

Growing B2B Services: Three Trends To Act Upon Now

By Jeneanne Rae, Carl Fudge, and Colin Hudson

INTRODUCTION

Many large corporations have struggled to think of themselves as anything other than product manufacturers, a mentality that has been ingrained over decades of manufacturing, branding and selling physical objects. While the mindset of “this is what we do” is understandable, the companies that have broken out of this mental box and made the leap into services have created value for their customers and contributed to the bottom line in equal measures.

This article highlights three emerging yet robust trends that illustrate how innovative product companies are successfully developing new services, and provides guidance around how to identify similar opportunities in your organization. The three big trends that we discuss are offerings that drive productivity, provide access to new customers, and foster engagement. We illustrate each trend with examples from traditionally product-centric companies that have successfully entered the services arena.

THE MIGRATION TO SERVICES

There is a strong business case for manufacturing companies to create new services: not only can services deliver profitable growth, but they can also provide superior strategic positioning.

The biggest reason that companies introduce new services is because of the potential for new revenue streams. Whereas rolling out new products through line extensions and other marketing tactics can

cannibalize sales of core products, as is the case with each new Apple iPod launch, new services create truly incremental revenue that can complement core products and even drive sales of those products, e.g. Apple's iTunes. Additionally, revenue streams from services are both recurring and predictable, balancing out the sometimes lumpy cash flows of product-centric companies.

Not only can services deliver revenue growth, but they often come with high profit margins too. This is especially true when considering automated online services such as Apple's App Store whose cost structure is minimal compared to the costs of owning and operating a physical supply chain. These revenue and profit advantages can be multiplied quickly due to the scalability of the internet – meaning that customers can access services from Web 2.0 platforms anywhere in the world. Innovations in information and communications technology (ICT) have accelerated the possibilities of far-reaching services that don't require significant investments in human resources or physical infrastructure.

Services also provide the strategic advantage of differentiation from the competition, and offer a means to cultivate customer loyalty and engagement. Companies are often able to charge a premium or drive preference through products that are accompanied by services, as it is often the services that make the customer experience unique. As an example, Research-In-Motion's (RIM) Blackberry product line has held sway with enterprise customers for years on the basis of its encryption services, which ensure corporate e-mail communications are secure.

The final advantage of services is that they allow for a better understanding of customers' needs. Customer behavior can be tracked and studied easily through data gathered across a system of touchpoints constituting the end-to-end experience of the service—a key strategic asset in today's world.

Developing successful service offerings is no simple task however, especially for large organizations that have operated under a model of “manufacture and market” for their entire existence. Successful manufacturers often run like a well-oiled machine, with physical plants, equipment, supply chains and retail partnerships all working together. Moving into services not only requires a different business model, but also a different set of skills, organizational structures, and technologies. The challenge to expand beyond products is daunting, but as our market exemplars show, the returns on the investment can be worth it.

DELIVERING PRODUCTIVITY GAINS VIA SERVICES

One area in which companies develop and deliver services is by helping their clients drive efficiency and productivity gains. We've seen businesses whose products are both capital intensive and technical—"big iron" businesses such as mainframe computing and buildings systems—develop offerings that help their customers by streamlining their operations and freeing up capacity to focus on their core business.

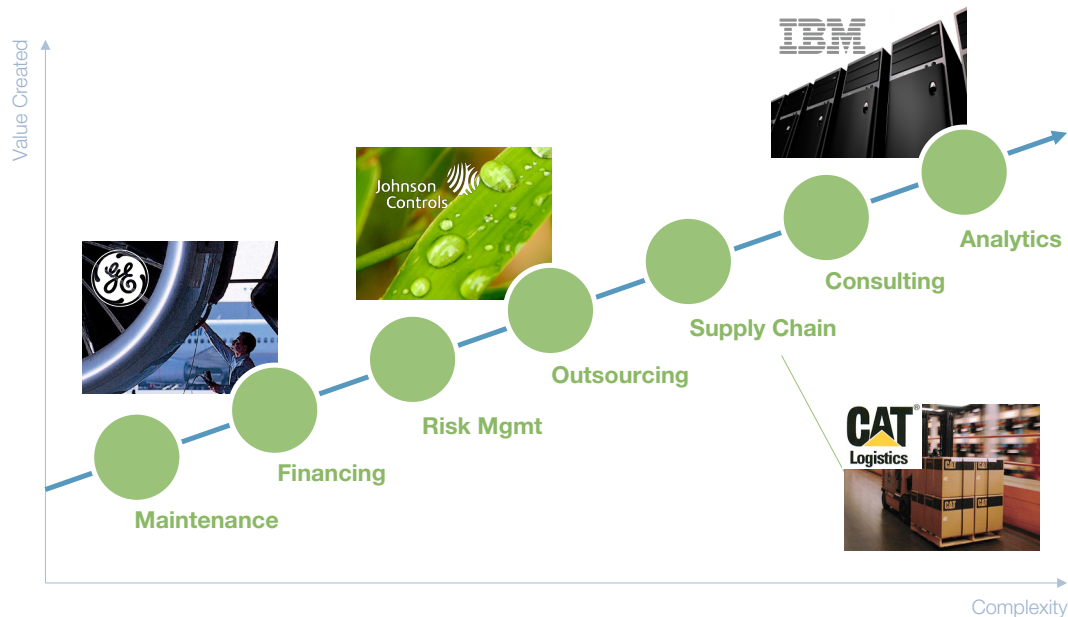


Figure 1: Increasingly sophisticated services support traditional product offerings.

The most frequent manifestations of productivity-enhancing service offerings are the following: maintenance, financing, business process outsourcing, risk management, supply chain management, consulting, and business analytics. These services represent the largest buckets of opportunity for companies to outsource non-core operations, that can suck up precious resources when executed in-house.

Clearly, companies would like to become more productive—and, in theory, more profitable—by focusing totally on the core of their business, rather than being weighed down by operations that they cannot execute distinctively. This is by no means a recent phenomenon, but the suite of innovative service offerings that companies can acquire in order to enable such productivity certainly is.

CAT Logistics (see Figure 2) is a great example of a company rooted in product manufacturing that found a way to deliver value to new and existing customers by delivering internal capabilities as commercial service offerings. CAT's services enable efficiency gains for its customers, many of whom are not purchasers of CAT's heavy machinery. Given its history as an old-line American industrial company, who would think that mainstay customers of Caterpillar would include U.S. Cellular, Land Rover and Bombardier Aerospace? CAT Logistics's growth over the past two decades has been driven by the desire to "help other companies lower distribution costs while improving customer service, asset utilization, and brand loyalty."

What does it take for companies to market new, innovative capabilities as a service? First, the organization must recognize the value such specialized capabilities hold for its customers, and build a business model that captures the requisite value for both parties.

For example, Johnson Control's York HVAC business built a new service called York Source that helps its customers optimize their equipment investment by minimizing downtime. Through a service model where the customer pays for units of chilled air instead of acquiring the machines (and paying for installation and other add-ons), the service guarantees greater equipment uptime.

Bringing this new model to life required a mental leap for the company as York Source CEO Ian Campbell explains, "We now charge for things we used to give away, and give away what we used to charge for." For many customers, these pay-to-play models are a good way to reduce both the cost of ownership and the risk of equipment failure.

Delivering productivity to customers requires a different business model than delivering a simple piece of manufactured equipment. Ask yourself, "How will we be compensated for the productivity that we confer to our customer?" In addition to the business model, services require a significantly different sales and marketing strategy compared to the core products.

TRANSFORM YOUR SUPPLY CHAIN

Few factors can impact the success of your company as much as the performance of your supply chain.

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In 1987, Caterpillar Inc. recognized an opportunity to not only provide products to its clients but also a service: supply-chain solutions, an area of expertise that it realized it could market “to help other companies lower distribution costs while improving customer service, asset utilization, and brand loyalty.” CAT Logistics was formed, and for the past 20 years it has sold differentiated supply chain solutions, offering “competitive advantage and attractive returns for the enterprise and our customers.”

CAT Logistics’s business model leverages proprietary warehousing and manufacturing supply-chain management software, and sells those capabilities to its customers, many of whom never had a demand for Caterpillar’s bread-and-butter products—heavy machinery. CAT Logistics’s 2010 total revenue was an estimated \$3.1B, which represented 7.2% of Caterpillar Inc.’s total net revenue of \$42.6B.

Figure 2: Historically product-centric Caterpillar Inc. has profited hugely from its service spinoff CAT Logistics.

CREATING ACCESS TO NEW CUSTOMERS VIA DIGITAL PLATFORMS

Another way in which traditionally product-centric companies have developed and delivered services is by looking at the underlying, unmet needs of “underserved” or “overserved” markets. This method is a hallmark tactic of disruptive innovation and leads to solutions that more effectively meet the needs of customers in those markets. These offerings manifest as services that provide access to new customers (B2B), or truly innovative platforms that create access to new customers for the platform creator’s customers (B2B2C), as in the case of Apple’s App Store.

Digital platforms that deliver access to new customers include Xiameter’s unique business model for B2B silicone sales (which addresses an “overserved” market—see Figure 3), and Apple’s App Store (which addresses an underserved market), both of which have created new marketplaces for services. These platforms create entirely new revenue streams from digitally delivered services, often at high margins due to the lower cost structure. In the case of Xiameter, a wholly-owned subsidiary of Dow Corning, the parent company’s investment in the platform was paid for within an unheard-of timeframe: just three months.

Another benefit of these digital platforms is that the service provider is able to control the customer's experience with the brand, rather than leaving it up to a third-party retailer or distributor.

more efficiency, in more ways

- Thousands of standard silicones
- Competitive, market-based prices
- Available 24/7 online, or through distribution



Launched in 2002 by Dow Corning, Xiameter is an online service platform that addresses a significant unmet market need: efficient, cost-effective silicone products purchased by a customer segment that regards such products as commoditized goods. Its goal is to reach “overserved” customers and offer an efficient alternative to low-cost Asian competitors. The conception and execution of the Xiameter platform is a model for disruptive innovation, particularly in an industry as staid as B2B silicone products.

The year before Xiameter was formed, Dow Corning lost \$28MM; in the year after Xiameter launched, Dow Corning made \$500MM. Online sales now comprise 30% of Dow Corning’s total sales—3x the industry average. Perhaps most notably, Dow Corning’s concern that Xiameter would cannibalize business was unfounded, as a vast majority of Xiameter’s business has been new clients.

**Figure 3: Xiameter enjoyed great success by addressing a significant unmet need:
a more efficient, cost-effective way to access commoditized products**

Apple's App Store illustrates how easy it is to scale a digital service once the underlying systems and business model have been developed. The platform creates access to customers for third-party software developers—from the makers of Angry Birds to subscriptions to the Wall Street Journal—that would otherwise not exist. For their role in creating this marketplace, Apple earns a healthy 30% cut of every app sold. Once the fixed costs of creating the underlying system have been re-couped, incremental sales cost very little. By providing the platform to aggregate demand for software, Apple gives software developers access to a key distribution channel and app seekers get access to new service solutions that entertain, inform and increase productivity. Tremendous value for all parties has been created through this entire system, which is one of the many reasons why Apple's stock has skyrocketed in recent years.

In order to develop services that create access to new customers, think about how you can aggregate either supply or demand in your industry. There are numerous examples of companies that have found ways to create value by providing a “one-stop-shop” of providers looking to deliver a service or customers who want to receive a service. Consider the examples of LinkedIn (aggregation of job hunters and

employers), Open Table (aggregation of restaurants and consumers), Masco Contractor Services (aggregation of local contractors and businesses) and indeed Apple's App store (aggregation of software developers and users). Each of these companies has discovered methods of creating access to new customers and channels, and have been rewarded handsomely for doing so.

DRIVING LOYALTY VIA ENGAGEMENT AND PROPRIETARY COMMUNITIES

Finally, many traditionally product-centric B2B companies understand the need to drive customer engagement, and have developed services that enable them to do so. These companies build loyalty by going above and beyond the traditional parameters of the supplier-client relationship by providing unexpected value by reducing customer churn and fostering enhanced customer intimacy, which in turn increases sales and margins. Customer engagement can be created through services along the spectrum of automation, from people-intensive partnerships to fully digitized and automated online communities.

The benefits of driving customer engagement are numerous. Customer engagement has been shown to increase "stickiness", which in turn fosters loyalty. Reichheld and Sasser assert that a 5% improvement in customer retention can cause an increase in profitability between 25% and 85% (in terms of net present value) depending upon the industry.¹ Additionally, services that drive customer engagement allow the company to have a better understanding of customer needs, because it is more actively involved in the conversation and customer experience than if it were exclusively a passive product manufacturer and marketer.

Sysco's free consulting service, Business Review, engages customers and allows the largest foodservice distributor in North America to thrive in an industry where products have become increasingly commoditized (see Figure 4). "If we could improve their business, that would improve our business with them," says COO Kenneth Spittler. Its services allow Sysco not only to differentiate itself from the competition, but also to make its customers more successful through education and training.

Engagement can also be created in the digital world by fostering a sense of community, as in the case of Johnson and Johnson's Baby Center, an online platform that offers various resources for expectant and current mothers. The service has various associated B2B revenue streams: sponsored forums, display ad-

vertising, and book sales, as well as an e-commerce partnership where J&J captures a percentage of each sale. BabyCenter's results have been tremendous so far—it has established itself as the preeminent website for moms, capturing 78% of the online market for new and expecting mothers. Acquired for \$10MM in 2001, it is now estimated to generate \$100-\$200MM in revenue; however, its value is more than purely financial, because it drives engagement with J&J's consumers and other businesses that have a vested interest in building relationships with moms.



Already the largest foodservice distributor in North America with ~\$35B of annual revenues, Sysco decided that it needed to become more sticky with its B2B customers. Because it competes in an industry where products have become commoditized, Sysco created a free consulting service for its clients called Business Review, which helps clients design menus, train wait staff, and market their businesses. Sysco turned its warehouse kitchens into schools for its customers.

Business Review helped the company survive and even thrive during the downturn, as revenues increased from 2006 to 2008 to \$37.5B.

Figure 4: Sysco's Business Review drove "stickiness" for its customers.

Companies like Sysco and J&J have been able to expand into new services successfully because they acknowledge both the tangible (new revenues) and intangible (increased brand awareness) consequences of driving consumer engagement. Expanding beyond one's core capabilities to building new service platforms that foster a sense of community around your brand or around a particular industry requires a deep understanding of the challenges (and the competing alternatives) facing your customers, as well as an approach for managing and delivering such services. In both of the cases mentioned, each company had to reframe its business purpose significantly in order to "get out of the box" and build a viable engagement model. Although direct ROI can be difficult to measure with respect to engagement models,

these companies have shown that such efforts can pay off generously by positioning themselves as leaders in their industries and in fostering increased customer loyalty.

CONCLUSION

By now, the point should be clear: services offer a way to add value to your organization, especially when they enable customers to become more productive, access new customers, and build brand loyalty through platforms that drive a sense of community. The case studies explored in this article illustrate the extent to which services demand a premium in the market, drive differentiation from the competition, and build loyalty. Entering the services arena is certainly not for the faint of heart, but because so many of these types of services can be automated, they have the potential to be highly accretive to the bottom line.

What's next? You're probably wondering how to go off and get started developing services! When it comes to identifying growth opportunities and new markets, most managers have been conditioned to apply market-sizing analysis and develop new technologies; however, as our case studies illustrate, the best way to identify and serve new and existing customers is to focus on unmet needs.

Footnotes

1. Storbacka, K. Strandvik, T. and Gronroos, C. (1994) "Managing Customer Relationships for Profit", International Journal of Service Industry Management, vol 5, no 5, 1994, pp 21-28.

AUTHOR BIOS



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