

Changes in Industrial Landscape and the Future of Service Economy Servitization of manufacturing



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Agenda

- Manufacturing Innovation and Competitiveness
- The Focus on Servitization
- Companies leading the Servitization Revolution



Manufacturing Innovation and Competitiveness

Increasing global competition and the search for profitable growth pushes manufacturing to the forefront of innovation

- Companies are continually challenged to improve shareholder value and find ways for sustainable profitable growth
- Globalization, digitalization and other megatrends are driving changes in an increasingly competitive landscape, causing manufacturing companies to adapt and alter their business models, as they continuously search for new growth opportunities
- New thinking, assertive strategies, and decisive actions that foster and accelerate the capacity for innovation while creating a stable and competitive cost environment will likely differentiate the most competitive companies

Manufacturing innovations must respond to a myriad of complex challenges to remain competitive



**Demographic changes
including, urbanization
and mobility**



Water scarcity



**Rapidly growing
demand for energy**



**Climate change,
environment and
sustainability**



**Growing demand for
food, nutrition and
health**

Rapid globalization has changed economic dynamics, and manufacturing supply chains, in profound and significant ways

Over the past 20 years, with the occurrence of rapid globalization the global manufacturing eco-system has experienced more change, impacting the prosperity of more companies, nations and people than at any time since the Industrial Revolution

**Free trade
proliferation**

**Digital technology
infrastructures**

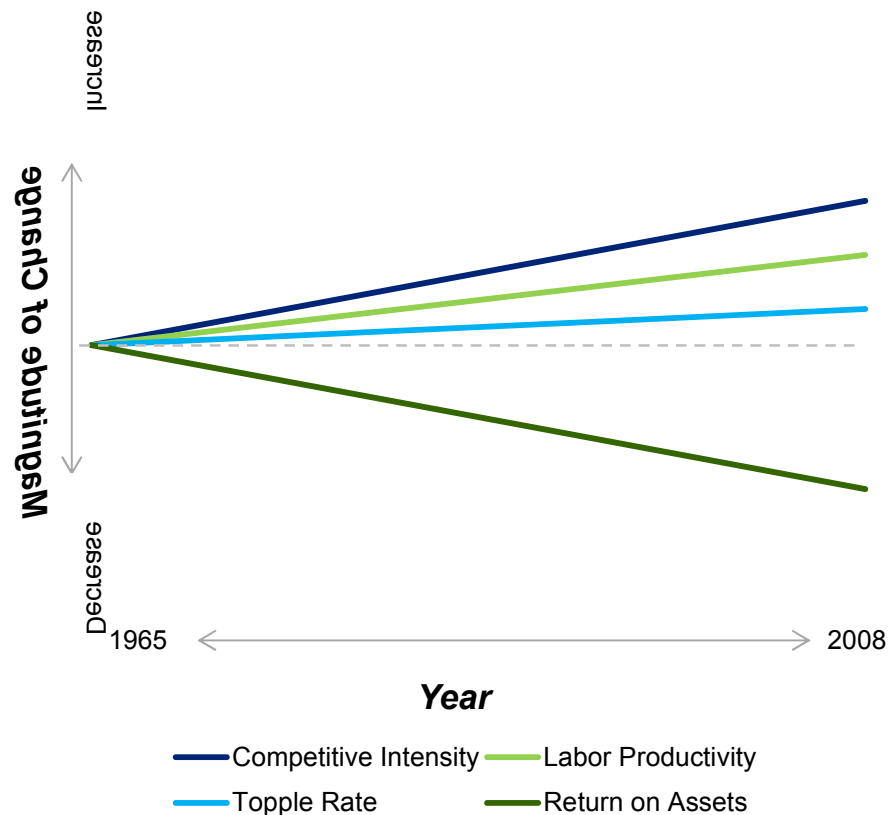


**The rise of a new
global middle class**

**Global disaggregation
of manufacturing
supply chains**

Increased market competition has made it difficult to sustain an operating competitive advantage, making sustainable growth increasingly challenging

Firm Performance Metric Trajectories (1965-2008) ¹



Increasing competitive intensity

U.S. competitive intensity has more than doubled during the last 40 years

Not capitalizing on increasing labor productivity

Over the past 40 years, labor productivity has more than doubled; however, that increase is not reflected in company performance

Winners have an increasingly precarious position

The “topple rate,” at which big companies lose their leadership positions, has more than doubled

Decreasing ROA*

ROA for U.S. firms has steadily fallen to a quarter of 1965 ROA with the gap between the “winners” and losers” increasing over time

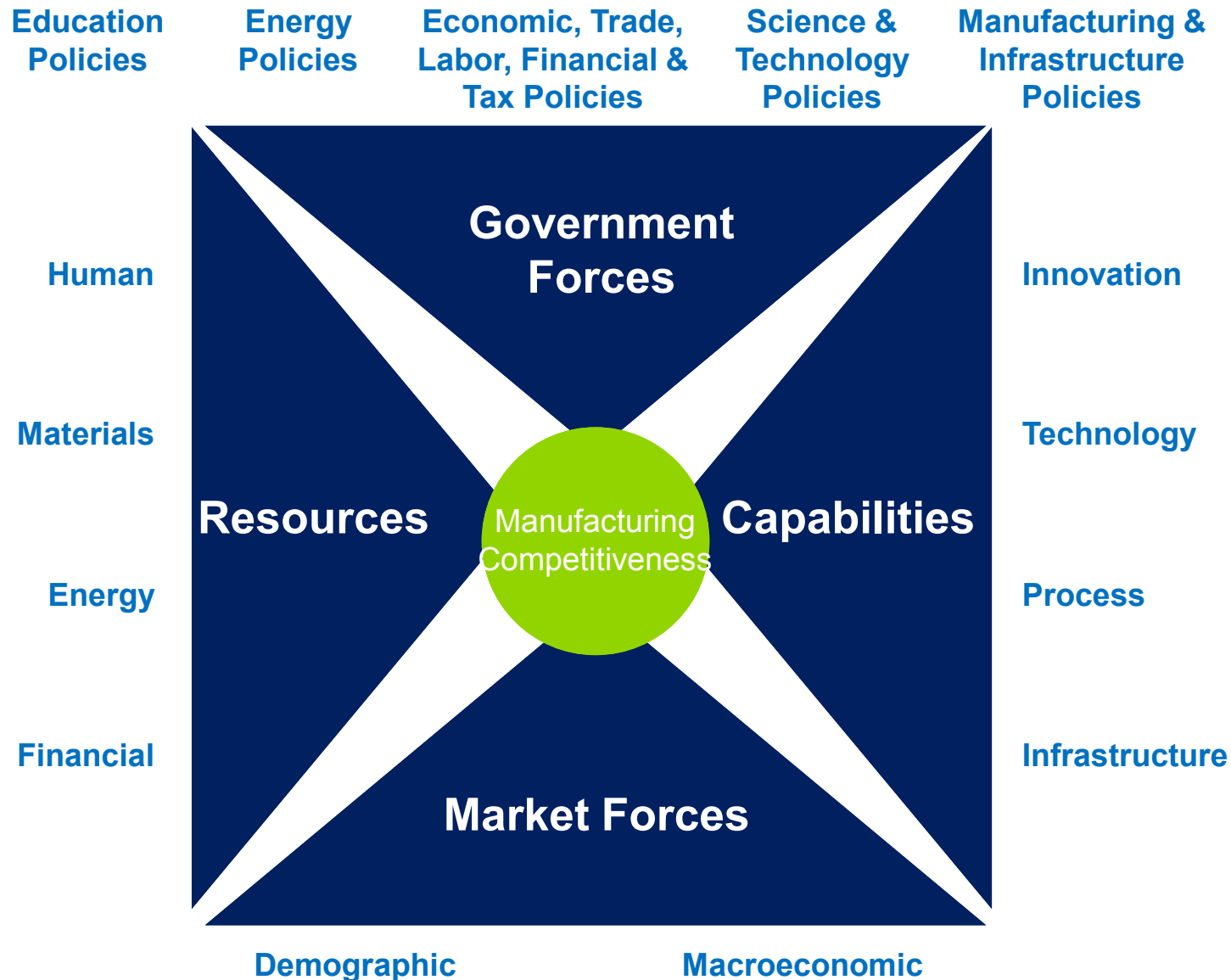
*ROA – Return on Assets

Source: Deloitte analysis (2009 Shift Index)

Note: 1. Shift index used more than a dozen vendors and data sources, four surveys, and five proprietary methodologies to compile data representing 15 industries over four decades

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Looking to the future, there are a number of key factors that will impact manufacturing competitiveness



Competition for resources, capabilities, and on public policy will intensify as both companies and countries compete for success



Infrastructure



Foreign Direct Investment



Materials Resources



Clean Energy



Innovation



Human Capital



Public Policy

The Focus on Servitization

The basis of competition has been shifting to focus on capturing value in services

- Today many manufacturing companies, consider themselves designers and producers of tangible products rather than providers of an integrated solutions to customers' broader needs
- However, the business models of many global manufacturers are under pressure, as companies compete in an ever more competitive and global economy where products are becoming more commoditized
- The time is right for manufacturers to shift their to include service as a critical strategic component for increasing revenue and profitability

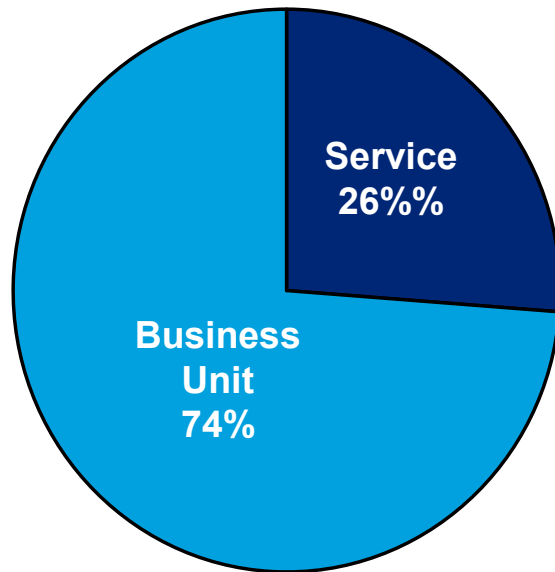


The growing importance of a service oriented business model could not be more critical in this increasingly complex and competitive environment

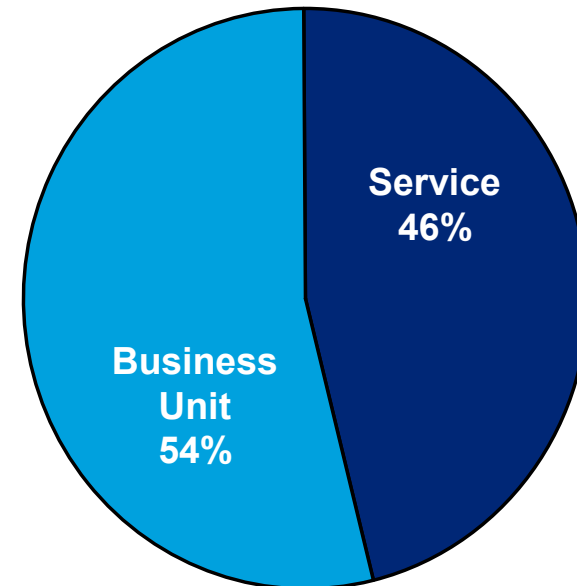
- **New basis of competition** caused by changing customer demands, maturing markets and the competitive savviness of low-cost rivals
- **Product proliferation** from barrage of new products, shorter sales cycles and long service life cycles can give rise to escalating costs and low customer focus
- **Quality backlash** can exact a severe toll in warranty costs and brand damage as a result of poor quality management
- **Continued outsourcing** shifts focus to relying more on the success of customer-facing, and service-oriented aspects of businesses
- **Service resilience** can be exploited during times of economic downturns
- **Increasing business complexity** means that success will require a global service perspective to support and enhance the product business

Manufacturers are driving revenue and profits through the service business

Share of Revenue



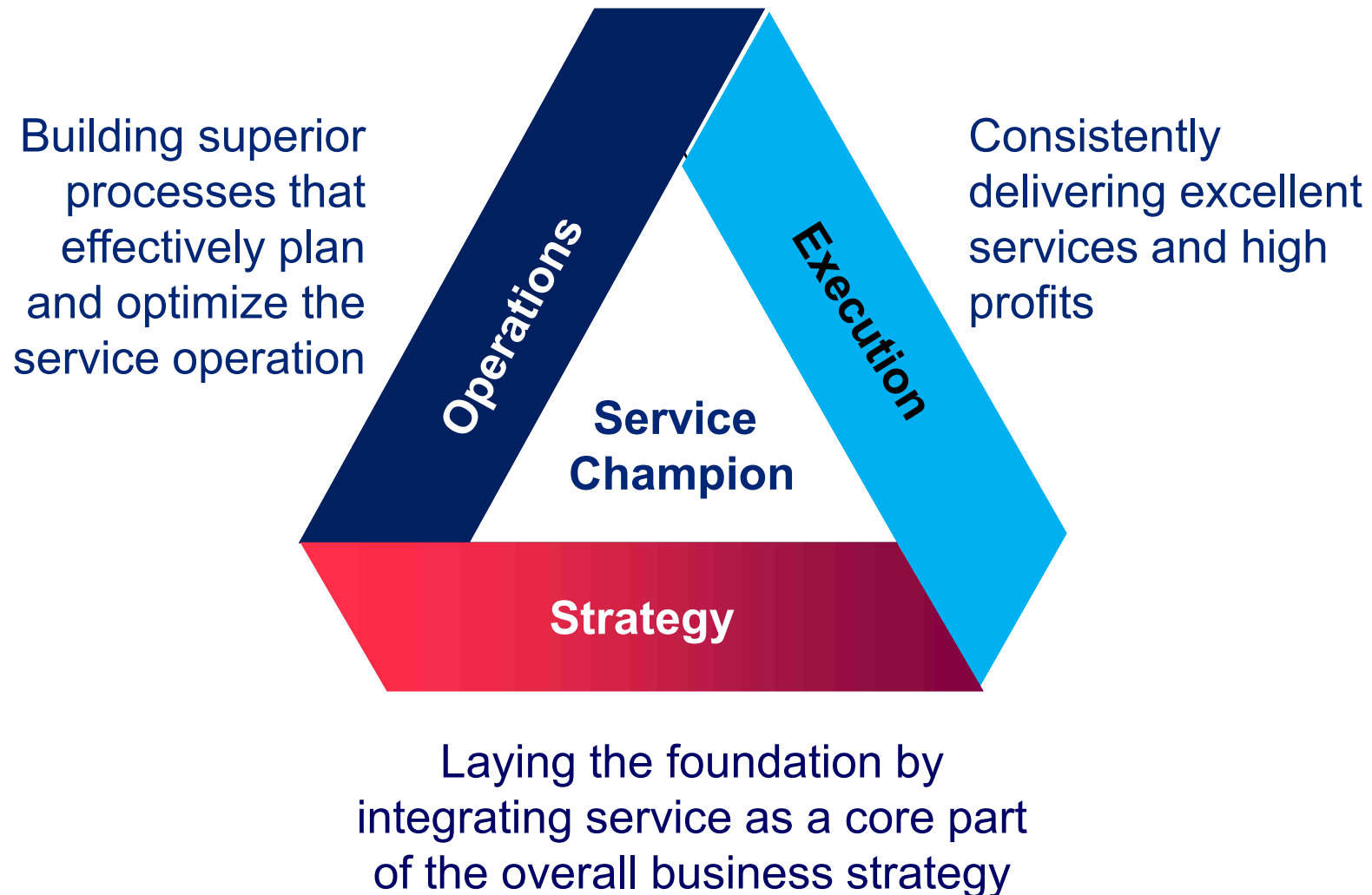
Share of Profit Contribution



The good news is, that more and more companies are gaining awareness of the importance of the service business in changing the basis of competition.

Successful companies are transforming their business through service excellence

Revolutionizing the service business by excelling in the three key elements;
Strategy, Operations and Execution



Strategy: Laying the foundation



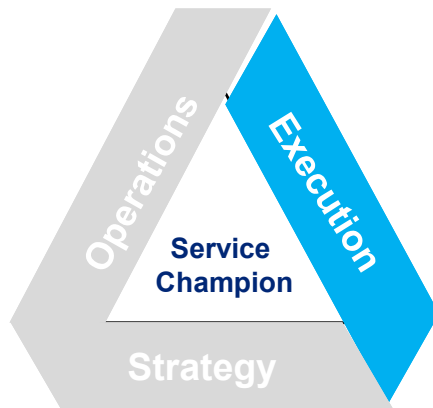
- Service champions like Siemens committed to service innovation by making service central to their corporate strategy
- With a clear understanding of their customer's needs, they designed their service business around their customers' requirement thereby creating customer satisfaction, loyalty and business performance
- Exhibit clear visibility into the critical design and investment decision criteria
- Research showed that companies that have extensive visibility into customer satisfaction, for example, achieve the highest service margins ... and enjoy 22 percent higher return on assets.

Operations: Leapfrogging through process and technology maturity



- Service champions, show that service excellence relies on processes and systems that create visibility across the supply and distribution network
- Specifically, they have adopted well-established robust collaborative processes as well as maturing technologies and tools that effectively plan and optimize the service operation
- Service champion Caterpillar Inc. shows that ongoing investment in and focus on improving the service and logistics operations can lead to outstanding customer service, resulting in greater customer loyalty and a foundation for profitable growth

Execution: Strategy and Operations alone do not guarantee success, manufactures must also master execution



- Manufacturers that measure customer service, have higher customer service scores, report higher margins, revenue growth, market share growth, profitability, and ROA goals
- Service champions are able to clearly differentiate themselves from the pack:
 - They have 10% higher on time delivery
 - 5 times more likely to experience exceptional profitability goal performance
 - 20 times more likely to experience exceptional ROA goal performance
- Caterpillar with its complex global service requirements has developed an extensive database of service records that gives it the ability to do a superior job of responding to its customers at a 99.7% on time delivery rate

Companies leading the Servitization Revolution

Many manufacturing companies across multiple industries are mastering the service business as a means to long term growth

Aerospace

Toward **performance-based service** and logistics agreements with customers

- **Rolls-Royce** has long been focused on selling “**Power By The Hour.**” Customers pay a fixed warranty and operational fee for the hours that their engines are running.
- Rolls-Royce **now focus on the entire package**, from products, installation, after-sales maintenance, repair and overhaul, to overall service and parts management

Industrial Products

Customers view provider **service offerings** as an **integral part** of the business.

- ABB offers its industrial automation customers “**performance service**” tailored to their needs. The offerings range from simple, product-focused maintenance and field services to “Automation
- Performance Management” where **ABB guarantees the performance levels and assumes the risks** of the equipment over its life cycle whether

High Tech & Telecom

Costly equipment **downtime** and the need to be serviced for decades.

- Printer makers, such as Hewlett-Packard and Xerox, have **derived more revenue and profit in selling ink and after-sales services** than in initial printer sales for quite some time.
- For semiconductor equipment makers like **Applied Materials**, **service and parts management is at a premium** and it is pivotal to selling the equipment in the first place.

Automotive

Digitization, connectivity, and technology lead to value features that have become **expected services**

- Telematics has created opportunities for business model innovation, enabling automotive manufacturers to offer connected services that meets consumer demand, **improves the customer experience**, creates **stronger customer connectedness and relationships** over the full life cycle of the vehicle, and helps to build brand loyalty

Rolls Royce surges ahead with service based business and turns turn risk into profit

- Market forces drive aerospace manufacturers towards service focused innovation and customer support as means to maintain and capture market share
- Rolls Royce's introduction of the "Power by the Hour" concept revolutionized the customer relationship and changed the business focus to performance-based service model
- This new approach to customer support and sustainment presents companies with significant opportunities to boost revenues and margins, but exposes them to unprecedented risks
- Rolls' Royce's service revenue accounts for about 53 percent of their \$11 billion-plus annual revenues, well above the industry average of 26 percent
- The company's service revenues has increased by more than 60 percent over the last five years and almost tripled over the past decade, growing more than twice as fast as Rolls-Royce's overall business



Changing competitive landscape forces Medical Device manufacturer to revolutionizes its service business

- A superior and quality focused service organization can help drive additional sales and create long-term relationships that helps manufactures respond better to their customers
- A medical device manufacturer of sterilization systems optimizes its global service business to help improve its operating margin
- Transformation of the service business required a review of the three essential elements for service excellence, Strategy, Planning & Operations, and Execution
- By increasing its customer focus, the manufacturer was able to show improvement in its field service and sales organizations, field service execution, and sales order management
- Improvement in all three elements, led the manufacturer realize benefits in excess of \$45M



What does the future hold for Servitization?

- Research supports the notion that service focused businesses typically generates higher profitability than “core” product manufacturing activities and tend to offer a stronger growth potential
- Amongst manufacturing companies around the world, service businesses now account for 26 percent of revenue and a significant 46 percent of profits.
- However, research also reveals that most companies are not executing at the level they should, especially in an increasingly competitive environment in which customers have more choices than ever before
- The services business, with its potential for significantly higher profitability and under-exploited growth potential, is the overlooked jewel of many corporate portfolios, rarely receiving the attention it deserves.
- A performance based environment presents new challenges and requires a broad range of new capabilities, and in many cases a new business model, that is usually very different from the manufacturers traditional business

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