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SUPERCHARGE YOUR SERVICES

SEVEN INNOVATION LESSONS FROM THE PROS

By Zhenya Lindgardt, Sam Ridesic, Peter Lawyer, and Olivia Morrissey

It is no secret that services are an attractive opportunity. With their high margins and relatively stable revenue streams, services—and service-oriented industries, such as legal and accounting—are highly profitable. B2B and B2C product companies have long recognized the advantages of wraparound services, but many companies find it difficult to add even the basics. Trickier still is providing the more sophisticated offerings that deliver value far beyond simply boosting product sales. What few of these companies understand is that adding successful services requires new business models.

The time for innovation is now. Given the array of forces disrupting business today, offering services is no longer optional for many product companies—it is imperative. (See the sidebar, "The Five Disruptive Forces Driving Services Innovation.") Profits are shifting to services across a wide range of industries, from grocery retail to large-equipment manufacturing to small surgical devices. Incumbents must reassess their existing products and services and make bold, decisive moves to combat the threat of new service-oriented players that are emerging in B2B and B2C industries.

The rise of the sharing economy, which includes companies such as Uber, and the subscription economy, which includes companies such as Netflix, has fundamentally changed the way people view everyday products. Today, everything has the potential to become a service.

Yet it is primarily start-ups—companies such as Airbnb, TaskRabbit, and Spotify—that are meeting consumer demand for new services and service platforms. On the B2B side, new service players—such as Mercateo in industrial goods and Castlight Health in health care—are attacking incumbents.

Moreover, digital service improvements on the B2C side have raised the service expectations of B2B customers. At the same time, technological advances—such as mobile Internet service, the Internet of

THE FIVE DISRUPTIVE FORCES DRIVING SERVICES INNOVATION

Five forces are disrupting the business landscape, making advanced services an imperative for incumbent companies:

- *Emergence of New Influencers.* More customers are turning to online sources for news and inspiration. Consider the wild success of home-remodeling inspiration site Houzz, which recently raised $165 million in funding. Incumbents are finding that a crucial point in the value chain is being disrupted by these new, digitally savvy and nimble start-ups.

- *Rise of New Interfaces.* A growing number of companies own no assets yet still have huge market valuations. Consider transport company Uber, which was recently valued at $40 billion despite owning no vehicles, and Alibaba, which had the world's largest initial public offering—$25 billion—but owns no inventory. Companies are battling to be the service broker between customers and products.

- *Ongoing Commoditization of Products.* This trend is not new, but neither is it going away. Services remain a powerful way for companies to differentiate themselves. As service offerings become more common, companies will need to up the ante by offering their customers more sophisticated solutions.

- *Consolidation of Retail Channels.* Amazon and other online retailers are driving consolidation in the retail channel. BCG research has found that while most superstores were able to carry about 150,000 SKUs, Amazon offered about 50 million.

- *Customer Centricity.* Today's digital tools are enabling companies to provide better—and smarter—services to customers than ever before. Data allows companies to create highly targeted, relevant services to attract and retain companies. Companies that fail to respond by offering their own specialized services will find it increasingly difficult to hold on to their customers.

Things, and the growing prevalence of big data—are rapidly opening up new service opportunities.

This leads us to the most important point: in many cases, offering only basic services, such as repair and maintenance, is no longer enough. Value-based offerings are the emerging paradigm in many industries. B2B and B2C customers expect more—they expect solutions.

The key question, of course, is how to successfully act on the knowledge that you need to supercharge your services. The following seven lessons from service pros will help, whether your company is just beginning the journey from products to services or wants to take its existing service offerings to the next level.

Lesson One: Track Erosion of Your Value Proposition

Monitoring and quantifying any changes in the value of your offerings is critical. The ongoing trend toward commoditization is eroding the value propositions of product-based companies faster than ever before. Services can be a powerful tool to create "stickier" relationships with customers, often going beyond simply protecting product sales to driving revenue in their own right.

PetSmart, for example, originally competed for customers by offering prices that were significantly lower than those of smaller pet retailers. By the late 1990s, however, many new players—including mass merchandisers and pure online retailers—had entered the market and were able not only to match PetSmart's low prices, but to beat them. PetSmart could no longer compete based on price alone.

In October 1999, when the company's share price reached a low of $2.63, PetSmart realized that it needed to attract customers in a different way. The company broadened its value proposition to offer a full range of pet services in addition to traditional products. It dropped its original slogan of "Where high prices have been housebroken," focused instead on a vision of total lifetime care, and developed a suite of services aimed at meeting the needs of pet "parents." New services included veterinary care, boarding, grooming, and training. In 2005, the company repositioned itself again to emphasize its focus on full pet care by rebranding from "PETsMART" to "PetSmart." Today, the company's slogan is "Partners in Pethood," and revenue from services accounts for 11 percent of the company's total sales.

Lesson Two: Use New Technology to Create New Services

Advances in technology are creating new possibilities for service offerings. To stay relevant, companies need to continuously rethink their existing offerings in light of new technologies.

IBM is a master at aligning with technology trends. The company transformed itself in the 1990s, moving away from hardware to focus on software and consulting services—a move that anticipated important trends in the market. And IBM didn't stop there: as new technology and consumer trends emerged, the company continued to reassess and adapt its service offerings.

One recent example is IBM's Smarter Planet initiative. The company launched a series of campaigns that highlight how some of the most exciting advances in technology—such as connected devices and cloud technology—are being used to address social business needs. These projects have tackled everything from installing smart grids for sustainable water conservation to using big-data analytics for improvements in urban services. The market quickly recognized IBM's innovative approach: the company's stock price surged immediately after the announcement. In 2015, revenue from Smarter Planet initiatives is expected to exceed $7 billion. Moreover, these projects have helped IBM hone its data and analytics skills, allowing the company to bring more weight and credibility to service projects in other sectors.

Lesson Three: Reclaim Customer Influence

Many companies struggle to retain influence over customers as the Internet has enabled new voices to reach more people. Consider how home-inspiration site Houzz is overtaking the big-box home-improvement retailers. Houzz's 25 million unique visitors per month have caught the attention of venture investors, who now value the company at over $2 billion, confident that as the site begins to monetize, it will capture a large portion of the market. Houzz is beginning to threaten traditional players by directly linking consumers with vendors and contractors. Companies that want to retain their brand equity and market clout must reclaim their customer influence.

Nike is a strong example of a company that has not only retained but increased its influence over customers. In his 2014 letter to shareholders, Nike CEO Mark Parker explained that one of his top priorities is to expand the company's digital ecosystem because "our consumers expect Nike to be as digitally connected as they are." The heart of that ecosystem, according to Parker, is Nike+.

In 2006, Nike anticipated the fitness trend and launched Nike+ as a way for athletes to track their performance and share their stats with an online community. Since then, Nike has fought against a growing number of fitness players, such as Fitbit, to retain customer influence and loyalty. A close follower of consumer fitness trends, Nike continues to invest in and improve its Nike+ services. For example, its Training Club application gives consumers a personal-trainer experience. This attention to services has paid off: Nike+ membership grew from 200,000 in 2006 to 28 million in 2014. The data from such a vast pool of members will be a powerful resource for Nike as it considers other ways to monetize this service beyond providing input on consumers' product preferences.

Lesson Four: Leverage Brand Equity and Capabilities to Win

Although start-ups may be more nimble, incumbents by their very nature have a number of competitive advantages when they move into services. A trusted brand, a strong economic position, and proven capabilities can be powerful tools when seeking partners and profits in adjacent services markets.

Medtronic used these strengths to its advantage when it established its health services arm, Medtronic Hospital Solutions, in 2013. One of the first hospitals to work with Medtronic in this new initiative explained that Medtronic's trusted reputation was the principle reason it pursued the partnership.

Medtronic Hospital Solutions helps manage and modernize cardiac-catheterization laboratory facilities in Europe. This focus was a cleverly calculated foray into services for two reasons. First, Medtronic is particularly well known in the cardiology space, making its decision to concentrate on catheterization labs highly logical. Second, by targeting Europe instead of the U.S., Medtronic was able to leverage its considerable size and economic strength. The company's backing was particularly welcome in Europe because many of the hospitals there are government funded, so start-up capital is less accessible than in the U.S. For its part, Medtronic gained a living laboratory for experimenting with a new business model that broadens the company's patient relationships and provides deeper insight into how its products are actually used.

Lesson Five: Restructure Relationships with Other Players in the Service Ecosystem

Offering best-in-class services sometimes means forming relationships with other companies to more quickly and successfully bring new services to customers. This can result in win-win opportunities for all the parties involved.

Apple's partnership with third-party application developers to make its products more valuable and to create a more comprehensive ecosystem is an obvious example of such a mutually beneficial relationship. The Container Store's continued success in a highly commoditized industry illustrates a more subtle instance. The key to the retailer's competitive advantage is a heavy investment in its vendor relationships to ensure that they are long term and mutually beneficial. The company has even codified the idea in its "Foundation Principles," one of which instructs employees to "Fill the other guy's basket to the brim. Making money then becomes an easy proposition." Because of these strong relationships, the Container Store can offer customers exclusive products that aren't available anywhere else. In fact, 59 percent of the retailer's sales in 2013 came from unique and highly differentiated products—a strong competitive advantage.

Lesson Six: Build Service as a Stand-Alone Model

When companies treat services purely as a way to increase product sales, they can miss the opportunity to turn services into growth engines and value creators in their own right. So instead, make sure to design and test the optimal stand-alone service model first, and integrate it into the existing business only where absolutely critical. Entravision Communications, a Spanish-language media company, did exactly that when it set up Luminar, a big-data analytics insights provider, as a separate business in 2012.

At the time, detailed consumer data on the U.S. Hispanic population was lacking, despite the group's collective spending power of approximately $1.5 trillion. Entravision had amassed large amounts of viewer data and was beginning to offer clients advanced analytics services. Client demand was strong, and when Entravision began to get requests for analyses that went beyond traditional media purchases, the idea for Luminar was born. Entravision set up Luminar as an autonomous business unit with a separate brand, an independent P&L structure, and its own management team to ensure that both businesses could grow and retain individual integrity. As Franklin Rios, the president of Luminar, explained in a 2013 interview with *MIT Sloan Management Review,* "[W]e felt that we needed to have, for lack of a better word, separation of church and state—we wanted to establish a new brand in order to carry its own weight." Luminar was already on track to deliver positive earnings in 2014.

Lesson Seven: Empower Employees to Enable a Robust Service Culture

Establishing a service culture is a vital part of a successful services strategy. After all, employees who are passionate about providing high-quality services lead to happy customers—and positive word-of-mouth advertising.

Zappos, the online apparel and footwear retailer, is well aware of the importance of such a culture. The company intentionally put in place processes that develop and nurture its exceptional customer-centric, service-oriented culture, which helps the company sustains its competitive advantage.

For example, Zappos is extremely interested in ensuring cultural fit during the hiring process. The company uses ten core values to design interview questions that probe how well a candidate might fit within the company. Zappos even asks each candidate's shuttle driver for feedback.

In addition, all new hires—everyone from entry-level employees to senior managers—first become call center representatives so that every person at every level within the organization has been taught how to provide exceptional customer service. At the end of this training, Zappos famously offers each person one month's salary to quit, thus ensuring that only employees who really want to stay are part of the Zappos team.

What's more, Zappos does not script its people's interactions with consumers. Instead, employees are encouraged to develop their own service styles and to use their own judgment when deciding how best to wow their customers, whether by spending hours on the phone with a shopper or by delivering pizza in response to hungry tweets. Zappos's service culture has become so renowned that the company teaches other businesses how to create one of their own. And it is part of the reason Amazon bought Zappos in 2009 for $1.2 billion.

In the past, large established companies typically believed that their competitive advantage came primarily from their physical assets. Today, success requires a different mind-set. Winners will focus on building a competitive advantage based on capabilities that include being able to repeatedly anticipate new opportunities and quickly develop new models in response. Services will be an increasingly important part of those new models. Value creation will become more and more difficult for companies that don't have a robust and growing service offering. Incumbent players that counter the latest disruptive forces by implementing these seven services lessons will be well positioned not just to survive, but thrive.

About the Authors

Zhenya Lindgardt is a senior partner and managing director in the New York office of The Boston Consulting Group. You may contact her by e-mail at lindgardt.zhenya@bcg.com.

Sam Ridesic is a senior partner and managing director in the firm's Toronto office. You may contact him by e-mail at ridesic.sam@bcg.com.

Peter Lawyer is a senior partner and managing director in BCG's Minneapolis office. You may contact him by e-mail at lawyer.peter@bcg.com.

Olivia Morrissey is an associate in the firm's New York office. You may contact her by e-mail at morrissey.olivia@bcg.com.

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