# Servitization in Manufacturing—The Final Frontier


## Abstract

The emergence of Product-as-a-Service concept has challenged the notion of product-focused manufacturing processes for both manufacturers and their industrial customers. Product offerings, bundled with value-added service propositions, promise to yield profits for manufacturers. With services surfacing as stable revenue-generating streams, it has necessitated comprehensive business model transformation—including rethinking strategies and the building of new capabilities. A model where the outcome or services are sold as a product, ensuring that customer needs are met while boosting the performance of the core product - is known as 'servitization'. Manufacturers must initiate a transition of operations, shifting from a product-oriented to a more customer and outcome-focused functional framework to sustain and grow in the emerging economy.

The industry is rapidly focusing on selling product benefits versus products and features with enhanced capabilities and competencies.

## The Changing Manufacturing Terrain

With decreasing product differentiation, escalating customer expectations, and evolving environmental and safety regulations—commoditization is on the rise. This disrupts established markets, and pressurizes companies to rethink their existing service business models.

Manufacturers are shifting their operational capabilities to:

- Packaging and delivering value services at every stage of the customer's value chain
- Apply best practices such as performance-based contracts.

Companies are transforming business models, from providing ad-hoc support to developing service models backed by business logic.

## The Growing Importance of the Service Business

The shift in the value proposition, from production activities to the fulfillment of customer demand has necessitated additional related functions to ensure adequate balance in value-creation. The function of formulating a contract is crucial for manufacturers who are striving to develop and grow their service business. Although a robust and well-defined contract can impact product sales negatively, it leads to an overall increase in revenue. For physical assets, the traditional contract entails a discrete demarcation of the sales transaction and after-sales product lifecycle support. Maintenance-repair-overhaul (MRO) costs are, for instance, considered inevitable for the buyer.

Performance-based contracts, on the other hand, determine the provider's revenue, based on defined performance metrics. This means that customers do not pay for tasks undertaken but the performance outcomes.

These are the different types of service contracts that are formulated between the provider and customer, in decreasing degree of profit potential:

- Performance-based, or outcome-based contracts
- Time and material contracts
- Spare parts sales and maintenance contracts
- MRO Contracts

Servitization gained momentum during the last recession as manufacturers were exploring ways to protect their revenue streams. While product sales kept dropping, manufacturers who turned to offering services wrapped around their products were able to sustain themselves, ensuring growth.

## Servitization as a Strategic Competitive Differentiator

As manufacturers adopt the role of a service provider to transform customer experience—using a business model rather than product-based innovation—it creates new revenue streams. The focus shifts from 'increasing product sales' to 'increasing product consumption'


*Figure 1: Value-Generation through Servitization*

Servitization directly links revenue generation to asset availability, reliability, and performance. Many industry-leading manufacturers are offering pay-per-use contracts, where the user does not own the equipment, but only pays for the time and amount of usage.

With strong focus on product and service outcomes, manufacturers are able to servitize their products across the entire business life cycle.

This creates:

- A completely new value system for customers that helps lock in long-term customer relationships and lock out competition.
- A competitive advantage, specifically in areas where scope for product differentiation is eroding and customer expectations of performance is increasing.
- Mutual incremental value creation between manufacturers and customers that extends beyond a one-time sales transaction and paves the way for repeat sales.

However, we need to analyze what enables the workings of this transformed business model.

## Reimagining Business Operations and Performance to Enable Servitization

Product manufacturers are progressively adopting sensors and control devices with data transmission and decision-control capabilities to receive real-time information on product health.

This data is being mined to derive actionable insights with the help of predictive analytics. By leveraging smart machines, advanced diagnostic and decision control tools, and customer service applications, manufacturers can provide timely resolution on product issues, provide first call resolution, and facilitate higher equipment uptime.

A servitization vision should encompass:

- Charting a service strategy
- Restructuring organizational functions
- Building capabilities
- Creating a service culture

## Challenges in Implementing Servitization

While servitization promises to ensure potent competitiveness with rapid growth, revenue, and profit-making opportunities, the real-world scenario reveals that it is often difficult to achieve the desired ROI in services.  This is mainly due to the fact that ROI on building and maintaining products for servitization require a high utilization of equipment and services.

These are some challenges confronting manufacturers:

- Shifting mindsets for a transformed organizational strategy
- Managing time scales while designing the service
- Facilitating functional and organizational realignment
- Supporting overarching organizational change
- Managing geographical and cultural diversity

Manufacturing companies can adopt the proposed framework to reimagine their entire service lifecycle, without disrupting their existing operations. This can help manufacturers drive quicker issue resolution, and provide predictive and proactive maintenance while delivering a consistent brand experience.

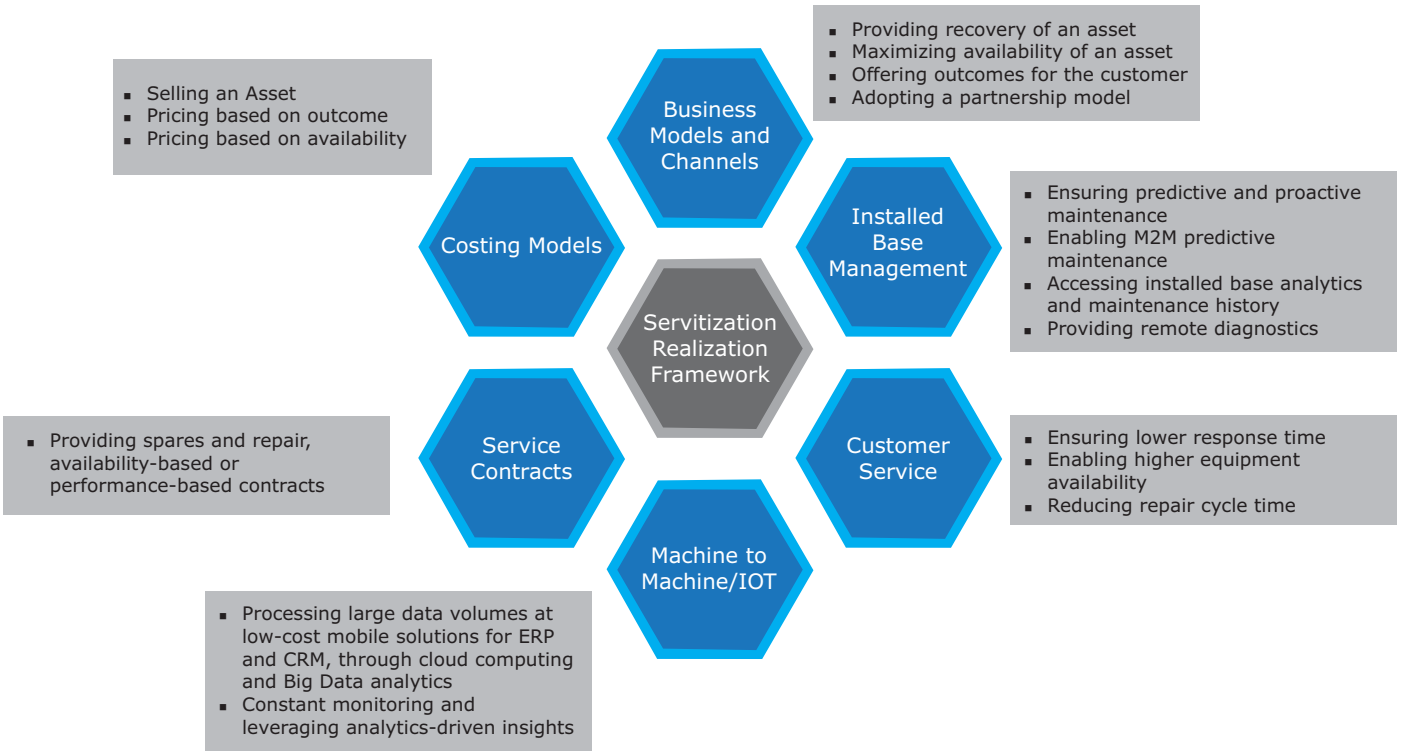


*Figure 2: The Proposed Servitization Framework*

## Benefits with Value-Added Product Portfolio

Servitization ensures financial sustainability as manufacturers are guaranteed regular and recurring sales revenue. Technicians are elevated to the position of lead generators as they play a critical role in building customer loyalty and forging long-term relationships by up-selling solutions. This results in a shift from capital expenditure to operational expenditure.

Moreover, servitization also:

- Transforms operations for manufacturers, as long-term contracts provide the assurance of a steady flow of income
- Reduces the cost of product innovation due to the product usage data that is available to the manufacturer at all times.
- Engages manufacturers in a continuous learning process from service to delivery, which helps them enhance future service offerings.

Customers in turn are able to eliminate risks of huge repair costs, leading to financial stability and an increased customer lifetime value.

## Conclusion

Servitization is a profitable business proposition for manufacturers, which opens up channels for forging longstanding customer relationships. With necessary investments in personnel and technology, manufacturers are able to provide differentiated offerings with services across the product lifecycle, and prepare for servitization with innovation.

In the emerging world of servitization, value creation and delivery is an ongoing process. Equipped with this strategic competitive differentiator, manufacturers are empowered with the capability of transforming product creation and servicing processes, and redefining value exchange with customers.

**About The Authors**

Susheelendra Bhandiwad

Susheelendra Bhandiwad is a Partner and Lead Consultant for Service Transformation within TCS' Manufacturing business unit. He has more than 17 years of industry experience in Customer Experience Management (CEM), and supply chain and operations in the manufacturing industry.

Sundarajulu V

Sundarajulu V is a business consultant for various CEM engagements with TCS' Manufacturing business unit. He has over 12 years of experience in CEM, automotive after-sales, and IT in North America, Europe, Middle East and Africa (EMEA), and APAC markets.

Samiksha Hariharan

Samiksha Hariharan is a Business Consultant in TCS' Manufacturing business unit. She has over 15 years of experience in IT strategy and consulting, and has worked with global customers in defining applications strategy, domain and functional consulting, and program management.

Ajay Shelar

Ajay Shelar is a Business Analyst in TCS' Manufacturing business unit and has about four years of experience in the Manufacturing industry in the procurement and supply chain domain. He is currently involved in various CEM projects.

**Contact**

Visit TCS' Manufacturing unit page for more information

Email: manufacturing.solutions@tcs.com



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