

## 'From Products to Services': Author Laurie Young on the Coming Chinese Challenge

When Lenovo bought IBM's personal computer division in 2005, it was a symbol of the increased sophistication and global ambitions of some large Chinese manufacturers. Is it possible that, for their next trick, Chinese companies will steal the new clothes of companies like IBM and GE, who have transformed themselves from sales-driven manufacturers to global service suppliers?

Author, consultant and former PricewaterhouseCoopers global marketing partner Laurie Young, for one, thinks that these and other Western companies will soon face a growing challenge from Chinese competitors. Young, whose fourth book, *From Products to Services: Insight and Experience from Companies Which Have Embraced the Service Economy* (Wiley), was published in Chinese in March, talked to China Knowledge@Wharton about this global phenomenon, and where China fits into the equation.

A number of Western manufacturers have not made the transition from manufacturing to services successfully, argues Young, who teaches in Wharton's executive education program. China, meanwhile, is seeing the beginning of a government-led move to raise awareness of what he calls "the service opportunity." Together, this spells an opportunity for Chinese companies to grow global service businesses, in addition to benefiting from an expanding domestic market.

Below is an edited version of the interview.

**China Knowledge@Wharton:** Can you tell us a little bit about yourself, and how you came to be interested in this area of "products to services"?

**Young:** I first came across this phenomenon when I was at Unisys between about 1990 and 1995. At that time the company was still a computer manufacturer, but it was at a strategic crossroads.

Like IBM and DEC, Unisys had grown very fast. By about 1987-88 they had a stunning net margin of nearly a thousand percent on their premier product, a mainframe computer. But within three years, everything had changed. They hit market maturity, as all their industrial customers already had the product. Sales volumes flattened almost overnight and, like IBM and others, they walked into a wall.

So they gradually started to look at options other than marketing products. They began to move into the supply of services, eventually hiring me as their first director of services marketing in Europe.

Later, I went on to start my own company to advise a number of companies who were going through a similar strategic evaluation at the time. Those included Ericsson, which in the late nineties was reaching market maturity in the West.

**China Knowledge@Wharton:** So, is this trend something that is specific to IT and telecommunications?

**Young:** Telecommunications equipment manufacturing and computer manufacturing are two examples, but it's far from limited to them. Nowadays, with the dominance of the service sector in so many Western economies, manufacturing companies older than ten or twenty years have to ask if their traditional businesses are dead dogs, and whether they should be moving into services.

One remarkable example I came across was a big European company that provides hydroelectric engineering projects. Nowadays, governments are no longer just saying, "Build us a dam." They're saying: "Supply us with electricity in a sustainable way – and we want the environment returned to what it was in 20 years." In other words, they're asking for a service, rather than just a dam.

In businesses like medical diagnostics, heavy engineering, copying (like Xerox) and production of air conditioners, the leading companies have been forced to go through a debate about whether to vacate manufacturing in favor of services and the potentially higher profit margins that can imply. They have had to ask themselves whether it would be more sustainable to provide air conditioning as a service, rather than just churning out equipment. Or, for instance, whether they should provide retail infrastructures in a building like cooling, refrigeration and internal transportation (like elevators) as a service instead of, for instance, just being a fridge supplier.

**China Knowledge@Wharton:** Where does that debate stand now?

**Young:** When I started at Unisys, many managers just wouldn't believe that the customers who bought their machines would spend money on some vague concept called "service." But since then in that industry they've seen the advent of things like systems integration. They are now moving to a model in IT where they are talking about software as a service – a massive change. We've seen the IBM story, of course, in which they took the same course as Unisys to become one of the biggest service organizations in the world. At the same time, things like outsourcing and privatization have caused an explosion in services.

That said, I am shocked to find that there are still companies in Europe and America who remain in that strategic debate. There are people in industries like telecommunications, consumer electronics and organizations that do engineering support for businesses and facilities who are just talking about this issue now.

**China Knowledge@Wharton:** How should companies go about making their decision?

**Young:** There are a number of questions to ask. But first and foremost is, "Is this a permanent change in our industry?" If it is a fundamental change in the maturity of the marketplace, then they have a strategic dilemma. They need to ask themselves: "Am I going to move into services? Or am I going to seek to remain as an efficient manufacturer?"

And some companies take the latter option. They decide, "We are manufacturers – that's our DNA, and we will not supply services." The one in the book that went on the record was Unilever. They set up a service company at the turn of the century to do cleaning of people's homes, but after two or three years of really serious investment found that they didn't have the skills to do it. I've advised several companies who have backtracked from it.

If they are going to remain as manufacturers, they need to improve productivity by investing in new technology and processes like "Just-in-Time" or "Six Sigma," and moving labor to cheap locations.

But either way, companies do need to make a choice. Those that stay in the middle, like the computer company DEC, suffer. They try to do everything and eventually their performance goes down.

**China Knowledge@Wharton:** Let's move on to talk about China. It seems some big Chinese companies are now looking at making the products to services leap – witness reports that Haier gave out copies of your book to their employees. So where is China in terms of this phenomenon?

**Young:** In China, there's an awareness-raising process that's just beginning. But I think what you see here in China is a government that is serious about understanding the different dynamics of the service business – what are the strategies, and how do you run it?

What they've done is to learn from the example of India. In 1998, India had 1% of the world market in service. And they managed to hold onto that despite the subsequent explosion in international service trade, growing at over 10% a year for much of the last decade. That was done through deliberate government policy to stimulate the service sector and encourage business people to get into the international export of services.

Similarly, the Chinese government announced over eighteen months ago that they are going to invest in their service sector. It's a massive investment, involving capital bailouts and tax breaks, covering everything from professional services though to IT outsourcing. And they are encouraging business leaders to become familiar with service business so that they can penetrate the international market in services in a very serious way.

I've been in Hong Kong and Singapore talking about this, and there are already people there helping business leaders in China to understand the dynamics of service development. What they are talking about seems to be similar to what the Japanese did twenty years ago: Start by exporting something that's cheap, and then gradually grow the quality in your export market and ravage those markets. You now have a number of Chinese manufacturing cities that are looking seriously at doing outsourcing on the world stage.

So I think what you are going to see over the next few years is the international export from China of cheap service. You can already see it in outsourcing, where there are already companies here who outsource the preparation of American tax forms. The same is going to happen in other markets.

**China Knowledge@Wharton:** Where do you see the opportunities for Chinese manufacturers to push into the service space?

**Young:** Companies operating in building facilities, office management products, IT and medical equipment are likely to see large service markets open up – not just abroad, but also at home. After all, the government's emphasis on services makes sense from the domestic angle, too. Manufacturing jobs were already starting to decline before the current recession, with people looking at other cheap labor markets like Vietnam.

At the same time, there's been a rise in the service economy. As the middle class has grown, they have started spending, yes, on things like consumer brands – but they also spend on services: things like leisure, health and transportation. And as consumers look for services, consumer product companies are also likely to take advantage of developing service markets and seek to give their customers new experiences. That is likely to affect markets from mobile phones to white goods.

**China Knowledge@Wharton:** Judging from your experience in this area, what sort of challenges do you think lie in wait for Chinese manufacturers trying to make the leap?

**Young:** Managerially, strategically and culturally, there is a learning process. One problem is that there are people here in China who still don't see service as something of value. The mindset can be, "If something goes wrong, it should have worked in the first place," rather

than, "There is value in providing a service to repair it."

People will have to learn how to run a service business effectively, and how to supply a service on the world market. They need to be aware that the way you market and sell a service is very different from a product. The same is true of operations – industrial services are especially complex and detailed. There are cultural issues to deal with as well.

**China Knowledge@Wharton:** What do you mean by cultural issues here?

**Young:** Cultural differences. If you provide products, they can be a factor. But they are a much bigger issue in services.

The fact is that people in different countries have very different expectations of service providers. In East coast America, for instance, it tends to be about speed. Quality of service in Sweden, on the other hand, is about fair mindedness, and doing things properly. In Britain, it's about being genuine: We don't mind you being late, so long as you're sincerely apologetic when you are!

The point is that if you put across a sort of bland, global ubiquitous nonsense you will lose out. People perceive it to be poor quality. So the key is to produce something that is customized to each culture – a cultural glove, if you like. You then put your fist – your volume, processes and detailed back office – inside that glove. HSBC has captured this very well in their advertising campaign about being the world's local bank.

I think people in Hong Kong and Singapore understand those cultural nuances, and have an opportunity to play an advisory role. They know how to deal with the idiosyncrasies of the Brits, New Yorkers and the French, and how to create the front end of massive international service offers. So I think we could see a reversal of what we've seen in the past, when Western firms have used those cities as a springboard into China. Things may start flowing back the other way.

**China Knowledge@Wharton:** What more can government do to smooth the way? If a Chinese policymaker enrolled in your Wharton course, what would you be suggesting?

**Young:** Well, I am a business man, not a politician, so that is not really my field. A few things come to mind, though. The first area where I think more could be done is to launch a policy initiative that educates business leaders about creating markets for the indigenous demand, and around the international opportunity. I think there has to be an education process that starts with business leaders, who need to learn about the value of the service, and how you get people to pay for service – what people in the West call "from free to fee."

Secondly, privatization. I know this can be a contentious issue in China, but there is no doubt that the privatizations which Prime Minister Thatcher initiated in Britain have had the effect of creating viable international service businesses in airlines, utilities and telecommunications. So privatization of large businesses would be something to look at.

A third thing is encouraging outsourcing among Chinese domestic firms. If you're a big business and you have within your organization things that are non-core, you probably have things in your value chain that are not performing so well. And when policymakers encourage outsourcing, they encourage the creation of services businesses that can then compete on the world stage.

Lastly, I would think it important to make capital available for international acquisitions and ventures abroad.

**China Knowledge@Wharton:** Do you see opportunities for acquisitions now?

**Young:** Yes, I think there are. To be frank, so many American and European companies have fouled up this move into services because they think it's easy, and have simply followed the pack. Right now in the West, there are companies that are publicly claiming to be successful service businesses that are in fact not earning the margins they should be.

McKinsey did a very detailed analysis on this, and found that a number of Western companies have done a bad job of it. It looks good on paper: they take the revenues that were for maintenance, customer training or advisory contracts, and make it look like they've got a lot of revenue from services. But they have failed to sort out their strategic focus properly, continued with their product push mentality, and become cheap suppliers of advice. In the end, their margins have gone down, and some have yet to make a profit there. That means they're struggling, which would make them acquisition targets.

**China Knowledge@Wharton:** Looking at the longer term, how do you rate Chinese companies' chances in the global services market place? How big a challenge will they pose to their established Western peers?

**Young:** As I said, the awareness raising process is just beginning in China. But those Western companies' failure is an opportunity for Chinese companies. So, within ten years I think there is a serious threat to some Western service markets from the firms in China. I could be wrong, but I don't think Western companies have got long to sort themselves out before this threat becomes real.

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