

The True Strategic Value of Services[©]

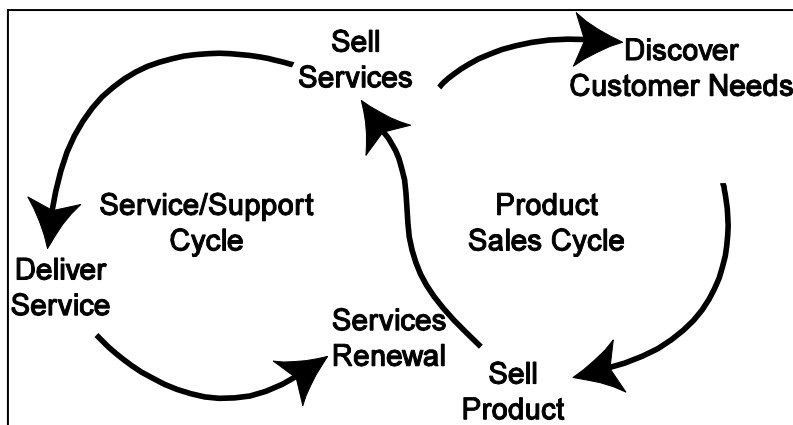
By Al Hahn

In this document, we are talking primarily about *technical* services. This is a loose definition since some services are decidedly more technical than others. We are not addressing legal services, accounting services, healthcare providers, or the kinds of service you expect at fast food outlets. For purpose of this discussion, I will put technical services into two different categories: *traditional services*, and *professional services*. When we mention traditional services, we mean break-fix repair and preventive maintenance services of the product hardware, or software product support such as telephone support or web-based support.

When we mention professional services there is a continuum of services from those that are very product-centric to those that are more customer-centric. Professional services start with planning and design services, continue with integration of hardware and software, progresses into testing and certification (of systems, not individuals), tuning and optimization, and often ends with disaster planning and recovery. They can include varieties of consulting which are usually more product-oriented, rather than management consulting. There are many types of software implementation services that are huge projects. Often training and education services are included in professional services offerings. In short, professional services are many and diverse, in contrast to traditional services. Since there are so many possibilities and the choices are varied, individual companies choose their portfolios of professional services very differently, even among competitors.

Traditional Services

Let's start our discussion with traditional services. Figure one displays two cycles, the



product sales cycle and the support cycle. The product sales cycle is fairly fast for most companies. While it can take a year or two for some products, most take only weeks or months to complete. The support cycle, by contrast, goes on for years, usually at least five to ten years.

During this time the customer calls for help at a reasonable frequency, resulting in many more touches than during the shorter product sales cycle. As a result, the long-term customer relationship tends to be driven by the support cycle, which can be seen when customer satisfaction is measured. According to our studies, customers with annual service or support contracts

have markedly higher customer satisfaction scores than those who purchase traditional support per-incident at time and materials rates. Those customers with contracts average 8.2-8.5 out of 10 in overall scoring of customer satisfaction with their vendor. Those without contracts average 6.0-6.5 in overall customer satisfaction. This difference is very important in its own right, but is seen to be crucial when we realize that customer satisfaction tends to drive customer loyalty scores. In these studies, when customer satisfaction scores go up, customer loyalty tends to go up. Conversely, when customer satisfaction goes down, customer loyalty also goes down.

The Payoff of Traditional Services

Customer loyalty impacts a company economically. While services can generate substantial revenues and profits, there is more at stake. Traditional services encourage repeat buying that affects product economics. Repeat product sales have lower sales costs than the initial sale to a particular customer. In fact, it is estimated that to make the initial product sale to a given customer, the cost is between 5 and 7 times higher than selling to a repeat buyer. Thus, you need to be at least average in percentage of repeat sales or suffer a cost disadvantage compared to other vendors. Also, repeat product sales, on average, provide slightly higher prices and, hence, enjoy higher margins. From our experience, we see that companies that “get” services and sell traditional (hardware or software) contracts well average 20-25% higher overall revenues, and 10-15% higher overall margins. This effect on total revenues and total margins is the true strategic benefit of traditional services.

How Service Changes the Customer Relationship

Before moving on to professional services, we should look at how traditional service works. Customers who buy traditional service and support contracts call, on average, twice as frequently as those without contracts. Customers who pay-per-transaction tend to become service avoiders. They equate calling for service or support with a hassle and with spending money. This is at the heart of their relationship with the vendor. Companies simply cannot afford for this negative perception to happen or they will suffer significantly lower customer satisfaction and loyalty scores, with an attendant loss in repeat business.

Professional Services

Professional services contribute in different ways than traditional services. First, in most markets today professional services are enjoying very good growth rates. Over the past decade, we have seen growth ranging from 20% to 40% per year. In the same time period traditional services growth has ranged from 0 to 10% annually. While there are certainly some companies who have under-penetrated their installed base with traditional services and could grow faster in those services, eventually the rates quoted here are the ones that are most likely to predominate. As a result, professional services have better long-term growth potential.

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Another aspect that is different is that professional services can precede the product sale. Traditional services must always follow since there has to be a product to support. The professional services which can lead are mostly in planning and design. When professional services lead, the products, traditional services, and other professional services follow, pulled-through by the leading professional services. It may be necessary to partner for some products and services, but the company with the leading professional services has the opportunity to maximize account control and wallet share. For this reason, these leading professional services should always be provided by employees, not partners.

Professional services tend to be larger projects, are viewed as higher risks, and usually require higher levels of approval. This combination makes them harder to sell and they usually have a longer sales cycle, as well. However, they are more likely to generate more revenue than traditional services per transaction. Estimates range from 50% more to 5 or 10 times more revenue per transaction. Most professional services are customized for each specific project and customer. Because of this, they often are composed of non-repeatable processes. Accordingly, project quality is variable and so are the costs, schedules and profits. Smart companies invest in developing repeatable processes for this business. They also invest in ways to improve the accuracy of their cost estimates and bidding processes.

When properly used, professional services can provide a significant competitive advantage. To begin with, since not all companies provide them, they create an advantage for those who do. Secondly, the larger projects provide a deeper understanding of the customer and are often driven by strategic initiatives. Even smaller projects tend to be more customer-centric than traditional services and products. Winning one of these projects provides an opportunity to be viewed as a strategic partner, rather than as just another vendor.

The Payoff of Professional Services

Professional services produce different benefits to the provider than do traditional services. These include greater long term growth in revenues, the ability to pull-through products and traditional services, more revenue per project, and competitive advantage. Like traditional services, they can change the customer relationship, but in a different way. Professional services can change a company's status from that of vendor to that of partner. This is a profound difference that can produce significant differences in the trust level and sharing of information over the long term. No vendor wants to compete against a company that is viewed as a strategic partner.

Summary

In summary, traditional services generate higher customer satisfaction and customer loyalty. This provides greater repeat purchasing of products and services. Repeat business provides greater revenues, lower costs, and higher profit margins. Professional services

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have high growth potential, greater revenues, and can pull through products and other services. They also position the provider as a valued partner. Lastly, they are a competitive differentiator. So we see different sets of strategic advantages from the two types of services. The typical technical product manufacturer can achieve either or both. These are the true strategic advantages. Other hoped-for advantages may not exist. The decision to add services should be rightfully viewed as strategic as it will require rethinking and adjusting many things.