

no10

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Ohde & Co

Myths and facts about Product Service

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Ohde & Co

In times of economic down-turn, the after-sales service always attracts increased attention.

This is driven both by the customers, who are forced to delay new investment and extend the life of their existing equipment, and by the suppliers, who see an opportunity to do more business from upgrades, service and maintenance, to mitigate lower sales of new equipment!

So, how can you grow your after-sales and service business profitably?

Based on 10 cases from our project portfolio, and a further 10 interviews with companies where product service has been an important part of business development, we have tried to identify what is required to be successful – and what should be avoided.

Key take aways

- Offer a more complete product service package – avoid just selling “technician hours”
- Convince customers to buy preventative maintenance – more efficient for your customer and for you
- Have a rational and understandable model for pricing proprietary spare parts vs. commodity spare parts
- If you expand your product service business from only selling proprietary spare parts to also offering services that require manual work; be aware that this may lower your margin
- Set clear and measurable targets that are relevant for the product service business and for each level of staff
- Clarify internally if the product service business is expected to be a profit centre or cost centre – avoid an ambiguous in-between position
- With increased remote connectivity, your business model probably needs to be revised

WHAT DO WE MEAN BY PRODUCT SERVICE?

Most industries have some kind of after-sales market, but the business logics vary, and require different tactics to serve the different markets. It will depend, for instance, on the extent to which your

product or service is integrated into your customers business, if the product is serviced at the customers site or at a facility elsewhere, or if there is a 3rd party service market in your industry.

Typical structure of a product service business*

The red boxes are our focus in this review

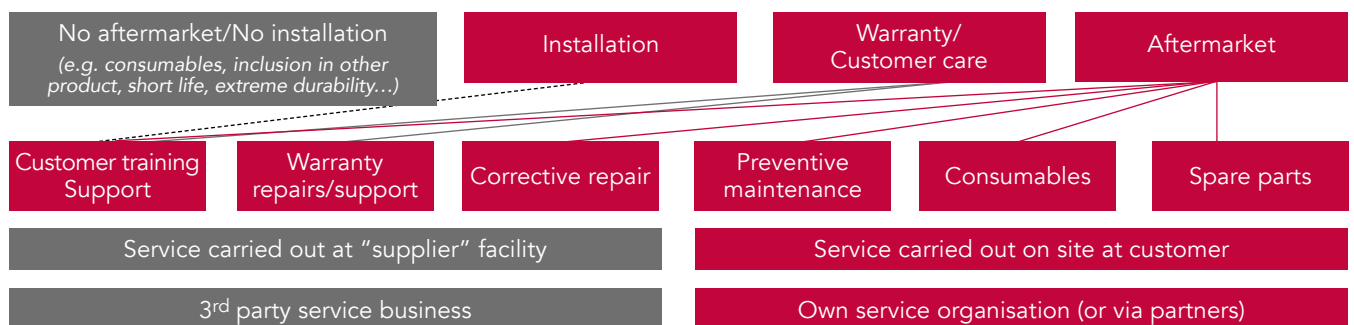


FIG 1.

* But definitions vary in different industries

Defining what is included in product service in your particular industry is a good start. One way of describing it can be as steps of increasing service offers:

Potential scope of product service business

How far you want to go, and where your optimum positioning is, will depend e.g. on:

- Customer requirements and needs
- Skills and competencies
- Where you can achieve economies of scale
- What competing product suppliers offer
- Competition from 3rd party product service suppliers

Most product suppliers need to offer at least this level of product service >>

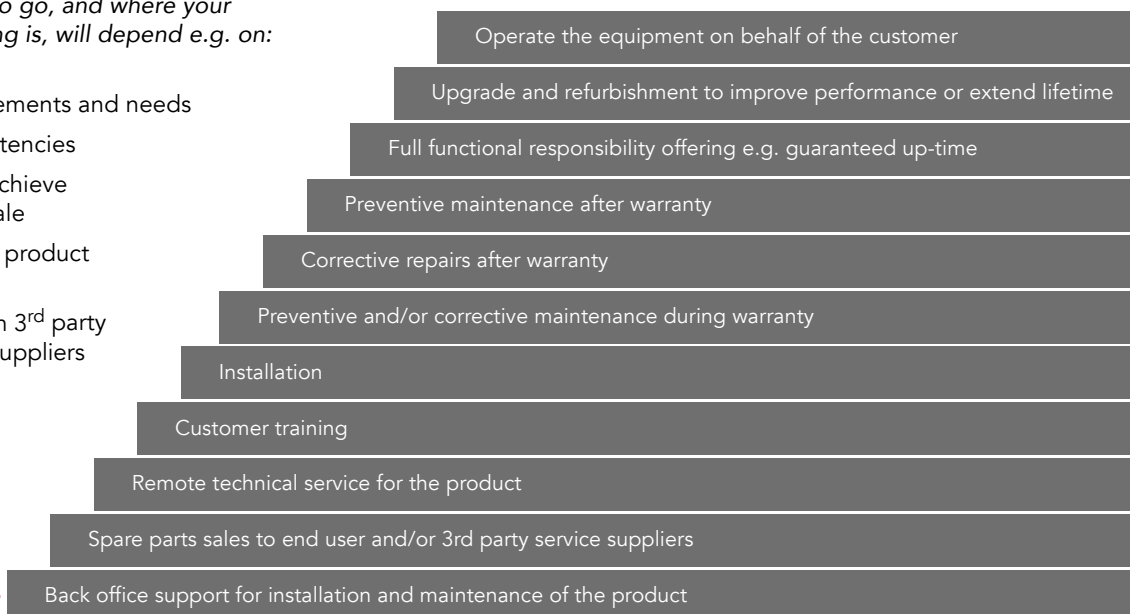


FIG 2.

HOW DOES THE INDUSTRY ENVIRONMENT AFFECT YOUR APPROACH?

If you have on-going sales of products – is there really a viable product service business to add to this?

Basic services – such as answering customer questions about deliveries and manuals – are in most cases a necessary complement to the sale of a product. This is an activity that is a pure cost and should probably be included in your product cost calculation.

If you want to develop a profitable product service business, you need to offer additional customer value. The customer must understand your offer and the advantages of buying maintenance, and other services, in addition to buying equipment and necessary spare parts. At the same time, you also need to be cost *efficient* to avoid adding revenue without margin.

How is your service market structured?

This is a question worth asking since the further you move away from just selling a product, the more you might become exposed to the conditions in a different kind of market. If you move into a service market where independent product service providers have a large market share, these can be formidable competitors. Their management set-up and performance control systems are specifically designed for running large groups of service technicians as efficiently as possible. They have the economy of scale that you don't, and you need to find other ways to compete!

Is time spent with the customer perceived as value adding by the customer?

Probably not – but could be! Value for your customer is a product that works when needed, and if it does so without any service at all, that must be an advantage! This means that if you want to be successful in the long term, equipment that is self-instructi-

ve and maintenance free would be ideal. But, being more realistic, until such products are developed, it is always going to be better if the installation, training and service is quick, and possible to plan in advance. Sudden faults and malfunctions that require corrective maintenance are always going to have a negative impact even if you are able to make the customer less unhappy by being responsive, quick, and carrying out the repair work smoothly!

Providing a timely response to customer problems is often the starting point for the service organisation in many companies. And since this is widely appreciated by the customer, it tends to form a highly responsive and reactive service organisation – but one that has very little experience of setting up a preventive maintenance plan and working proactively with the customer. Customers are also often driven by the same attitude; don't spend money in advance but be quick to fix problems when they occur.

If you want to take your service business to the next level, you need to find a way out of such a locked-up business environment!

WHAT DIFFERENT BUSINESS MODELS DO WE SEE?

Is a service business more profitable than product sales?

This is a tricky question. In some businesses it is, but not in others. It depends partly on what is included in the definition of "product service".

The profitability of the different service activities shown in fig. 2 differs. If you are currently running a profitable spare parts sales operation it will probably be tough to achieve the same margins if growth is achieved by adding more labour-intensive repair and maintenance services.

Supplying a wider range of spare parts is often the next step in expanding into services and if you have proprietary spare parts (or consumables), and control the market, this is likely to deliver a very healthy margin. There are companies where spare part sales

contributes more than 50% of sales and as much as 75% of profit. There are even cases, both in B-C and in B-B businesses, where the original product is deliberately sold at a low margin and where this then becomes the platform for selling very profitable service, spare parts, consumables, and up-grades.

A good “lean” approach in manufacturing – and one which we recommend – is to try to standardise components across different products. An unintended effect can, however, be that you create large volumes that attract pirate parts suppliers! This has happened in some industries and can reduce margins significantly and very quickly.

A service business where you are mainly selling

man hours, is usually going to show lower margins than a service business primarily selling proprietary spare parts. If the man hour content is high, a key issue is to avoid selling the labour content, spare parts e t c. as separate items. You want to develop a business model that as far as possible is de-coupled from the number of working hours and instead focusses on the customer’s perception of the value provided.

Another important parameter is avoiding complexity. Are you able to focus and standardize your service offer? From the PIMS® strategy database we can see that service providers who manage to keep a focused portfolio earn substantially more than companies trying to provide a wide range of services!

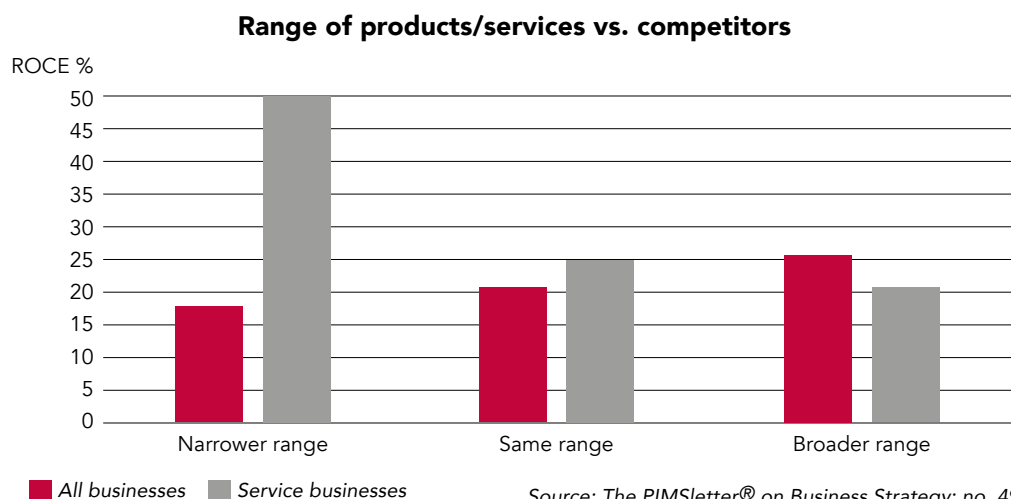


FIG 3.

Source: The PIMSletter® on Business Strategy; no. 49

You should, however, have potential advantages:

- For all spare parts that are not pure commodities you should have the lowest purchase price, thanks to economy of scale.
- By analysing accumulated customer data, you should also be the expert on the operational performance of the product and product quality data – such as optimal maintenance intervals, mean time between failures, cost efficient preventive maintenance protocols e t c.
- If you have dedicated service staff, you should be the specialist on both preventive and corrective maintenance for your products.
- Your engineering department is the authority on the design and functionality of your products and therefore should be the obvious choice when a customer needs to upgrade, rebuild, or refurbish the equipment.

What could convince a customer to consider overall performance rather than spare part prices or service hours?

If you can integrate your offer and include all relevant skills and competences that the customer needs, you will be able to provide your customer outstanding value. Your customers total cost will be lower than it would otherwise have been, and you will be able to command a higher price.

But when is this approach successful and how can it be implemented? Start by taking a closer look at:

- **Customer Value Creation:** is there a space to fill by expanding into service and is it worth pursuing? An important part in assessing this is really to understand your customers' situation and what they need. Is the customer purely driven by a 30 year life cycle cost calculation (which we have seen in wind-power) or, at the other extreme, cannot purchase integrated service offers at all (for legal reasons, public procurement regulations e t c).
- **Do you have unique competences that could be turned into true advantages for the customer?** Ability to optimize your customers total production or equipment? Increasing up-time? Reducing service cost? Increasing equipment output? A deep knowledge of your customer's own processes is a most important factor when designing your own offer!
- **Do your customers service the equipment themselves – inhouse?** Beating an inhouse service provider is often more complicated than competing with external providers. It might be worth trying if you take a substantial technical step forward. But maybe it is a better solution to help the customers staff do the work on site.
- **If your direct customer is e.g. an integrator, your product will often be serviced by your customer as part of the complete installation and you will probably not want to try to compete.**
- **Are there independent service providers covering a wide range of equipment that give them a cost advantage in service visits?** Can you convince the customer to buy service of your equipment directly from you? Would there be an advantage if you start servicing also your competitor's equipment?

DOES PRODUCT SERVICE ACHIEVE LOWER EFFICIENCY THAN MANUFACTURING?

This can be the case. The reason is, however, not that service people are less efficient, but because it is a fundamental reality of the industry.

Unfortunately, it is not always possible to plan when corrective maintenance will need to be carried out or how long it will take. There are ways of improving efficiency such as remote access to the equipment, knowledge sharing between technicians to quickly learn the smartest way of solving a problem e t c.

The best way of increasing efficiency is, however, to try turning corrective maintenance into preventive maintenance. Preventive maintenance is much easier to plan and perform efficiently! Even if you can charge your customer slightly more for acute repairs this will probably not cover the efficiency loss in your organisation. Taking the next step into remote service is also much easier if you change your business model towards more preventive maintenance. Then, the loss of invoicing physical service visits does not mean reduced total revenue and will help you reduce cost!

One good source of efficiency improvement that is sometimes forgotten is a systematic evaluation of product performance and service data. This can help you optimise both your future products and your maintenance programs, like changes in service intervals, change of components to extend life time e t c.

Service staff often work alone, or in small groups, remote from their home base. This increases the need for independent problem-solving skills, but inevitably makes the staff less easy to manage when people are spread out over large areas. Ways to address this are:

- Well set, and clearly communicated, targets
- Consistent follow up
- Information and meeting formats to make sure that your team is well informed and shared best practice
- A smart set of incentives to keep focus on the right things

Will remote monitoring and connectivity change the service industry?

It is already changing it, and it is important to be proactive and understand both your business model and your customers' business models!

Remote access can make it possible to reduce time spent on corrective maintenance. But there is a cost for you to design and run the remote access systems and if you are invoicing the customer by the hour – and these hours now become fewer – you might even make less money.

Connected equipment may also make customers wary of losing control of sensitive production data. If you want access to your customers' equipment it is crucial that you can either convince them that this is not a risk, or to design your remote system in a way where the production data is kept separate. In some industries, where connectivity has been developed by the suppliers at a substantial cost, a majority of the customers will not allow access!

Working capital efficiency in product service businesses

An issue that has always challenged service businesses is the tied-up capital in spare parts stock. This tends to exceed levels in manufacturing many times over. There are several useful models that you can apply in order to reduce stock levels, but the important thing to remember is that, except for pure consumables, you should be very careful when applying the same models you use when optimizing your manufacturing stocks! The forces driving consumption are not the same and not even the same for different spare parts in the same stock. An example is, that what we call slow movers/low frequency/low volume items, often have an erratic demand. They are hard to forecast and most MPS-systems fail to handle them properly without rules set by "humans"!

It is also worth asking yourself if you must offer all customers the same service level or if it is possible to differentiate pricing based on response time? One way of handling some of the stock issues might be to centralise spare parts stock if customers accept a longer lead time!

ORGANISING YOUR PRODUCT SERVICE BUSINESS

Our experience is that, like many other organisational issues, there is no uniform solution to organizing your service business. When after-sales is very integrated with the sale of new equipment the problems seem to be limited. But this probably also limits focus and drive for growth, since service is given very little attention and develops a reactive attitude.

So, should your product service business be organized as a profit centre or a cost centre? Again, there is no clear-cut answer. Making product service more independent can generate unintended internal tension. We have however seen that the biggest problems come from unclear targets, unclear rules, and mixed responsibilities – irrespective of which model you choose. If this is combined with an organisation lacking the ability to solve conflicts, it can get really messy and hurt the company's overall performance and impression with customers. So, set clear rules and don't be afraid to take decisive actions and solve conflicts quickly!

One misconception that we have come across is that after-sales will open up opportunities for new sales. If the customer's maintenance operation is separated from where decisions on new investments are made, this is not the case. If so, then keep sales of new equipment separated from after-sales, but don't miss the chance to exchange information and help each other!

Don't hesitate to contact us for an evaluation of your present performance to improve efficiency and expand your service business!

OHDE & CO was founded in 1993. We all have long experience from both operational management positions and management consultancy. Typical customers are mid-sized companies in manufacturing and services.

We are associated with Malik Management, St.Gallen and PIMS Associates, London. Through this cooperation we have access to the well-known and extensive database and business simulation tool; PIMS – Profit Impact of Market Strategy.



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