



How product companies can servitize and successfully develop new services





The importance to develop and deliver services is rapidly increasing

How is your organization succeeding?

In a world with steadily increasing pace of change, product companies seek new ways to stay competitive and profitable. Digitalization, connected products and new emerging business models are just a few of the key industry trends that are on top of the executives' agendas today.

This article will explore how product companies can translate these trends to business growth through servitization of their products, some of the challenges they may face, and describe how they should approach service development.



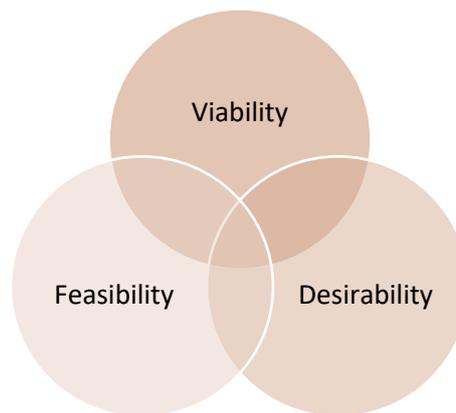
TO SUCCEED IN SERVICE DEVELOPMENT MEANS OVERCOMING challenges in three key areas



Customer preferences and the competitive environment for product companies are changing, and these can no longer solely compete with physical products. Servitization is the trend and process where product companies transform to compete with product and service offers. The reasons why product companies decide to take the leap towards services are many. To grow the business, capture higher profit margins and larger market share, meet new customer demands and needs, escape the commodity trap, differentiate against competitors and thereby create competitive advantage are only a few examples of positive grounds for servitization.

Succeeding with service development is a key strategic priority in any service transformation journey. Our experience, from working with product companies in many different industries, is that the development of services is challenging but can be very rewarding for those who succeed.

Product companies aiming to grow their business through expanding into services usually face several challenges. New services must encompass three criteria: Desirability, Viability and Feasibility.



Adapted from: Change by Design, Tim Brown, CEO IDEO

A reason why one or several of the criteria is not fulfilled is that product companies approach service development with a product development logic. Usually, the same processes, methods, and tools for product development are applied for service development. Why they tend to do so is because the company already has the product-related processes, tools, competencies, governance structures etc. in place. For the company and the management, it is convenient to use existing structures, procedures and tools since it is something they already recognize. Unfortunately, the desired outcome using this logic is seldom reached.

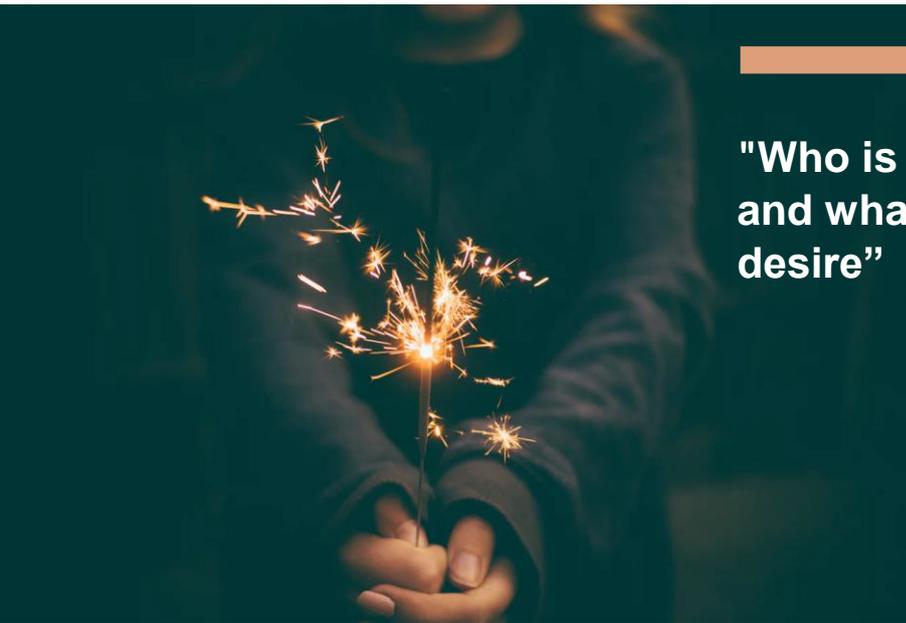
THE SERVICE DOES NOT SOLVE A TRUE CUSTOMER PROBLEM AND the customers do not desire it

A key focus within desirability is to understand if the service could create a gain or relieve a pain for the customers, if the service will appeal to the customers, and if they will desire it. Essential when developing a new service is to understand what the target customer segments are, what solution will solve their problems and what value the service will deliver to them.

A challenge when developing a new service is understanding who the customers and end-users are as these might differ from the traditional product segmentation of customers and end-users. Who is the actual receiver of the service? And are the customer and end-user the same?

Inherent differences between products and services change the relationship between the two parties and the interaction between the two will most likely look different from when solely offering products. More frequent and closer interactions with the customer will increase the risk of a bad experience but also increase the chances of good experiences, additional sales, and building a closer relationship and retain customers.

The company stands in front of a decision of how the relationship with the customers should be structured; what acquisitions and delivery channels to use and also when to first engage the customers in the development of the service. The company must also decide how tightly to couple the delivery of the products and services.



**"Who is your customer
and what do they truly
desire"**

THE SERVICE DOES NOT CREATE VALUE FOR ALL STAKEHOLDERS AND IS THEREBY **not creating a viable business**

The key focus within business viability is the value creation for the company, for its partners and for its customers. There must be a sustainable value for all the parties involved in order to balance the equation. How the value differs from competitors' value propositions is also an area to address. In what way is the value the service brings unique?

Some of the main challenges when developing a service are associated with the financial implication of the service – the revenue models and the cost structures. How is the company going to capture the value that is created, what should be charged for and is there an inherent value in the revenue model itself that the customer is willing to pay for? How much will this cost in both initial investments but also in the delivery and maintenance of the service? Will there be cannibalization on products and aftermarket due to the new service?

The opportunities in revenue models to choose from differs between traditional products and services. Products are often of transactional nature where the product is priced based on product cost, whereas services allow for a vast amount of revenue models. Nevertheless, setting a price for a service is easier said than done. From a customer point of view, traditional products are owned whereas services are a capability that the customer is willing to pay for. When developing a new service, firms must understand what underlying values the customer desires. A question one could ask is how deep and where in the customers business the service provides value.

In the automotive industry, it is nowadays not rare to offer maintenance services for a monthly fixed fee. Depending on industry the customers may value the predictability of future cost but for different reasons. Owners of commercial vehicles may desire it because of increased cost and budget control, whereas owners of a passenger car may value it due to constraints in personal income. Businesses operating in a market with high fluctuations of customer demand may desire a more flexible service from their supplier. Amazon Web Services offers their clients a solution which the client only pays for the storage that they use on Amazons servers - a usage-based business model. Some require services that are highly critical for successful operations which have a direct impact on their revenue. For example, Rolls-Royce provides the “power-by-the-hour” concept which is a performance-based revenue model.

When discussing revenue models, one must eventually discuss the cost structure for provided services. These costs include the initial development cost but also the cost of delivering and maintaining the service to the customers. In a product company, the service development often faces several challenges. The service cost structure and revenue model are often benchmarked similarly to the development of the product.



”... sustainable value for all involved in order to balance the equation...”

THE SERVICE IS NOT POSSIBLE TO DELIVER EFFECTIVELY AND IS THEREBY **not creating a feasible solution**

As mentioned, product companies approach service development with a product development logic. Resources and capabilities to support a new service often differ from the requirements of a product. Gearing up the organization from being a product-oriented to a service-oriented company not only means that you must make significant technology investments along the existing investments around the product, but also in the organization and the people within it.

Misalignment between product development and service development is a key issue. Products are pushed out to the customers and services are then added to that product, thus limiting the possibilities of the service development and the value it can create. The processes between the product and service development need to be adjusted accordingly to maximize the gain of pursuing service development. Another closely related challenge is that the service development is often multi-functional and goes beyond the product development organization to other functions such as sales, customer relations, and aftermarket. This could also imply that IT systems need to be reviewed to see if they can fully support the new service. Getting the right organizational set-up enables successful service development.

Another challenge is that the development of the service is placed and driven in the existing organizational structure. This does not only put stress on the organization if more resources aren't provided, it could also mean that the organization has difficulties how to prioritize between the existing day-to-day activities and service development. If the organization also lack both the knowledge and understanding of how to develop services this could reinforce the organizational stress. In some cases, the fear of the new service and how it will impact the organization and their role in the future can cause unwillingness to support or even active resistance towards the service development. A service may be technologically feasible, however, is it also organizationally feasible?



customer-centric service development model

At Fortos, we believe that product companies need to approach service development in a different way than their traditional product development process. Product companies should take a holistic approach to integrate service development and business model development. A number of additional measures are highlighted in the following sections which a product company are recommended to take in order to get service development right.

Decouple service and product development and get the project setup right

Development of services and products differ from each other, they have different inherent logic and development cycles. However, product and service development projects have strong interdependencies which need to be managed at a portfolio and roadmap level.



Getting the governance, resourcing, and staffing of service development projects is crucial. Our experience points to the need for top management support in the projects, especially in product-centric companies. This should be embedded in the governance model of the development process and project setup. The setup with cross-functional teams is of equal importance, even though the workload may differ over the development and deployment phases

Create a deep insight into the target customer segments' operations

In order to secure that the developed services fulfill the customer desirability criteria, it is important that real customers are involved throughout the entire development process and that their value-creating process is well understood. There is no need to develop something that is not desirable from a customer point of view.



In many cases, the customers themselves may not know what they want. Recall the famous quote by Henry Ford: *"If I had asked people what they wanted, they would have said faster horses."* This quote is often misused as an excuse to not involve customers in the development process. In fact, what Henry Ford understood was the actual need of the customers: more effective and efficient transportation than the horse could produce.

Product companies working with service development are recommended to apply methods, tools and techniques from other disciplines than traditional product development to gain in-depth insight into their customers' process and also how they can co-create new services together with the customers, end-users and also partners in the value chain such as dealers and suppliers.

Approach service development with an iterative way of working

Service Development requires a different way of working than the traditional waterfall model common in product development projects. Applying an iterative and agile design approach in tandem with involving customers early in the process has some key advantages.

Firstly, it enables the team to validate the customer desirability criteria for the service earlier on in the process, and thus resources can be allocated and spent more effectively.



Secondly, it allows the team to test their hypothesis through multiple rounds of beta testing to identify the minimal viable service by what matters most to the customer.

Thirdly, the method enables the team to maintain both the flexibility to adhere to new customer feedbacks as well as “speed” to shorten the lead time for the service to be deployed in the market.

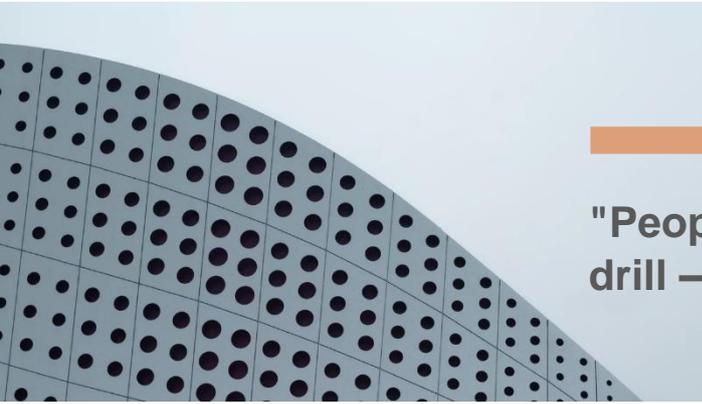
The iterative approach should, of course, be combined with an efficient project portfolio approach so the right projects are funded, and more ideas explored. Lastly, you must be able to kill more of your darling ideas when they are unveiled not to be fit.

Case: HILTI

An example of a firm that has successfully servitized is the Liechtenstein tool manufacturer Hilti. Hilti has for long identified itself with high quality physical products and did recognize the need for changing mindset, capabilities and processes when they launched Fleet Management, which is a “hardware as a service” business model. Hilti recognized servitization as a way to drive the degree of differentiation from competitors and also to build a closer relationship with the customers which is harder for competitors to copy.

The company had a standardized process with gates for developing products, but while the services became more and more important for the company they soon understood that the product development process was too rigid for services. Hilti then developed a service development process which is more concerned with iterations and early prototypes.

Hilti understands that if they would work in the traditional way, everything would have taken too long. In service development, you have to be fast and flexible and that the teams are encouraged to think and act in an entrepreneurial way. The team and the service development need strong top management support in order to drive the internal change process.

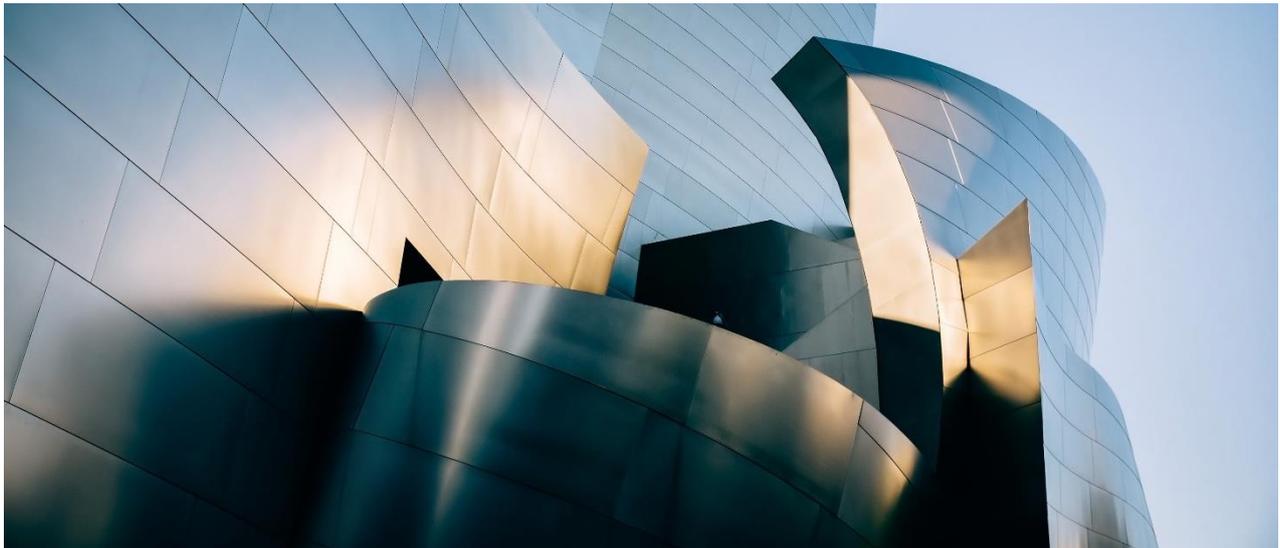


**"People don't want a
drill – they want a hole"**

and conclusion

The automotive industry is one example of an industry currently changing at an unprecedented pace. We believe other industries will follow a similar pattern with increasing speed of change driven by trends such as digitalization, connected products and new emerging business models.

Product companies can become more competitive and profitable by servitizing their product offers and grow their service business. This becomes increasingly important as the pace of change increases.



Looking forward

Is your company seeking new growth opportunities through servitizing your product offers? At Fortos we have a long experience of supporting product companies with how they should approach service development. We also have a comprehensive offer for the entire service transformation journey:

- Service Strategy & Business Models
- Service Organization & Processes
- Service Portfolio Management
- New Service & Offers Development

Get in touch with us. We have a passion for helping our clients succeeding and we are looking forward to discussing your challenges!



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is our heritage.**

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