From products to services, a risky but necessary move

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Expanding from products to services is one of the main business trends of the past 10 years. However, this strategy has a high risk factor.

In recent years, 80 percent of companies have opted for expanding their range of products to incorporate services. The motivation behind this move may sound familiar: product sales are slowing down in developed markets, and competition from Asia is cutting into margins. At the cost level, it is hard to compete against these companies, while innovations, apart from being expensive, get copied in no time.

One possible solution is to offer services to customers, and not just those deriving directly from the product, but also those that create greater added value for customers, such as consulting or logistics. Additional services like these are of considerable appeal. For starters, they offer better margins. They also allow a company to create a tailor-made offer and help build a more tight-knit relationship with customers.

Nonetheless, expansion also entails risk. On this note, one disheartening statistic is that just 20 percent of companies that have decided to offer services actually consider their decision to be a successful one.

In their article "La expansión de productos a servicios, un movimiento estratégico obligado pero con riesgos" ("Expanding from Products to Services, a Necessary Albeit Risky Strategic Move"), IESE professors Philip G. Moscoso and Alejandro Lago say there must be some factor to account for the success of firms such as IBM and Xerox in their expansion to include services, while others such as Gateway have failed to get off the ground.

To explain why, Moscoso and Lago examined the business practices of companies that have achieved the best results in expanding to include services. With this multisectorial analysis as their starting point, the authors came up with a set of systematic guidelines that can substantially improve the chances of success when expanding to include services.

To limit the chances of failure, companies should look after two fundamental areas of action, they say. First, they should develop an adequate strategic plan, and second, translate that into an organizational structure and pertinent operational plan for offering services.

Strategic plan

Start by asking yourself what the primary goal is in offering new services: is it about giving support to the existing product-sales business (a defensive move) or about establishing an independent platform for growth (an offensive move)? This is a key decision, as it also affects numerous other related decisions, such as price setting and the organizational structure.

Once the primary motivation has been determined, secondary targets must be set - aiming to create a more personalized offer, for example, or delivering cost savings to customers.

In the second step, the main question requiring thorough analysis is why a customer would be interested in signing up for the newly offered services.

The authors urge companies to capitalize on the fact that the services could boost sales of their existing products and thus create an improved value proposition. To do so, the company must carefully choose which customers will be the targets for each service offered and, oftentimes a more difficult decision, which ones are not.

Meanwhile, the company should avoid offering services that customers do not place enough value on, in relation to the cost of what is being offered - something that seems obvious but is not always done.

Organizational and operational plans

After deciding on the strategic business plan for the services, the success of the expansion to include services will depend largely on having an adequate organizational design. The primary organizational decision is to establish the level of integration between the products and services businesses. In the development of any adjacent business, there is often a tension that needs to be recognized - that is, trying to take advantage of possible synergies with the existing products business by means of an integrated structure, while at the same time promoting the independent development of new services.

Finally, expanding to include services requires translating and specifically defining the organizational structure into a corresponding business operation. The processes, systems and metrics all need to be defined.

Many times, operational innovation and excellence with the new services can turn into a source of competitive advantage, particularly when competitors try to replicate the expansion. At this level, companies once again encounter some important yet unexpected pitfalls.

For instance, many try to replicate the methodologies that worked so well in their factories and supply chains, believing that they will be equally valid for optimizing the productivity of their services. Here again, they obviate the important differences between products and services. A good many executives are content with improving the profitability of their services via cost reduction, and squander the opportunities inherent in services, such as managing demand or coproduction with customers.

Moscoso and Lago confirm that expanding to include services is an important challenge for product-oriented companies. However, the benefits of a successful expansion can be significant and thus justify the attempt to do so. Particularly in highly commoditized sectors, this move is virtually a requirement, given that the alternative of not venturing into services could lead the company to compete exclusively through its pricing against companies benefitting from far lower labor costs.

There are other strategic alternatives to consider, such as launching new products, entering new markets or opening up new channels. But, as the authors point out, their failure rates are just as considerable.