

STRATEGY

When moving into the services market, strategic intent becomes a key business imperative. Only by clarifying the purpose of their services businesses can leaders ensure that they are positioned to make good profits and compete successfully.

By Laurie Young



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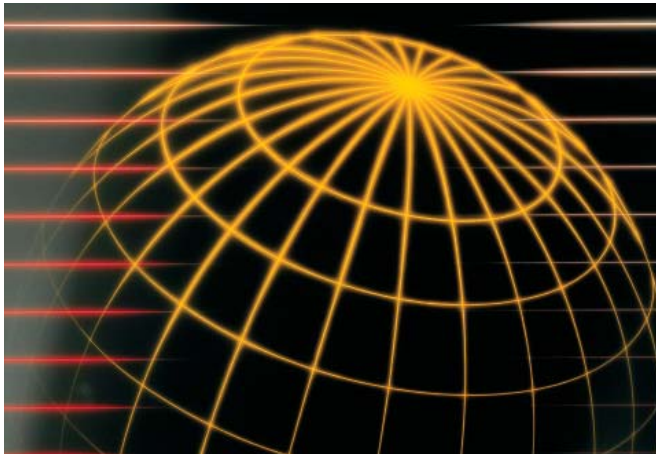
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While many of the famous moves into service have been led by top management (IBM and GE, for instance), a surprisingly large number have taken place in response to lobbying from middle management. Some, too, have occurred as a result of an unstructured response to opportunistic projects developing naturally in the market. Consequently, a process of osmosis has driven many firms further and further into service markets, with the momentum eventually tipping them fully into the services business.



**Avoiding the
Strategy**

**Black
Hole**



Such an evolution is more normal and healthy than it is generally acknowledged to be. A number of successful strategies trumpeted at shareholder meetings or in the press are actually post hoc rationalizations of middle-management experimentation. But services businesses are very different from product companies and therefore are risky for a manufacturer to move into. For instance, there is evidence that the service arms of many technology companies have performed poorly when they have moved away from familiar work. In fact, while many now claim to be services providers with a large percentage of services revenue, they hide shaky profits and sunken costs, which can become a black hole for shareholder funds.

Leaders should step back and properly assess the strategic implications of this change to which they have become committed. They then should decide whether to validate, invest in, or even withdraw from these fledgling businesses. In short, they need a realistic service strategy.

The Value of Strategy

Good strategy is a framework of ideas developed by the leadership of a company that creates a common purpose. It involves making decisions about direction, communicating those decisions, and allocating the resources to make them possible.

Unfortunately some business leaders tend not to invest much time in strategy because their focus has been short-term and needs-driven. Yet, whatever the size and shape of the company, business leaders must take time to consider the future health of their business and how they go to market. They need to focus on the strategic imperatives relevant at any one time and allocate resources appropriately to chart the next steps of the organization. This can be done in a style and manner geared to the culture of the firm and the judg-

ment of the leadership—and it can be done quickly. It can be elaborate, planned, and documented, or intuitive and iterative. But it should be done.

The Need for Clarity of Purpose

It is surprising how many product companies have wandered into offering competitive services without completing, at any level in their organization, a proper evaluation of the costs, risks, and competencies involved. In fact, some of these initiatives start as “skunk” works, hidden from skeptical senior people until sufficient revenue has accumulated. As a result, services businesses within manufacturing companies are often confused about their purpose. They suffer seemingly irresolvable tensions with other parts of their own firm. For example, they might be asked to grow revenue but have the price of their skills discounted by a sales force intent on selling products. As a result, service units that were very profitable when supporting the company’s products can lose margin and erode profits when used as a springboard into more directly competitive services markets.

Moreover, most of these changes have occurred in industries where there has been a boom in service needs or where there have been large margins due to inefficiencies in the market. This has allowed novices to learn the dynamics of the new business and to survive internal conflict or profound mistakes. It has hidden or compensated for tensions, depressed margins, and errors. For instance, one senior vice president of a major firm recently accounted that it took them 10 years to learn how to do outsourcing properly, and that profits suffered until they did.

A number of these markets have now tightened. They also face unprecedented competition from countries like India with increasingly better quality, cheaper offers, and the intent to do in international service markets what the Japanese did in international product markets two decades ago. Many American and European firms simply are not ready for this type of competition. They now must address fundamental strategic issues that would have best been resolved when they first embarked on an ambitious service strategy. These issues include pricing, discount controls, channel conflict, and market position.

For instance, several technology firms have adopted the ubiquitous “solutions selling” approach in order to customize their offers around the needs of their buyers and to be less product-orientated. However, those that have not invested in the associated mass-customization processes or technologies have lost out. Others have undermined their margins

with this approach by not putting in place discount controls on services or competitor products. Whenever a project includes more items than their own products, salespeople tend to discount these items, reducing profit.

The resolution of all of these issues can be directed by clearly identifying the focus of the business; its “strategic intent.” This is much more than a few words in a bland statement. Strategic intent is the *raison d’etre*; the overriding purpose of a business. It gives direction to the management team and all operational decisions, avoiding extraneous activities and unnecessary costs. Clarifying the strategic intent of a service business leads naturally to the coproduction of services with customers, investment in technology, industrialization of erratic service components, productivity improvement, and the setting of buyers’ expectations.

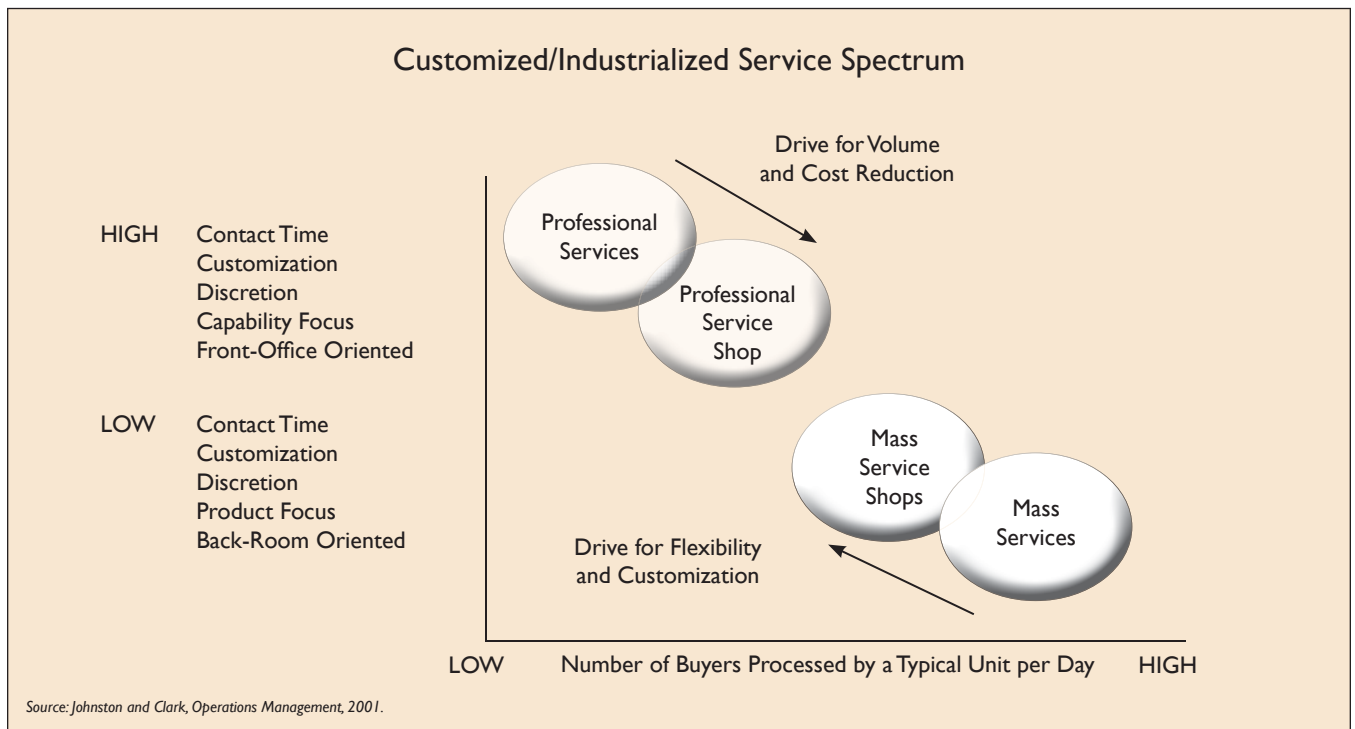
Only by clarifying the purpose of their services businesses can leaders ensure that they are positioned to make good profits and compete successfully. This might lead to the creation of several different services businesses in different markets, a spate of acquisitions, or at the other extreme, withdrawal from some markets. By clarifying the strategic intent of the new services business, the leaders are more likely to be successful in their move from products to services.

Clarifying the “Service Concept”

A critical step in deciding the strategic focus of a service business is to clarify the “service concept” that it is to offer. This is a shared understanding of the nature of the service; the organizing idea. It defines the service experience, the service outcome, the service operations, and the value proposition. The business must decide where its competence lies and which form of service maximizes those skills to ensure healthy margins. It might focus on high-end, customized professional services or more process-based advisory work, volume-driven process services, or pure aftercare. But it must decide.

Figure 1 illustrates this decision. Professional services range from high-end customized services (at the top left of the figure) to the more process-based offers in the “professional service shop.” Volume-based services, on the other hand, occupy the bottom right of the figure. Many of these are trying to customize their offering in order to give their buyers a more individualized service and to improve perception. They are trying to become “mass service shops.” Each of these business types has its own dynamics and success criteria. The margins, approach to market, degree of engagement with buyers, and personnel used vary enormously between these vastly different offerings. Suppliers must be

Figure 1



Avoiding the Strategy Black Hole

clear about their business models if they are to maximize profit and survive over the long term.

The strategic significance of this to new entrants (particularly product companies entering service markets) is the fact that different offers suit different firms. A high-end strategy firm like McKinsey might specialize in unique customized approaches, whereas one of the IT-based management consultancies, such as Accenture, might be better suited to more volume, process-based offers. Each service business, particularly a new entrant, needs a clear view of the service

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concept that is appropriate to their competence if they are to thrive. They cannot please customers with unique, customized professional advice (based on non-replicable expertise) while at the same time trying to replicate everything in industrialized services packages.

Methods of Determining the Strategic Focus

There are several concepts that have helped leaders, whether they are in charge of one service business or responsible for a large business with multiple service units. When used to resolve the overriding intention of a business, they are probably interchangeable. Of overriding importance, though, is the achievement of clarity. Whether leaders use the experience curve, value chain analysis, core competence, a mission statement, or a statement of strategic intent, there comes a time when the developing business must have clarity in order to thrive.

Purists would argue (probably correctly) that each of these concepts is complex and serves different functions. Some would suggest that a large business developing a well-rounded strategy should cover them all. For the busy business leader, though, any one can be used as a banner to rally the business around one clear purpose. In tightening markets, this in itself will improve performance. It is more important to create a sense of mission than, for example, to create a neatly composed, bland mission statement.

Probably the most useful and well-worked conceptual tool for this conundrum is the experience curve, pioneered by Boston Consulting Group during the early 1960s. It shows that, in the area of its prime focus, the unit costs of a business fall with experience of operating in an industry and

with cumulative volume of production. The consultancy invested in substantial research and used “the scientific method” to validate the concept. Although appearing deceptively simple, and intuitively right, the concept (see *Figure 2*) is still used in manufacturing companies to set cost targets, based on a projection of the curve for each business.

A manufacturer moving into a service market should identify the prime operations of the proposed service business and concentrate management’s attention on gaining productivity in these areas. This will consolidate its posi-

tion in the market. Targets for future cost gains can be set by projecting the developing experience curve. The leaders should also be clear about the “experience” and cost base of established competitors and how the new business will gain a foothold against their existing advantages.

Getting It Crystal Clear

The result of this strategy work should be clarity about the nature of each services business. Is it supporting equipment or not? Is it a scaleable, process-based service or a high-

Figure 2

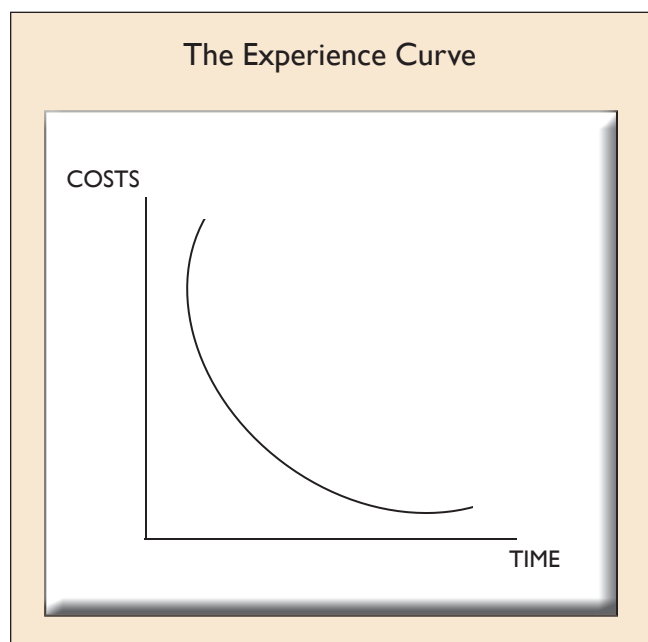
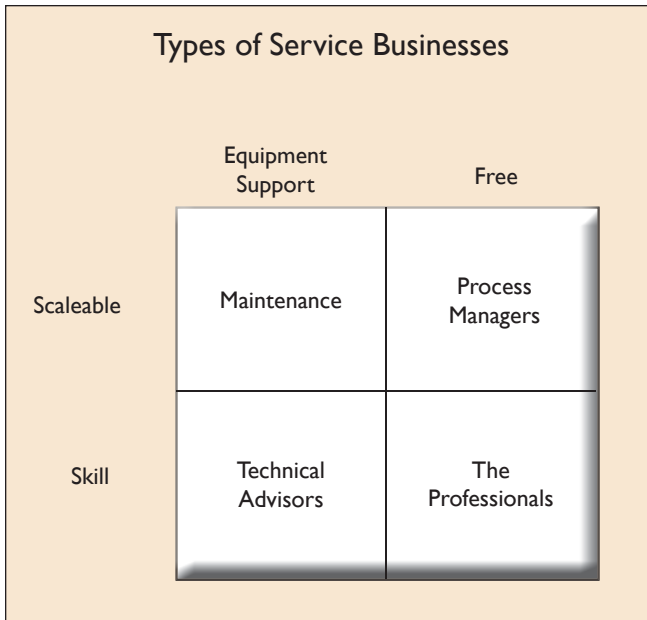


Figure 3



margin professional service? A representation of these different forces, which is an adaptation of a McKinsey model,¹ is shown in *Figure 3*. Debate among the leaders of a firm

about where each service unit fits on these axes of different success criteria will uncover whether there really is clarity of purpose.

Businesses in many different parts of the developed economies have created services offers. These range from maintenance and process-based support to systems integration and solutions sales to high-end professional services or financial offers. They can be more profitable than the commoditized products that their owners produce, but they also can lose massive amounts of money due to disorganized management and foggy strategic thinking. Product companies moving into services businesses must understand the different success criteria in these different businesses. If not, as newcomers to the service economy, they will struggle to make real returns once markets tighten or efficient competition arrives. Despite modern skepticism of strategic tools or analytical approaches, they should clarify the strategic intent of their services businesses, either investing in or withdrawing from opportunities.

Note:

1. See Auguste, Harmon, and Pandit. *McKinsey Quarterly* 2006.

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