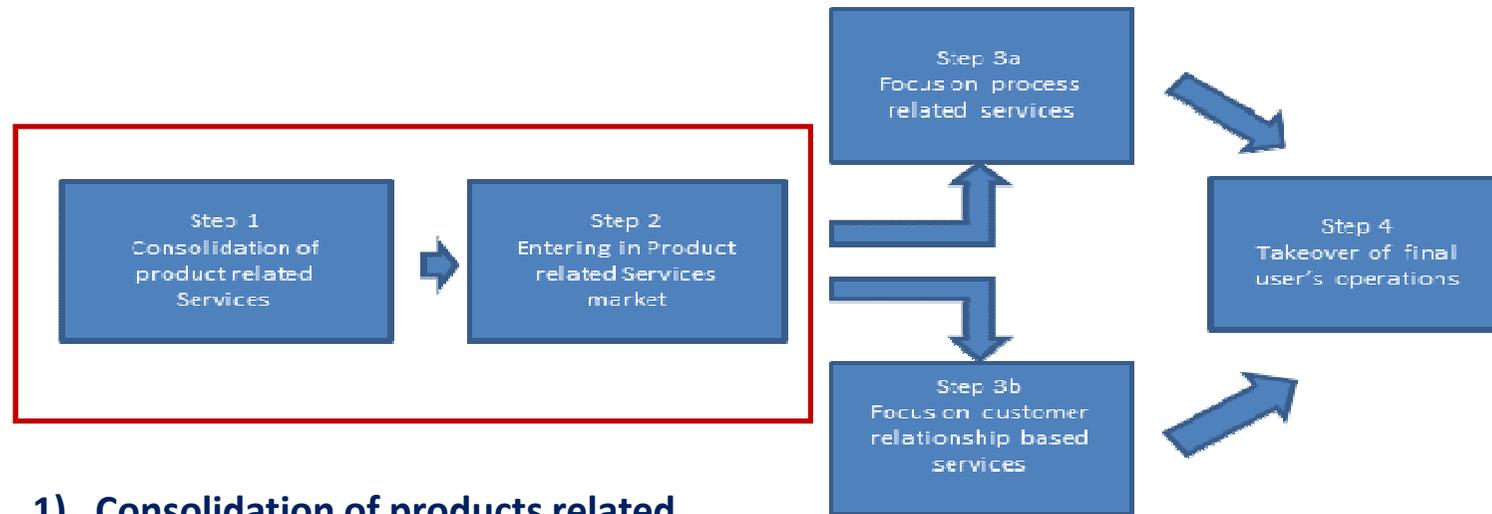
(Neely et al., 2011)

# The transition towards servitization



Oliva and Kallenberg (2003)

# The transition towards servitization



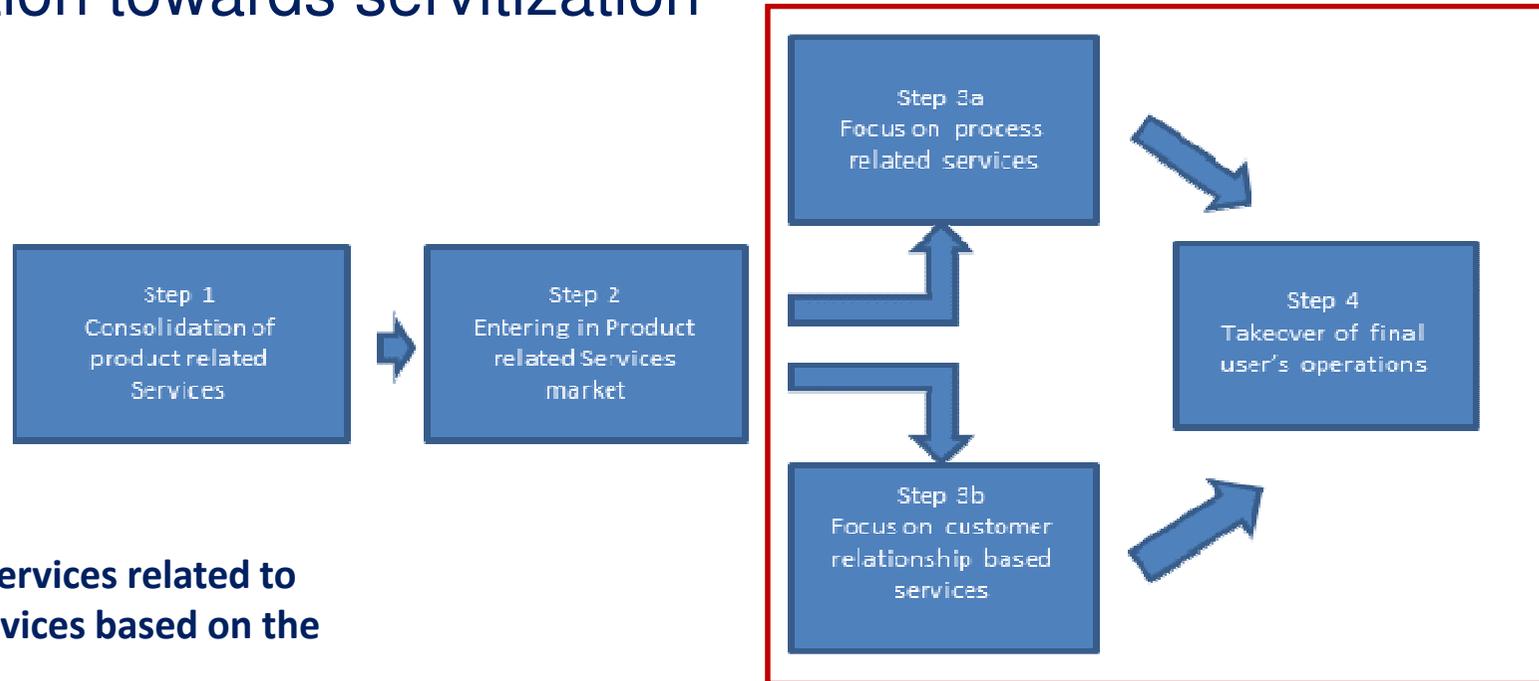
## 1) Consolidation of products related services:

It consists in **consolidating** the offers into a **single organizational unit**, stemming from the assumption that most manufacturing firms already provide services in order to support their products.

## 2) The entry into a service market related to the products:

it means identifying profit **opportunities and establishing** the processes and structure to exploit them.

# The transition towards servitization



### 3) Replacement of services related to products with services based on the relationship:

They are mainly devoted to fulfil specific customer's need and services centered in processes, with the objective to improve the **customer's efficiency**

### 4) Takeover of the final user's operations and the assumption of operational risks and end user processes: This means changing the emphasis of the manufacturer's business to **becoming a provider of solutions**

# Types of service strategies

They vary in terms of service offering, value proposition and pricing:

- **After-Sales Service Provider (ASP)**

- ✓ Customers are mainly interested to a properly functioning product for a low price.
- ✓ Attractive prices for both products and services are the key factors for competitive success.
- ✓ Firms pursuing such strategy focus on ensuring the functionality of the product along its life-cycle.
- ✓ Services are charged separately and represent an essential part of total value creation.
- ✓ Example: car maintenance and repairing.

- **Customer Support Provider (CSP)**

- ✓ Based on product performance and reliability, since customers are demanding more services, increasing the efficiency and effectiveness of the product in the operating phase.
- ✓ This strategy mainly concentrates on optimizing customer operating processes, through services customized and bundled according to customer needs, in order to prevent breakdowns.
- ✓ The price of the services is not integrated in the product price.
- ✓ Example: digital connectivity with a truck and related control on correct functioning of the engine on time.

# Types of service strategies

## ▪ **Outsourcing Partner (OP)**

- ✓ Customers' need is to improve cash flows and reduce the capital employed.
- ✓ Customers expect to buy mainly the performance of the product that they need.
- ✓ The competition is on price and the product margins are low.
- ✓ The Outsourcing Partners assume the operating risk and full responsibility for the customer's operating processes.
- ✓ They don't provide customized service packages.
- ✓ Operational services are standardized and focused on efficiency and economies of scale.
- ✓ Example: fleet management.

## ▪ **Development Partner (DP)**

- ✓ It provides specific solutions for customer's operating processes and co-produces, with the customers, innovative solutions for customer processes.
- ✓ The critical success factor is a great specialization on customer processes.
- ✓ There is an intense relationship between the service provider and the customer.
- ✓ The competencies jointly developed represent a resource-position barrier.
- ✓ Example: Document management

## Motivations that drive servitization strategy

«Product firms invest in services in order to **diversify** their **revenue and profit streams** when entering the mature phase of the industry evolution, characterized by declining prices due to intensive competition among a decreasing number of firms or a shrinking market.

Product firms might offer services also under different competitive circumstances ....».

## Motivations that drive servitization strategy: IBM case

«The first computers for business use, introduced during the 1950s and 1960s, were expensive machines based on a new and largely unknown technology and this made buyers reluctant to purchase the products. ...

**Various services**, such as leasing arrangements that bundled maintenance and pay for usage contracts, were, therefore, **essential to entice customers to buy these devices**.

In the case of IBM,



**services preceded and initially substituted for product sales».**

## Determinants of servitization strategy

External	Internal
Mature market and products that become commodities	Leveraging on product knowledge and competencies
Customer's needs and expectations	Capturing more value in the relationship with customer
Competitive pressure	Creating new business opportunities

Kowalkowski and Ulaga (2017)

# External determinants of servitization strategy

## **Mature market and products that become commodities**

- Product demand is stable or decreasing
- Product price is decreasing
- Products become commodities and massified, especially if competition is global

## **More sophisticated and challenging customer needs (B2B customers)**

- Cultural change of customer's mindset
- Customer is more informed thanks to a bigger availability of information
- Increasing interest in integrated solutions
- Outsourcing of non core activities

## **Rising competition from**

- Market leaders that can be also pioneers in service offerings
- Competitors from emerging markets (i.e. Huawei)
- Non manufacturing firms, such as distributors, retailers, consultancy firms, etc.
- Future competitors, emerging as a consequence of disruptive innovations, especially digital innovation

# Internal determinants of servitization strategy

## **Developing technical knowledge and competences on product and processes**

### **in order to:**

- Developing services
- Designing services since product R&D
- Designing smart services through digital technologies

## **Leveraging on customer relationship to increase value in the life cycle:**

- Services need frequent interactions and favor long term relationship
- By delivering services, the firm can better understand customer's processes and needs and thus it can offer new products and services
- A strong relationship with loyal customers allow to capture latent or explicit demand of products and services

## **New market opportunities**

- Creation of new eco systems: i.e. the eco system of designers of applications for iOS (Apple)
- Creation of distinctive assets, difficult to be copied: i.e. Rolls-Royce 's Total Care formula
- New business models based on pay-as-you-go, developed by a constellation of actors who collaborate to create final customer's value: i.e. Philips and Cofely for the lighting systems of Amsterdam airport, Enjoy car sharing (Eni, Fiat, Piaggio)

## Determinants of servitization strategy

External	Internal
Technologies: i.e. digitalization	Business driven servitization
Institutional theory: isomorphism	Environmental driven servitization
Evolutionary theories: how servitization takes place across industries and countries	

Pistoni and Songini, 2018

## Business driven servitization

### Business driven servitization

Services are more profitable than goods

Services can support differentiation strategies

Services create higher growth opportunities, especially in mature market

Services facilitate sales of products

Services increase customer loyalty and can answer to increasing customer expectations

Services can balance the effects of economic cycles on different cash flows

## Business driven servitization

Financial opportunities	Strategic opportunities	Marketing opportunities
Higher growth in revenues	More sustainable competitive advantage thanks to services	Services can be used to sell more products
Better profit margin	Services represent a differentiation manoeuvre	Services increase customer loyalty
Stability of income	Services are levers for new competitive opportunities	Services induce repeated sales, by intensifying contact opportunities
The combination of products and services is less influenced by price-based competition	Services create barriers to competitors	By offering services companies can better understand customer needs and develop more tailored offerings
Product-service sales are counter-cycle or less linked to the economic cycles	Services reduce the need to compete on costs	

# Business driven servitization

**Four main reasons** why manufacturing firms should servitize:

- To lock out competitors
- To lock in customers
- To increase the level of differentiation
- To gain financial benefit

**Advantages for customers**

- Reduced risk
- Decreasing, stabilizing and making predictable costs of services



**Integrated solutions or product-service systems (PSS)**

- Improve firm position in the value chain
- Enhance offering value
- Improve innovation potential

# Environmental driven servitization

## Environmental driven servitization

Services can help in changing production and consumption models

The servitized business model along with customers' revision of the ownership concept may reduce the adverse environmental impact of products

The dematerialization of physical products breaks the link between the value delivered to the customer and the amount of physical materials needed to create that value

Integrated PSS offering the value of use instead of the product itself may reduce environmental impact

Companies have all the incentives to make the PSS efficient and they get paid by the result

Consumer would alter their behaviour as soon as they gain insight into all the costs involved with the use

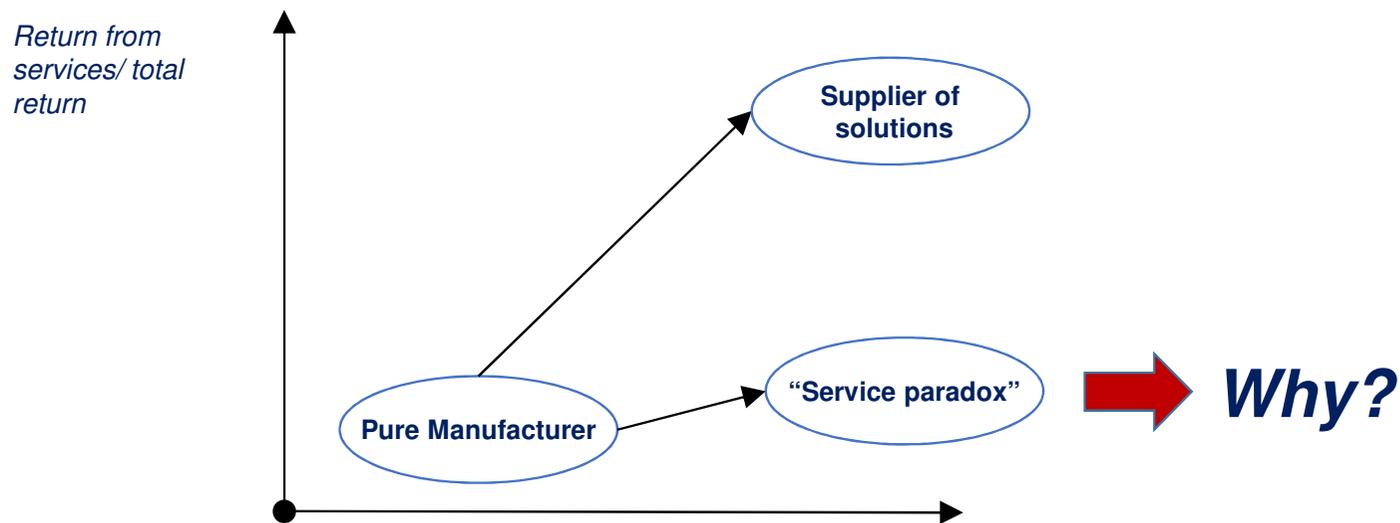


# The service paradox in manufacturing companies

«There are many cases of companies that, despite making the transition to services, did not get the expected correspondingly high returns.

This phenomenon is so diffused that scholars have coined the term ‘service paradox in manufacturing companies’ (Gebauer et al., 2005).

(Pistoni and Songini, 2018)



# Servitization strategy: critical issues



Organizational



Strategic and Cultural



Value Chain

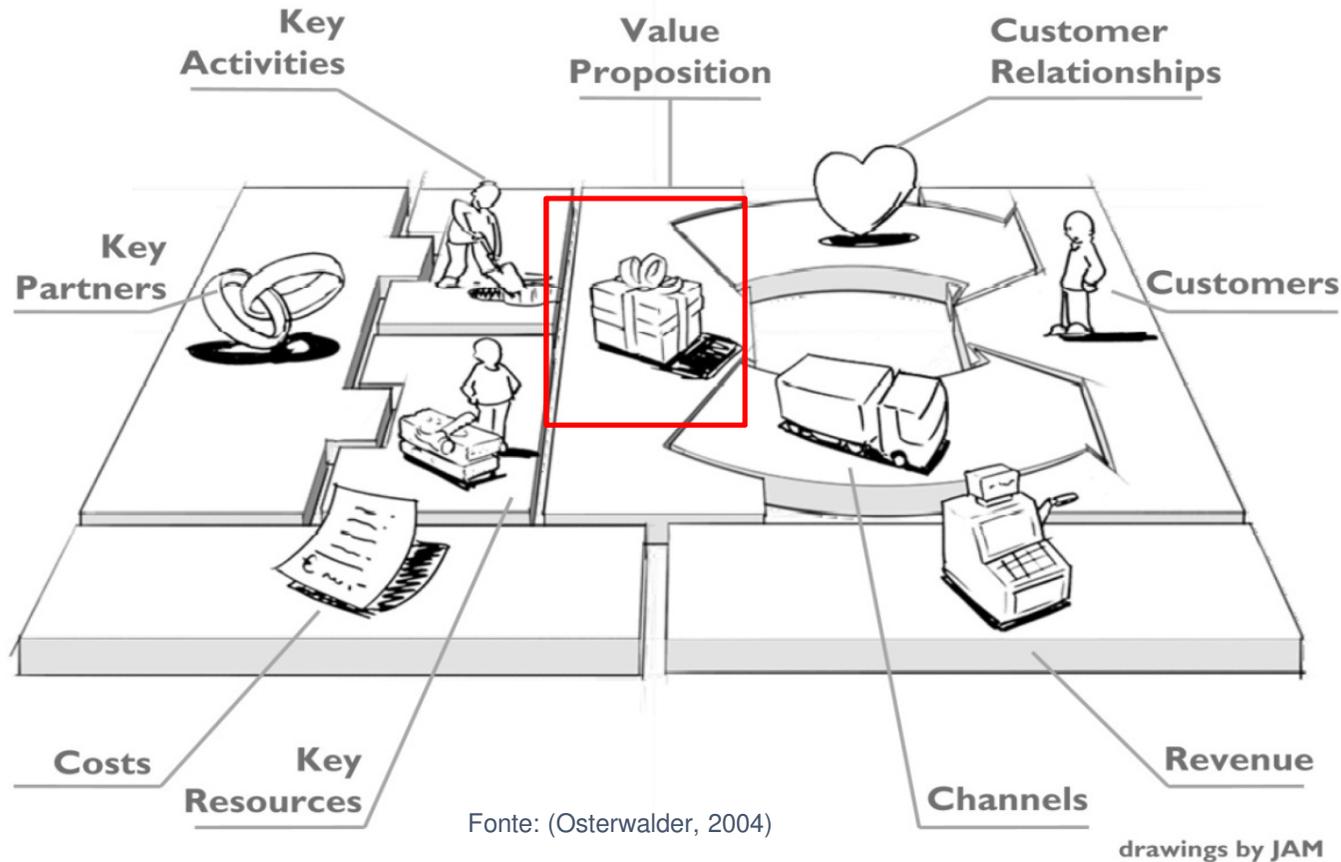


Financial Performance



Processes

# The service paradox: a consistent business model



Designing a consistent business model

# The servitization implementation issues

Challenges faced by companies to successfully implement the servitization strategy:

- **the pillars** of the servitization strategy design  
The main choices a company has to deal with in order to operationalize the new business model, such as:
  - ✓ the product-service offering design
  - ✓ the organizational transformation
  - ✓ the networking configuration
  - ✓ the supply-chain relationships.
  
- **the prerequisites** to the servitization strategy implementation  
The essential elements required for the transition toward servitization:
  - ✓ the cultural shift
  - ✓ the individual behavior.

# The servitization implementation issues

