FROM PRODUCER TO SERVICE PROVIDER

Why some companies fail to make the transition

By Professor Stefan Michel – April 2010

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Industrial companies are increasingly defining themselves as "service providers" and offering customers "one-stop solutions". They promise "total customer solutions" thanks to "integrated value chains". But current empirical studies show that the transition from producer to service provider is often unsuccessful. Failure manifests itself in two forms: on the one hand customers complain that they don't receive a solution, just more complex offers, and on the other, the producers complain that their costs outweigh the additional income. In my studies I have identified five challenges that have to be overcome in order to achieve a successful transition.

1st hurdle: The offer

Studies show that there is a misunderstanding between providers and consumers of solutions with regard to the offer. Providers often see a solution as a combination of products, services and service guarantees. The customer requirement is addressed with a variety of modules or service packages. But customers don't expect a solution to be a complex package of services, they expect a joint process that involves defining the problem, finding a solution, innovation, implementation and long-term use.

2nd hurdle: The innovation

The second hurdle is a consequence of what I was just referring to. Product-focused companies see innovation and research & development (R&D) as a process which leads to a technically improved solution which can usually be patented. Thomas A. Edison, the inventor of the light bulb, the gramophone and a thousand other things, is often mentioned as a prime example of this kind of innovation. In one of our studies we were able to show that, increasingly, innovations that are not based primarily on a technological breakthrough are penetrating the markets. These innovations, such as the Grameen Bank in Bangladesh, the Swiss free daily newspaper "20 Minuten", the DVD rental service Netflix, budget airline Ryanair, Mobility CarSharing and Apple's iTunes have all radically redesigned the role of the customer. In other words, it is not the product that is redefined, but the customer, who is becoming a user, purchaser and payer. There is no R&D lab or research budget for these innovations, and in many companies there isn't any one person who is responsible for them.

3rd hurdle: The business model

The transition from producer to service provider alters the fundamental business model. If this is not recognized early on, profits will plummet and the transformation will come to a screeching halt. A typical symptom of a product-focused business model is thinking in terms of product life cycles and portfolios, often illustrated in quadrants using stars, question marks, "cash cows" and "poor dogs". This model is based on the assumption that every innovation requires major investment that can be amortized through large production volumes (economies of scale), aided in part by patent protection. Services work in a fundamentally different way, because innovations are less expensive and cannot be patented. Economies of scale are often limited and the product life cycle is not a suitable tool for analysis. The variable costs are also of less relevance when it comes to calculating prices. The customers' willingness to pay, which has to be systematically determined through consultations and sales meetings, is much more important.

4th hurdle: The sale

Selling services is substantially different from selling products. The differences can be so vast that staff changes are unavoidable during the transition. In most cases, though, intensive training sessions, behavioral training, new sales tools and suitable incentive systems can be used to prepare the existing sales team for the new challenges. In reference to the first hurdle, the sale is no longer a link between the product (offer) and the customer (need), but the catalyst for the innovation process and the implementation of the customer solution. This requires an in-depth understanding of the customer's processes and means that, far from the work being over, the sale doesn't really start until the contract is signed. The goal is no longer to make the sale, but to strengthen the customer relationship, increase customer loyalty and secure customer profitability. These goals must be indicated in the incentive system. Short-tem sales targets will torpedo a long-term customer focus.

5th hurdle: The corporate culture

Most companies need to fundamentally change their corporate culture in order to overcome these hurdles. It's already clear that such a change requires considerable resources, poses risks and will be difficult for many of those involved. IBM, to name one example, took more than a decade to transform itself from a computer manufacturer into a strategic IT service provider.

Three of my colleagues, Tom Malnight, Peter Killing and Tracey Keys, have developed a method which companies can use to deal with existential transformations. The process begins with the management sitting down with other key players within the company to define three to five "must-win battles". "Must-win battles" are strategic objectives that are essential for the long-term future of the company. If the transformation into service provider is not one of these must-win battles, then it probably doesn't have the necessary priority to be successful. Once the must-win battles have been defined, the management must prove that they mean business, through action, not words. They must be prepared to sacrifice sacred cows, and they must provide sufficient resources for the must-win battles. They must also be able to convince their employees that the transformation is necessary and is the right thing to do. I've seen numerous cases where employees have become extremely cynical after being saddled with project after project.

This leads me to the following conclusion: the transition from producer to service provider will be unsuccessful if the company is not prepared to make a fundamental change. This change is manifested in the offer, the innovations, the business model and in the sale. Or, to sum up: a company that is not prepared to invest in a new corporate culture will not succeed.

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