



# Turning service into a growth engine

By C. Edwin Starr, David J. Standridge and Brian M. Sprague

There is substantial shareholder value hidden in servicing products after they are sold. In fact, over time, service may actually contribute more to earnings than sales do. Here's how it's done.

For companies caught up in the excitement and stress of making and selling a new product, it's probably a stretch to think ahead to that time in the future when their innovation will be a commodity. However, in most instances, that time will come.

So what can a company do to grow its revenues and margins as the product moves from hot new item to one of many look-alikes on the shelf? Turn the services that keep the product functioning into a growth engine.

Many companies regard servicing the product as little more than a distraction. From that perspective, service is only a cost, and the best contribution it can make to the bottom line is to go away, or at least shrink. We are convinced that quite the contrary is true—that service can add substantially to shareholder value. In fact, over time, service may actually contribute more to earnings than sales of the product do.

Turning service into a growing profit center requires a shift in focus. Everything a company provides after the sale—spare parts replacement, professional services,



help desks, warehousing, product recalls, field technicians and the rest—needs to be managed as an integrated whole.

Indeed, we have found that a company that institutes a first-rate service management capability can increase its service revenues by between 10 percent and 20 percent. Moreover, by making its service functions more efficient, a company can reduce operating expenses by 15 percent to 30 percent.

Finally, the knowledge gained by the service organization, which is in constant contact with the company's customers, can be fed back into the manufacturing organization to help it make better products. Better products translate into a 10 percent to 20 percent reduction in warranty expenses. In addition, because there will be fewer faulty products sold, the company will not need to field-test as much equipment, which can help reduce capital expenditures by anywhere from 10 percent to 25 percent.

Many manufacturing companies have benefited already by rigorously and thoughtfully developing their service potential. At General Motors Corporation, for example, post-sale parts and services account for a small portion of revenues, but they provide superior profit margins.

An Accenture study of the auto industry a few years ago revealed that sales of \$9 billion in parts and services contributed \$2 billion in profits at GM. By comparison, car sales of \$150 billion produced earnings of just \$1 billion for the company. In contrast, electronics and high-tech companies have been, by and large, somewhat slower in reaping the rewards of service management. That is largely because historically, they have concentrated on creating innovative products rather than on providing service.

So how do companies transform themselves to take advantage of the bottom-line-enhancing potential of service offerings? A manufacturer must evolve into a company that sells not simply products, or even products plus various services. It must sell solutions. To reach that goal, a company typically will pass through four stages of development.

**Stage I: Products.** The organization focuses solely on product development, engineering, manufacturing, and sales and marketing.

**Stage II: Products plus.** The organization offers some support services, but they are focused primarily on basic "break-fix" maintenance.

**Stage III: Services.** The organization moves to provide a larger portfolio of service offerings. In most cases, a separate service organization is created with a separate profit-and-

loss statement, and the product and service organizations operate independently of each other.

**Stage IV: Solutions.** In this stage, product and service capabilities are tightly integrated. The organization works to develop and sell a package of products and services to meet customer needs. Generally, as the product becomes a commodity, its gross margins slide from between 60 percent and 70 percent to about 20 percent. Gross margins for services typically range from 20 percent for simple break-fix services to 45 percent for higher-value-added services like technology enhancement or professional support.

As the product margins fall, the service margins no longer dilute overall earnings. The total margin of product and service combined should remain in the 30 percent to 40 percent range—not as heady as those 60 percent to 70 percent margins the company enjoyed when the product was the industry sensation, but far better than the 20 percent that seemed to be the product's destiny when it eventually lost its unique position in the marketplace.

All this, of course, is far easier said than done. Indeed, the passage is difficult and becomes more so the higher the stage. Most companies we have worked with have made a successful transition from Stage I to Stage II. Some have reached Stage III. The climb to Stage IV is steep and slippery—but very rewarding.

There is no clear roadmap for reaching the summit of Stage IV. The best route will vary considerably from company to company, as will the time the journey will take. But we can offer some basic principles to keep in mind, as well as some intermediate goals to guide you along the

way. Even in the earliest stages, it is wise to begin thinking about what will be needed to reach Stage IV.

### Share customer information

Each department within the company—engineering, sales and service—has an enormous and valuable store of information about customers, including what products they have bought, what problems they have had and what they are likely to buy in the future.

This information could constitute an invaluable portrait of the customer. Unfortunately, it is almost never brought together and shared. Each department works from its own information platform and rarely knows about interaction between the customer and other parts of the company.

The result can be disastrous. Imagine that you are a software provider, and the CIO of a customer company calls your service department with a serious problem. Maybe a glitch in your software is playing havoc with his websites, and his company's online sales operation is paralyzed as a result. On the same day, one of your salespeople, unaware of the problem, calls the CIO in an attempt to sell him some additional software. The CIO assumes the call is to respond to his request for help. When he realizes it's actually a sales call, he becomes furious. He's under pressure to fix a problem caused by your troubled system, and all you care about is another sale—or so it looks from his perspective. A customer relationship of many years could collapse.

If, on the other hand, the salesperson were able to access a single portal on his computer and get an immediate

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update of all interactions with the customer, he would be aware of the service trouble and be better prepared to provide solutions. He could call the CIO, outline the steps being taken to resolve the problem and, in the same spirit of wanting to help, suggest ideas on new software that may be of tremendous value to the company, or perhaps offer to arrange a training course on the software's advanced applications.

By pooling all of the customer information in your company, not only do you reduce the risk of offending customers, you open up opportunities to establish stronger relationships that dramatically facilitate selling additional products and services.

### Reward service people

In many “product-centric” companies, the service department is the homely stepchild of the organization. New hires may take positions in the service department to learn how the product works—and once they do, they transfer into engineering, the “core” of the company. Similarly, some sales trainees start by selling services while waiting for an opening in product sales, where the prestige and big money are. Service employees sometimes have difficulty seeing themselves as revenue producers who can boost the company's profit margins.

The first step toward changing that attitude is to put a senior executive in charge of the service organization. That may require hiring an outsider with deep service experience, because many executives in product-focused companies lack the mindset to develop service into a growing profit center. This senior executive will be responsible for hiring and training employees who

view service as a vital, revenue-producing function for the company, and who consider service a career, not a place to wait for an opening in the product side of the business.

Service employees must know that they are critical to the company's future—that customer satisfaction and future service and product sales are dependent upon their actions. Customer satisfaction ratings are a common metric within service organizations, but the firm that strives to be a leading service provider must instill the behaviors and incentives to move beyond that metric and establish the mindset of superior service. Other basic metrics—for example, mean time to repair, cost per incident and profitability per service contract—should be tracked as well.

Service personnel must be well trained and properly rewarded, and there should be specific metrics that determine a portion of their total compensation. An Accenture study of customer relationship management capabilities determined that fairly compensating and rewarding service personnel was one of the top five factors affecting return on sales.

### Invest in technician productivity

The faster the customer's equipment is back in working order, the happier the customer will be, and the sooner the technician can move on to the next job. But in most companies, the technicians keep tripping over obstacles. Say the customer assumes he is using one version of the product but is actually using another. So the technician brings the wrong parts. Or technician Johnson starts to work on the repair, but after six hours—before the job is completed—he has to leave. Technician Franklin, who relieves

him, has no idea where Johnson left off and, consequently, repeats a lot of Johnson's work.

What Johnson, Franklin and the other technicians need is the help of diagnostic equipment that electronically links them to the customer's equipment. Technicians will know before they leave on a service call precisely which product model the customer is using, what the nature of the problem is, what solutions exist and that the part most likely to be required is already on the truck and reserved for this job.

Xerox Corporation has installed diagnostic capabilities in many of its copiers that signal the manufacturer when a part is nearing the end of its lifetime—before a problem is visible to the customer. In addition, there is so much “processing capability” in the equipment that the machine can record critical data, such as meter reads for billing purposes, and automatically send it to the manufacturer—eliminating this step for the technician and the customer.

As technician Johnson works on the repair job, the diagnostic equipment will automatically record everything he does, so when technician Franklin's shift begins, he will know just where to pick up. This level of service will give customers plenty of incentive to stay—and little reason to move to a competitor. (For a related article, see page 34.)

Diagnostic equipment is expensive, because it is generally part of a one-of-a-kind system. Training and retraining technicians to keep up with changing product models is costly as well. But because technicians and the rest of the service staff are both the most consistent link between the

manufacturer and the customer and an excellent source of continued revenues, the return on investment is high.

### Manage customer interaction

Companies should measure all the margins—beginning with the sale of the product and continuing through service interactions. With those measurements in mind, they should manage relations with the customer through the entire lifecycle of the product and the support it requires.

Sending a technician on a repair job is costly. But telephone support in which a customer actually speaks with a technician is expensive as well. The cost can range from \$10 to \$20 per call, so for a manufacturer who receives thousands of calls a week, phone support becomes a significant expense. One simple way a company can reduce the volume of interactive phone calls and simultaneously improve customer satisfaction is by offering self-service training. An effective approach is to encourage customers to call in to an hour-long audio seminar that is conducted every couple of weeks. Customers can listen to discussions on how to make the best use of the product and resolve its most frequent service issues.

The seminar not only helps customers use the product effectively but also leads them to buy additional training courses or product upgrades, thus expanding revenues. Siebel Systems, a leading provider of e-business application software, has used this technique successfully as one element in a broad education program for users.

Leading firms provide customer self-service and predictive maintenance to eliminate service breakdowns. When a problem does occur, often

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BEA Systems, a leading application infrastructure software company, offers such a capability. Customers can access BEA's personalized service system, view the top 10 queries and, using natural language tools, search a variety of knowledge bases to resolve issues. If they are unable to find the answer to their query, customers can easily open a service request, provide updates to the technician working their case and view the service request status, all online in real time. To be sure, BEA's customers are, for the most part, technical people who feel comfortable seeking solutions online. But self-service systems have been devised for customers who are less technically adept as well.

### Integrate materials and service operations

Manufacturing companies are often run with a singular focus on engineering. They make the product and the spare parts, but they don't give much thought to bringing the spare parts and the customers together quickly and efficiently.

One exception is Caterpillar, the world's largest maker of mining and construction equipment, diesel and natural gas engines, and industrial gas turbines. The company has done an exceptional job of satisfying customer needs with a program that delivers a spare part within 48 hours of the customer's call—or the customer gets the part free. Caterpillar's investment in a system that makes hundreds of thousands of parts available on short notice was expensive, but the edge it has given the company over its rivals is enormous.

Carmaker Saturn Corporation has initiated a distinctive program to keep its dealers stocked with the parts they are most likely to need—and not a lot of excess that is apt to stay on the shelves. Traditionally, automobile manufacturers let dealers decide what to hold in their inventories. Some dealers are expert at calculating their needs, but many more are not. So when GM founded Saturn in 1985, the new manufacturer informed dealers that Saturn would strongly advise them on what parts to stock.

Saturn's service system goes even further. Dealer Smith, who is based in, say, one neighborhood of St. Louis, must help out dealer Jones, from another part of town, if Jones is short a part. As a consequence of the Saturn plan, dealers' inventory costs are, on average, only half those of dealers of other auto manufacturers.

### Bundle products and services

In the highly competitive jet engine business, manufacturers such as GE Aircraft Engines, Pratt & Whitney, Rolls-Royce and Honeywell Aerospace realized years ago that the value of servicing a product over its life can exceed the original sales price by as much as five times. The manufacturers developed innovative concepts to lock in lucrative single-source service deals. Instead of selling engines, spare parts and service labor along with long-term financing deals, the manufacturers sell "propulsion" service.

The manufacturer takes care of the engine for its lifetime, and the airline pays the manufacturer for the time the engine is in use. These power-by-the-hour contracts have challenged conventional business

thinking about the high-margin spare parts business. Suddenly, selling more spare parts is no longer the way to optimize margins. Instead, the emphasis is on designing engines for the lowest lifecycle cost of service, for accessibility and ease of rapid maintenance, and for information-processing techniques that predict engine failure.

Companies in other sectors have begun looking into similar shifts in emphasis. Manufacturers of everything from semiconductor fabrication equipment to complex construction and mining products are considering the value proposition that can be offered by making service an integral element of the product; some are even contemplating emphasizing service in the sales proposition.

Increasingly, leaders in their industries will recognize that it is not enough to manufacture a superb product. A product can no longer be considered distinct from everything that is required to keep it functioning throughout its lifetime. Those who build a strong service management capability will establish service as a differentiator. Service will help tip the scales during future product sales, increase customer satisfaction and provide higher margins, even during difficult economic times. ■

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