FROM FIXED FEE TO FIXATING ON PROFIT

The new financial fundamentals of ‘Everything-as-a-Service’
WHY MAKE THE MOVE?

From phones to planes and photocopiers, manufacturers are discarding the business of selling and repairing products in favor of a model that focuses on guaranteeing the availability of those products and their embedded software. These companies are seizing upon the promises of digital technologies and new customer insights to deliver “everything” as a service. But, could moving to Everything-as-a-Service also mean putting everything at risk? If, as part of their service transformation, businesses do not make fundamental changes in their existing financial structures, many may be doing just that.

For product-based companies, moving to Everything-as-a-Service is a decisive shift away from age-old, very profitable aftermarket business models based on selling parts and one-off repairs. Given that, in industries such as aerospace, median margins from spare parts can be in the range of 40 percent, the decision to move to Everything-as-a-Service is not a simple one. Yet, that profitability, and its cost of goods to manufacturers, can be unpredictable and “lumpy.” Increasing the sustainability and predictability of aftermarket revenues and profits has always been a goal for companies that obtain a significant share of their revenue and profit from the aftermarket. Shifting to as-a-Service models provides that opportunity.

Manufacturers identified great promise in Everything-as-a-Service based on the financial results software companies demonstrated during that industry’s shift to services in the early 2010s. Comparing the performance of pure Software-as-a-Service (SaaS) companies, built on the power of new digital technologies and platforms, against their more traditional, on-premise software counterparts, Accenture has found that pure-play SaaS companies significantly outperformed across key financial metrics.

PROOF POINT FOR MANUFACTURERS: WHEN THE TIDE TURNED TOWARD SaaS

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<th>TRADITIONAL SOFTWARE</th>
<th>VS. PURE PLAY SAAS</th>
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<tbody>
<tr>
<td>YoY Revenue Growth (2014)</td>
<td>4%</td>
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<tr>
<td>3-Year Average Annual Return to Shareholders (2011-2014)</td>
<td>13%</td>
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<tr>
<td>3-Year Revenue CAGR (2011-2014)</td>
<td>6%</td>
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Figure 1. Software Licensure Model vs SaaS (Source: Capital IQ, Accenture Research)
WHAT DOES IT MEAN?

Looking across industries, the move to as-a-Service can take many forms: a fixed fee for a given number of MRI scans, a given fee structure for a set number of aircraft landings, a promise to provide a guaranteed amount of uptime for a server farm or wafer fab. In all of these cases, manufacturers have made a connection between their enterprise value and the value that their products provide to their customers. And it is here where product companies moving to services may not be fully capturing the benefits of the shift to Everything-as-a-Service.

The shift to Everything-as-a-Service changes the aftermarket business model as shown below:

**FROM**

- **“ONE-OFF” SALES OF PARTS AND REPAIR**
- **HIGH MARGIN INDIVIDUAL, “LUMPY” SALES AND REVENUE**
- **LOOSE LINKAGE OF AFTERMARKET AND ORIGINAL SALE**

**TO**

- **Viewing parts and service events in the context of the asset lifetime and value**
- **Slightly lower margin, predictable revenue**
- **Coupling or bundling of product and service**

**REQUIRES**

- Higher need to predict and execute service events and part planning holistically
- Greater emphasis on predictable, accurate invoicing and collection
- Increased need to measure manage long and short-term contract performance

A failure to address these requirements creates distinct risks to long-term financial performance as shown below:

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<th>FAILURE TO:</th>
<th>LEADS TO:</th>
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<tr>
<td>Predict demand and execute parts and service fulfillment holistically</td>
<td>Failure to meet promised service levels that threatens customer retention</td>
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<tr>
<td>Consistently invoice and collect</td>
<td>Failure to meet internal and market expectations of predictable cash flow and income generation</td>
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<tr>
<td>Measure short and long-term contract performance</td>
<td>Failure to fully understand contract cost and profitability, putting margin targets and market confidence at risk</td>
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Despite these risks, many companies that have embarked on an as-a-Service journey are still operating with financial capabilities that are better suited to managing purchase orders and invoices for discrete repair events. And while the discrete activities along the service chain in many ways remain the same, the fact that they are now taking place within a long-term contract changes everything.
Accenture identified three steps that companies need to take to maximize the financial results of their shift to Everything-as-a-Service: improve the predictability of part and service demand; increase visibility into cost and collections; and center the business on contracts.

Figure 2: Elements of Financial Health in as-a-Service
IMPROVE THE PREDICTABILITY OF PART AND SERVICE DEMAND

Product companies have long invested in understanding the potential demand for parts and for service events such as repairs and overhauls. However, these two demand streams have often been kept at arms’ length in separate plans, financial statements and organizations. In a transaction-driven world, this approach largely worked. Parts and services had their own demand stream, each was its own profit and loss, and when they intersected, services could be treated as a “customer” of parts.

But, things change dramatically when parts and service events are delivered together as part of a single promised customer outcome that is its own contract and has its own targets for cost, revenue and profitability. Meeting those targets depends upon carrying out the right service events at the right time, with the right parts to satisfy both promised service levels and internally promised financials. Continued separation of part and service demand reduces the predictability of demand for total services and can lead to increased working capital and lower performance to customer-demanded service levels.

Enabling predictability of demand

FOUNDATIONAL
- Agreed profit and loss structure and contribution for parts and service to Everything-as-a-Service offerings
- Joint demand planning process for spare parts and service across multiple time fences

PROGRESSIVE
- Parts pricing optimization for individual sales and sales within as-a-Service
- Using analytics to strengthen the planning process and provide “what-if” capabilities

LEADING
- Full incorporation of quality and engineering into predictability modeling
- Predictive demand signals from IoT-enabled devices

IMPROVE VISIBILITY INTO COST AND COLLECTION

Everything-as-a-Service is attractive because it creates more predictable revenue, allowing providers to increase profitability by focusing on managing cost. Yet, many companies may not have effective mechanisms in place to create the visibility to cost required to meet this goal. Legacy business models built around selling parts and repair events may understand cost per part or have high-level estimates for repair event cost, but lack the detailed activity-level understanding of cost required to gain insights into the true cost of service delivery.

While managing receivables is important to any business, it is absolutely foundational to Everything-as-a-Service providers. In a business built on predictability of cash flow, it becomes increasingly important to reduce inaccuracies and delays in the invoicing process. Increasingly, service providers are seeking to bring the asset closer to the invoice, triggering payment based on a highly accurate understanding of how, when, and to what extent an asset is being used.

Enabling visibility to cost and collections

FOUNDATIONAL
- Standard costing defined for the elements of Everything-as-a-Service (labor, parts, repair, etc.)
- Cost centers and profit centers to accurately reflect the shift to service-driven business
- Common processes in place for invoicing and collections for services

PROGRESSIVE
- Use of analytics to shift from estimating to understanding “true cost” of service delivery
- Incorporating asset data to increase accuracy of when to bill based on contract terms
- Clear understanding of service accounts receivable cycle and where to improve
- Analytics exist to model external costs such as warranty

LEADING
- Cash flow forecasting in place across a wide variety of contract payment terms (e.g. milestone, delivery, etc.)
- “Should cost” modeling of service contract elements
- Highly automated billing and collections driven by accurate usage data
PUTTING THE CONTRACT AT THE CENTER

Long-term service agreements start with a contract that defines service levels, degree of asset availability, pricing and other aspects of service delivery. Each step in service delivery—from deciding whether to use a new or used part in a repair, to how often an asset should be overhauled—can be tied to the service contract. Yet, too often, contracts are signed and kept separate from the processes and systems that are used to support Everything-as-a-Service.

But, with an Everything-as-a-Service model, contracts can no longer be simply pieces of paper to be signed and filed. They must be tightly integrated into the process of estimating and delivering on contract outcomes. Margins estimated during the sales process must be tracked, modeled and supported during contract execution. Terms and service levels promised in contracts must be embedded in the decision-making process for contract execution. This will likely require significant changes for many companies such as more rigorous contract estimating at complete processes, digitally representing contracts in both sales and service execution systems, and providing detailed analytics to understand performance to promised contract financials.

Enabling contract management

**FOUNDATIONAL**
- An end-to-end "contract thread" to manage service contracts from negotiation, through sale, delivery and renewal
- A defined set of standard offerings that can be combined to provide customer-specific service contracts

**PROGRESSIVE**
- Contract execution and financial requirements are managed in core systems such as ERP and CRM
- Processes and analytics are in place to model contract estimate at complete

**LEADING**
- Modeling of new contracts and contract scenarios to understand potential outcomes
Companies in high technology and aerospace are quickly moving to adopt as-a-Service business models in order to capture longer lasting and more predictable revenue streams. While many of these companies have well-developed spare parts and repair networks, their ability to capture the benefits of Everything-as-a-Service may well rest on how they address changes in capturing revenue, understanding cost and managing profitability of service contracts. New services and products can capture customers’ attention and secure loyalty. But, without new capabilities in cost, revenue and contract management, companies will struggle to translate that attention and loyalty into profitability.
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