How to Develop Profitable Services

While 50% of some manufacturing companies’ revenue comes from services, other companies are struggling—and even failing—to turn a profit from their service businesses. Following three years of research, Wolfgang Ulaga has developed a four-step process that guarantees service profitability for companies.

Based on an interview with Wolfgang Ulaga and his article “How to Sell Services More Profitably”** (Harvard Business Review, 2008).

Many western manufacturing companies are having to differentiate themselves because they’re facing stiff competition in the commodities market. Turning to product-related services and solutions could be regarded as a purely defensive reaction. But Wolfgang Ulaga believes developing these value-added services provides companies with opportunities for growth. Services are also a powerful way to achieve ‘customer lock-in’, by using what the professor describes as a Trojan horse approach, i.e. entering into a customer’s business and gradually extending the offering. But for every success story, at least five companies struggle to turn a profit from their service businesses. The HEC professor doesn’t think it’s particularly easy for companies to move into services: they need to adapt to meet completely new demands and this requires them to acquire skills that they don’t necessarily have. Wolfgang Ulaga has therefore identified four key steps that companies must follow on the path to service profitability.

ARE YOU ALREADY A SERVICE COMPANY?
‘What’s interesting is that many product companies are already in the business of delivering services but are missing out on the revenues they could generate,’ explains Wolfgang Ulaga. Selling a machine implies that the company can install and repair it. This represents huge, immediate, and untapped potential. Companies must first analyze what services they already provide. An audit of existing services provided by the company’s divisions and international subsidiaries is a prerequisite for uncovering profitable existing service offerings. The best method is to task a senior executive with the job of switching services from free to fee, i.e. charging for services that previously were free. That’s what Air Liquide did in the mid-1990s when it decided to charge a rental fee of 5 to 7 euros per cylinder per month—a generated several hundred million euros a year in fees.

INDUSTRIALIZE THE BACK OFFICE
What are the visible and hidden costs of service production and delivery processes? The second step consists of identifying the costs in order to differentiate the most profitable services from loss-making services. Wolfgang Ulaga has identified companies with well-developed, tailor-made service offerings that are very costly and not at all profitable. ‘There has to be a balance between the personalization and standardization of the service offering,’ he says. This involves building flexible service platforms and exploiting process innovations made possible by new technologies. The world’s leading bearings manufacturer SKF is a successful service provider—the company provides customers with access to an electronic monitoring tool via a secure Internet browser that alerts them about potential machine failure.

CAREER
Wolfgang Ulaga is an associate professor at HEC School of Management (Paris), where he teaches Marketing Management and Business-to-Business Marketing. In addition, he designs and delivers customized executive programmes to companies. Before starting his career in academia, Dr. Ulaga worked in Frankfurt and Paris as a consultant for DML & Associés, an international management consulting firm.
CREATE A SERVICE-SAVVY SALES FORCE

A sales force with wide experience in the company’s businesses can incorporate simple services into its traditional sales approach. But if companies move into more complex value-added customer solutions, the sales force can no longer handle both product and service sales. These new services require longer sales cycles, and the sales force often needs to talk to people higher up in the customer’s hierarchy. Product salespeople have neither the right profile, training, nor the right motivation to deal with such a situation. And they’re often hostile to change. So what are the solutions? Intensive training, hiring new salespeople, and restructuring the sales force to refocus skills—salespeople who establish relationships with customers and sell services over time—in specialized areas. Some of the companies studied have replaced 80% of their existing sales forces. It’s often necessary to hire specialists. Air Liquide, for example, hired several agri-food engineers to develop sales expertise for services in food processing industries across Europe.

FOCUS ON CUSTOMERS’ PROCESSES

The last step concerns the sale of complex solutions. When a company supplies an industrial customer with gas cylinders, it doesn’t need to have detailed knowledge of the company’s operations and structure. But when companies need to adopt a holistic approach to solving the customers’ problems, such information is required. This is when companies quickly become aware of the need to acquire new skills, internally or through external means. The industrial-coatings specialist PPG had to learn how painting robots function before taking over the paint shop in Fiat’s Torino automotive plant.

CONCLUSION: DEVELOPING SERVICES BOOSTS GROWTH

This four-step process ensures that companies don’t get their fingers burnt when developing profitable service businesses. The researcher believes ‘it is in companies’ strategic interests to develop services. In the last few years, especially in Europe, services have provided many industrial groups with major growth opportunities.’ Thyssen-Krupp, which was on the point of abandoning services at the beginning of the new millennium, has now made services the spearhead of its strategy. Following this dramatic reversal of policy, Thyssen-Krupp Services AG is now one of the Group’s most profitable divisions. Having completed this qualitative study, Wolfgang Ulaga is now conducting a benchmarking study of the best practices of 300 managers responsible for services and solutions in the industrial sector. The HEC Foundation is financing the study and the results are expected at the end of 2008.


RESEARCH METHODOLOGY

Struck by the diversity of the messages from firms on the profitability of their services, Wolfgang Ulaga focused his research on the development of services in industrial companies from 2006 to 2008. The first stage in the research consisted of a pilot study of an industrial group. He interviewed departmental managers in different business units and countries. He then conducted in-depth studies of twenty leading industrial companies. This consisted of interviews with managing directors, executive board members, directors of strategy, and sales and marketing directors.