

Prices & Value Added

## Article 12

When will customers be willing to consider services and not just price...

# Creating Growth with Services

*In a world of commoditized products, companies are turning to service offerings for growth. The key to success involves redefining markets in terms of customer activities and outcomes, not products and services.*

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Faced with saturation of their core product markets, companies in search of growth are increasingly turning to services.<sup>1</sup> A few companies have enjoyed success with this approach—General Electric Co., IBM Corp., Siemens AG and Hewlett-Packard Co., for example. GE's Transportation Systems division had stable revenues and operating profits between 1999 and 2002, despite absorbing a drop of more than 60% in the number of locomotives it sold. Between 1996 and 2002, revenue from services climbed from \$500 million to about \$1.5 billion, a trend that the division expects will continue.

Not all product manufacturers are so fortunate. Intel Corp., for instance, spent \$150 million to launch a unit whose function was to set up data centers to host Web sites for companies. After three years, Intel shut down the unit and announced that it was refocusing on its core microprocessor business.<sup>2</sup> Similarly, Boeing Capital Corp., the financial services subsidiary of Boeing Co., recently reined in its efforts to provide financial services to other industries.<sup>3</sup> A systematic approach to creating services-led growth can help managers of product companies improve the odds of success. Companies must begin by redefining their markets in terms of customer activities and customer outcomes instead of products and services. By mapping the customer-activity chain and relating the map to a service-opportunity matrix, managers can systematically explore opportunities for new services in four directions.<sup>4</sup> Equally important, they must assess the pitfalls and risks that these opportunities represent, and another matrix—on risk mitigation—serves as a tool for that task.

## The Customer-Activity Chain

Companies traditionally think about markets in terms of the offerings they sell. But as Peter Drucker has pointed out, "What the customer buys and considers value is never a product. It is always utility—that is, what a product does for him."<sup>5</sup> Customers

seek particular outcomes, and they engage in activities to achieve them.

These activities can be mapped along a customer-activity chain, a concept that has been discussed by several authors in different but broadly consistent ways.<sup>6</sup> A customer-activity chain has the following characteristics:

- It must represent an end-to-end temporal sequence of logically related activities. For consumers, these activities can center on a stage of life (education, career, parenting), the pursuit of a specific interest (fishing, golf) or the ownership of a specific asset (home, automobile, camera). For businesses, it can center on a process (logistics management, human resource management) or a set of assets (computer systems, machinery).
- It must lead to defined customer outcomes. For instance, retirees may want "financial independence" and "peace of mind." Purchasers of computer systems may desire "higher employee productivity." Business travelers may seek "to get to a meeting on time and in a positive frame of mind." These outcomes become the basis for defining the quality of the customer experience.
- It must be defined at the segment level, not at the aggregate market level. For instance, it makes no sense to talk about the customer-activity chain for information workers when analyzing productivity. Activities should be mapped according to segments—lawyers, sales executives, health care practitioners and so on.
- It will often cross industry and product-market boundaries. For example, in the home ownership customer-activity cycle, customers might engage with contractors, insurance companies, realtors, banks, telecom companies and many other service providers. In fact, services are often the glue that holds the activity sequence together.

The customer-activity chain is the foundation for exploring services-led growth opportunities. Analogous to product-centric growth strategies like product line extension, product line

To identify temporal expansion opportunities, managers should create a blueprint that maps the customer-activity chain from one end to another and reveals the outcomes that customers seek.

filling and brand extensions, customer-activity chains can be extended, filled, expanded or reconfigured with new services. To structure the investigation of these opportunities, it is useful to categorize them on the basis of the impact they have on the customer-activity chain. The service-opportunity matrix provides the necessary framework.

### The Service-Opportunity Matrix

Once companies are thinking in terms of the customer-activity chain, they can classify new services along two dimensions: the focus of growth (where does growth occur?) and the type of growth (how does growth occur?). The "where" question can be answered by thinking about primary and complementary, or adjacent, activity chains. For example, visiting a dealership is a primary activity on the auto ownership chain, whereas seeking insurance quotes is a complementary activity that falls on an adjacent chain. Service growth opportunities can be found on both chains and in two ways (the "how" question): first by adding new activities and second by reconfiguring existing activities.

Merging the focus of growth with the type of growth results in the two-by-two service-opportunity matrix. The four elements of the framework include

- Temporal expansion: growth from services that add new activities to a primary activity chain
- Spatial expansion: growth from services that add new activities to an adjacent chain
- Temporal reconfiguration: growth from services that change the structure and control of activities within a primary chain
- Spatial reconfiguration: growth from services that change the structure and control of activities within an adjacent chain (See "The Service Opportunity Matrix")

### Temporal Expansion

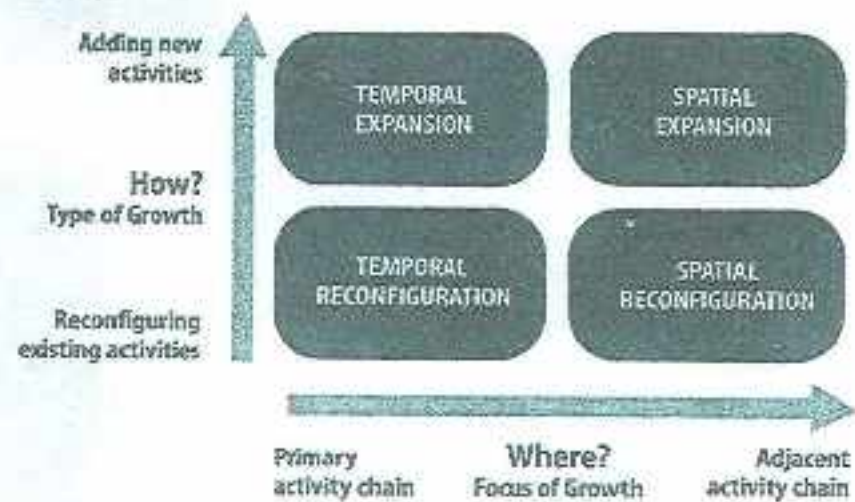
An activity chain can be thought of in terms of time—the time it takes a customer to perform all the various tasks he or she needs to reach a specific outcome. And companies can expand the temporal nature of the chain, or fill in gaps within it, by adding new services that help people perform activities at every stage of the process.

Eastman Kodak Co. has created new services designed to help consumers "manage and share memories" using digital photography. Until the advent of digital technology, Kodak's involvement with customers ended when they ordered prints. The company has since found ways to add significantly to its interaction with customers. (See "Temporal Expansion by Kodak.")

Kodak acquired a startup called Ofoto Inc., for example, which offers an online printing service that makes it easy for customers to order prints (because it is expensive and inconvenient, only 2% of analog photographs are ever reprinted). Con-

### The Service Opportunity Matrix

Companies seeking services-led growth should redefine their markets in terms of customer activities and outcomes. By adding or reconfiguring customer activities along a primary or adjacent activity chain, companies can find opportunities for growth.



sumers also can create online albums, order greeting cards, archive their photos on a CD, and buy frames and other merchandise. Ofoto has had more than 2 million customers in two years, and its customer base is growing at a rate of 13% per month. Most of that growth is organic—59% of new members come through referrals from other Ofoto members. Almost 12% of all prints ordered on Ofoto are from shared albums.

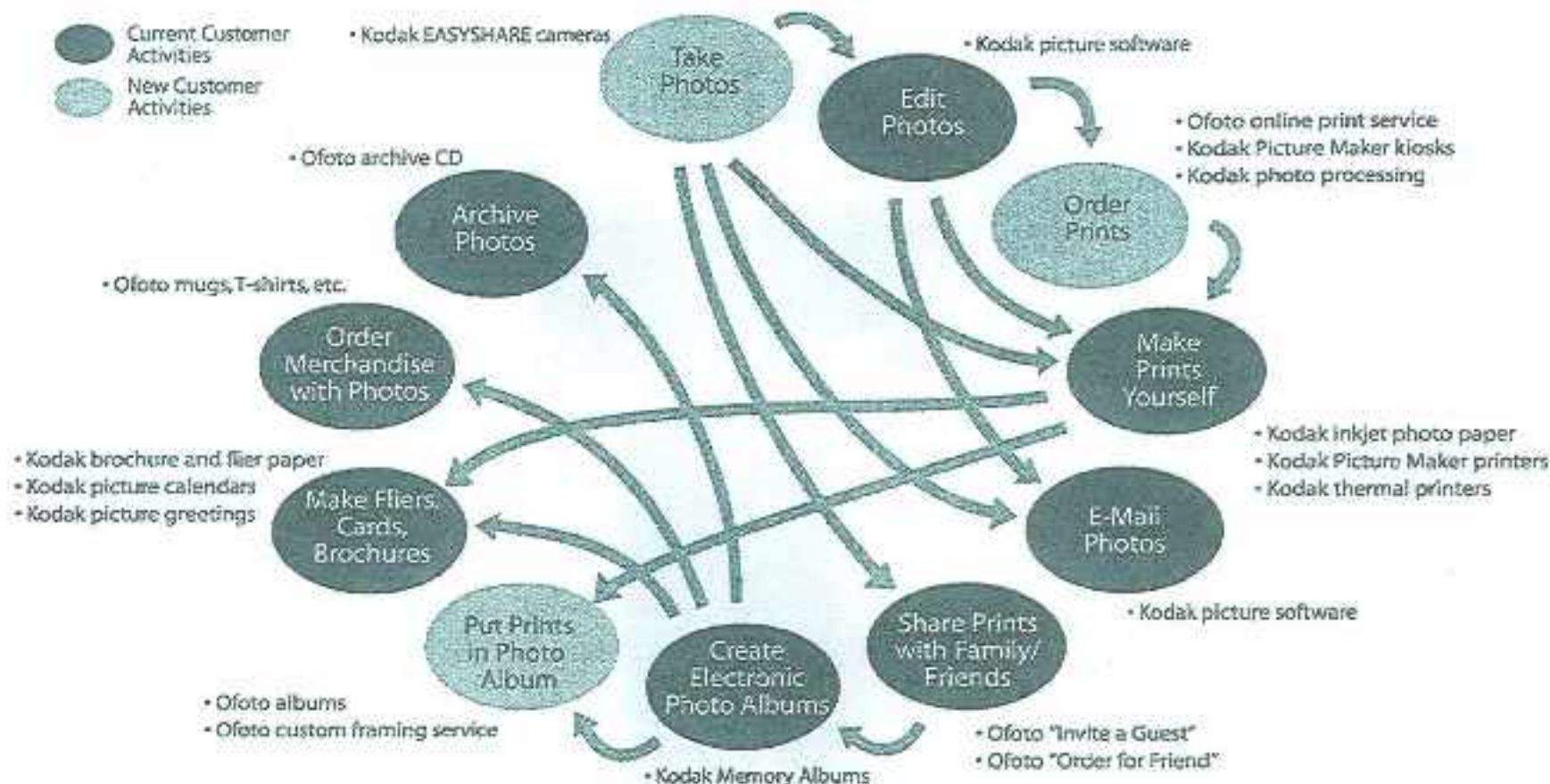
In addition to the Ofoto acquisition, Kodak has installed 30,000 kiosks in retail locations, where customers can take film or memory cards from digital cameras to make prints. In the future, the company plans to develop a new generation of XML Web services centered on digital photography.<sup>7</sup> While Kodak is struggling as its analog film business declines rapidly, it is the second-largest seller of digital cameras, and its digital camera business turned profitable two years after launch.<sup>8</sup> A big part of the reason for Kodak's success is its deeper presence within the customer's activity chain.

To identify temporal expansion opportunities, managers should create a blueprint that maps the customer-activity chain from one end to another. The blueprint should reveal the outcomes that customers seek, detail the sequence of activities they currently engage in and could potentially engage in, and demarcate the gaps and problems in the existing activity chain. The following questions and examples can guide the exploration for expansion opportunities:

**Can Services Be Added That Precede the Sale of the Core Product?** Noble House Custom Tailors is based in Hong Kong, where relatively cheap labor allows the company

**Temporal Expansion by Kodak**

Kodak has added many new digital services along the customer's primary activity chain related to "managing and sharing memories."



to produce fine clothing at competitive prices. But the clothes really are custom-tailored because the company's master tailor frequently visits dozens of cities across the United States and Europe. During those visits, which are widely advertised locally, he meets scores of customers by appointment, taking their measurements and helping them choose fabrics. People who might normally buy off the rack in order to save money are thus able to enjoy the services of a professional tailor.

**Can Services Be Added That Follow the Sale of the Core Product?** When a customer selects a casket from Batesville Casket Co. in Batesville, Indiana, the company arranges for a tree to be planted in memory of the deceased. The business thus maintains a connection to people far beyond the primary activity of casket selection. Each year, Batesville Casket receives thousands of letters of appreciation from families for planting the memorial trees.

**Can Services Be Added To Accompany the Product?** For example, online florists and gift companies could offer to take a digital picture or video clip of the person receiving the flowers or opening the gift and then e-mail the picture or clip to the sender. The gift giver would virtually have the experience of delivering the gift in person.

**Can the Product Be Augmented With Network-Based Services?** Sewing-machine manufacturer Bernina offers a range of software for its machines that facilitates complex and creative embroidery and stitching projects. The software is thus

a platform for supporting customer relationships over time, as users progress from stitching novices to experts.

**Can the Product Be Updated With Services?** Computer security specialist McAfee.com offers packaged versions of its VirusScan antivirus software in retail stores. But new computer viruses emerge frequently, so the virus-definition files quickly become outdated. To deal with that problem, McAfee provides an online service that allows VirusScan buyers to update their virus-definition files frequently.

**Spatial Expansion**

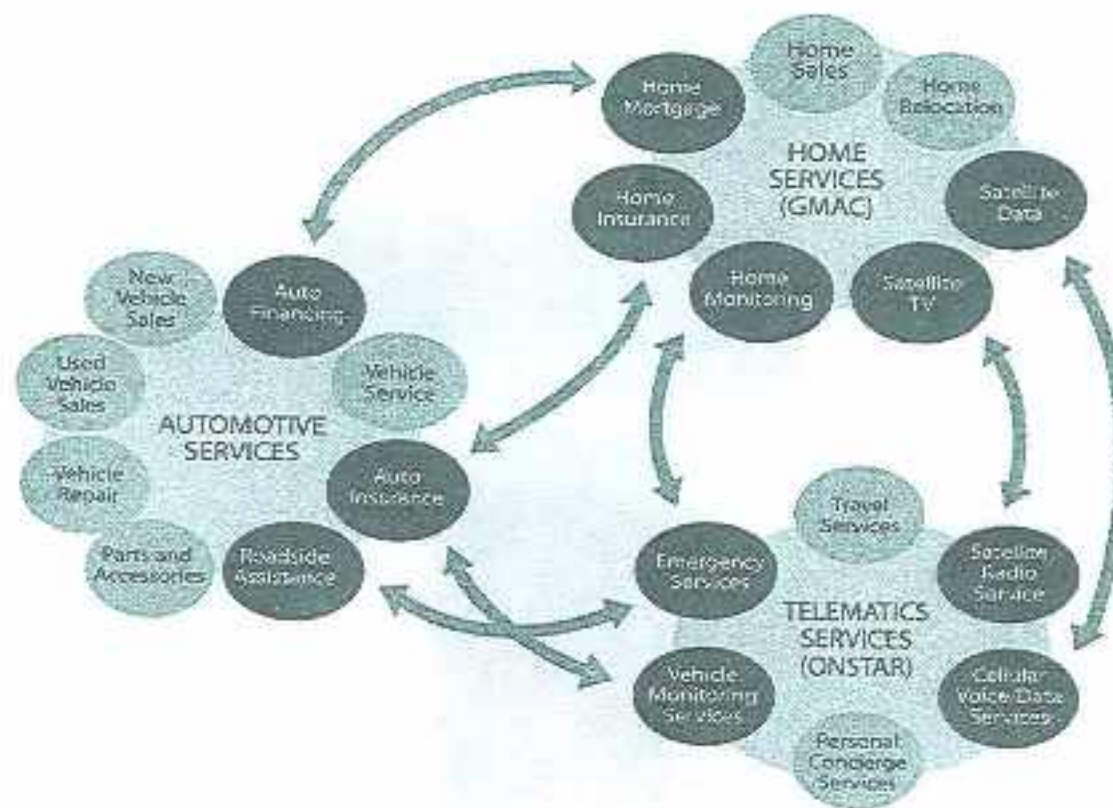
Temporal expansion focuses on the primary activity chain, but companies can also introduce new services into adjacent opportunity spaces. While temporally linked services deepen relationships with customers, spatially linked services broaden them.<sup>9</sup>

To uncover opportunities for spatial expansion, managers need to think about the following questions: Are there activities that are not typically part of the primary chain but are closely associated with it? Can existing products or service platforms anchor the introduction of services in another context? Can the company's reputation related to the primary activity chain be extended to other contexts? The connection between primary and adjacent chains need not be a matter of shared activities. Chains that appear to be unconnected by overlapping activities may be tightly linked along the dimensions of capability or reputation.

General Motors Corp. has leveraged its core automotive business to offer new service platforms for adjacent activity

## Spatial Expansion by GM

GM is leveraging its expertise in activity chains that are adjacent to the primary chain of automotive services. (Linked activities appear in blue.)



chains. Like most automobile manufacturers, GM offers a comprehensive set of temporally linked services for the primary activity chain of car ownership. Its OnStar platform, however, helps customers with related tasks: emergency services dispatch, stolen vehicle location, roadside assistance, remote diagnostics, route support, convenience and concierge services. Every month, OnStar unlocks about 28,000 doors, dispatches 13,000 roadside assistance vehicles, responds to 700 air-bag deployments and locates 700 lost vehicles.

By the end of 2001, there were almost 2 million OnStar subscribers and the product was offered on more than 40 GM models. While GM offers the first year's OnStar service for free, it claims renewal rates as high as 80%, at annual subscription fees ranging from about \$200 to more than \$800. In addition, GM has become the country's largest reseller of cellular service thanks to OnStar's Personal Calling service. According to some projections, OnStar may bring in more than \$2 billion by 2005.

New services that emerge from spatial linkages can in turn be linked to each other and can themselves become platforms for other services. GMAC Mortgage Corp., another expansion on an adjacent activity chain, is now the fifth-largest mortgage company in the United States. GM is creating an extension of OnStar for the home that will extend its remote monitoring, diagnostics and emergency response services. The company's goal is to be a comprehensive services provider, covering automobile and home ownership, financial services, communications and entertainment. (See "Spatial Expansion by GM.")

The search for spatial expansion opportunities begins with the identification of promising "pivot points" in current activi-

ties and capabilities that can lead to involvement with customers in other areas and continues with the identification of platforms or brands that can support new services. Managers must ask the following questions to identify opportunities in this dimension:

**Can Products Become Platforms for Embedded Services?** Treadmill manufacturers, for example, have transformed treadmills into platforms for fitness services. Using computers and video equipment, treadmill buyers can log on to iFIT.com for basic workouts (in which the treadmill's speed and incline are remotely controlled), music workouts (which include heart-rate-paced music and verbal encouragements from a trainer) and scenic workouts (which combine virtual landscapes delivered online using streaming video with music, the trainer's voice and treadmill control signals).

**Can the Existing Customer Base Be "Rented"?** Costco Wholesale Corp. has leveraged the collective bargaining power of its 35 million individual and business members to expand beyond its customers' primary activity chain. The wholesale discounter now contracts with many vendors to provide services and special deals that cover auto and real estate sales, financing, insurance, online software training, communications packages and small-business loans.

**Can the Existing Customer Interface Be Leveraged?** Recognizing that millions of users are familiar and comfortable with its online interface, eBay Inc. has teamed with Elance Inc. to offer the services of more than 300,000 professionals who work on Web-delivered projects, including software develop-

## The search for temporal reconfiguration opportunities requires managers to understand which capabilities are central to their own business but peripheral to those of their customers.

ment and Web and graphic design. Customers post projects online, and service professionals make bids. In addition to receiving the bids, customers can review service providers' profiles, portfolios of sample work and feedback ratings before choosing someone to do the job.

### Temporal Reconfiguration

Opportunities for temporal reconfiguration arise again on the primary activity chain. Companies do not add new services in this part of the matrix; they shift the boundary between the activities they perform and those done by customers. Their motivations for undertaking such a shift are threefold. First, companies are better at managing assets or performing business processes that are closely related to their core competencies but not to those of customers. Second, they can aggregate demand across customers to create economies of scale that they can pass on to customers. Third, they can apply knowledge about best practices from the industries in which they provide such services.

United Parcel Service of America Inc., for example, used to focus on a narrow set of activities involved in the package delivery business—picking up, shipping, tracking and dropping off packages. It now takes ownership of the much broader set of activities performed by customers in managing their supply chain, logistics and customer-care operations. Many of the activities performed by UPS for its customers are not new individually, but UPS adds value by integrating them. (See "Temporal Reconfiguration by UPS.")

The UPS Logistics Group has designed transportation networks for customers such as Ford Motor Co. The redesigned network reduced the time Ford needed to deliver vehicles from its plants to dealers by up to 40%. The group also designed and operates a dedicated global distribution center in Singapore for National Semiconductor Corp. The center manages the movement of National Semiconductor's products from its manufacturing plants in Malaysia and Singapore to customers around the world. UPS expects to ship 450,000 orders annually, with an average delivery time of 48 hours. National Semiconductor estimates it will save 15% in shipping and inventory costs with this arrangement. UPS has also partnered with Nike Inc., taking responsibility for managing all the back-end processes for direct selling, including order management, shipping, delivery, returns management, inventory management and customer support.

The search for temporal reconfiguration opportunities often begins inside the company with an evaluation of its capabilities. Specifically, the company's managers must understand which capabilities are central to their own business but peripheral to those of their customers; they must also decide what the firm can do better than its customers in terms of cost, speed, quality or agility.<sup>10</sup> Managers should ask the following questions to identify opportunities for temporal reconfiguration:

### Temporal Reconfiguration at UPS

With its logistics-management offerings, UPS handles a much broader set of customer activities than it did when it was only in the package delivery business.



**Can Customer Burdens Involving Customization Be Reduced?** By taking over activities related to product customization, Dell Inc. embeds itself deeper into the IT operations of its enterprise customers and creates additional revenues from services. For example, Dell provides services related to hardware and software image development, migration and recovery, custom configuration and installation of software, asset tagging, and parts replacement.

**Can Customer Burdens Involving Product Storage Be Reduced?** Gadue's Dry Cleaning of Burlington, Vermont, stores customers' winter clothes during the summer and vice versa. The clothes are laundered and readied for pickup at a week's notice.

**Can Process Expertise Be Leveraged?** DuPont is an expert on the application of paint and the minimization of waste and harmful emissions. After DuPont contracted with Ford to run its paint shops, Ford's painting costs were reduced by 35% to 40%, while its emissions of volatile organic compounds declined by 50%. DuPont, which is paid on the basis of the number of painted vehicles, actually sells less paint than before because it has an incentive to paint cars with the least amount of waste. But the company makes more money as a result of the improved efficiency.

**Can Customers' Inventory-Control and Stocking Processes Be Replaced?** With vendor-managed inventory systems, many manufacturers now track inventory electronically and take charge of ordering, delivery and stocking processes for