

**Profitable Growth through Service**

July, 2005

**Arthur D Little**

## Executive Lunch Service

---

In today's meeting we would like to discuss following topics with our guests:

- Results of Arthur D. Little's "Service Innovation" study
- Growth levers based on Arthur D. Little's experience
- Guests' perspective: Status of own service business and key challenges
- Conclusions and next steps

## Inhalt

---

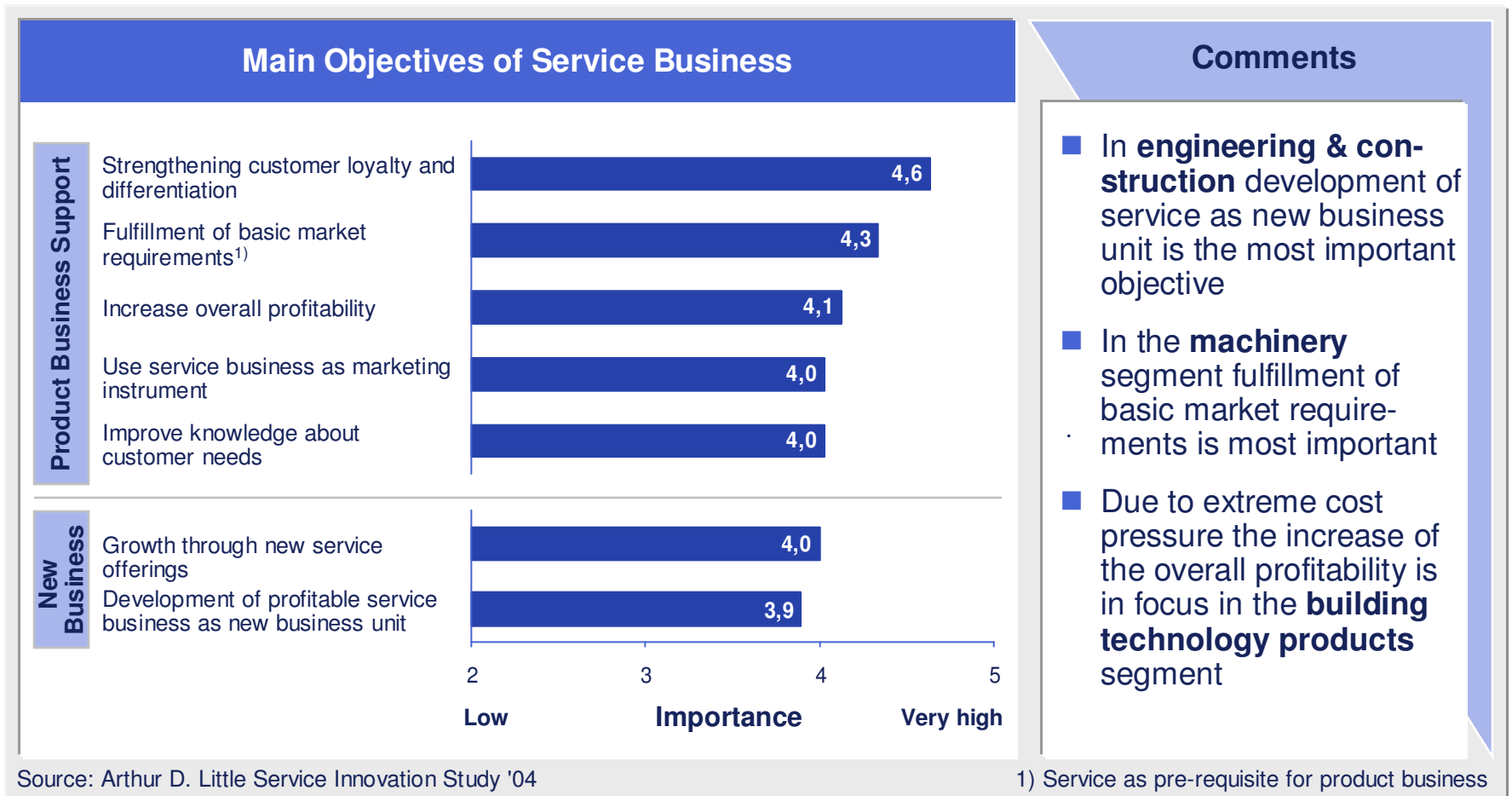
1

Arthur D. Little's "Service Innovation" Study

2

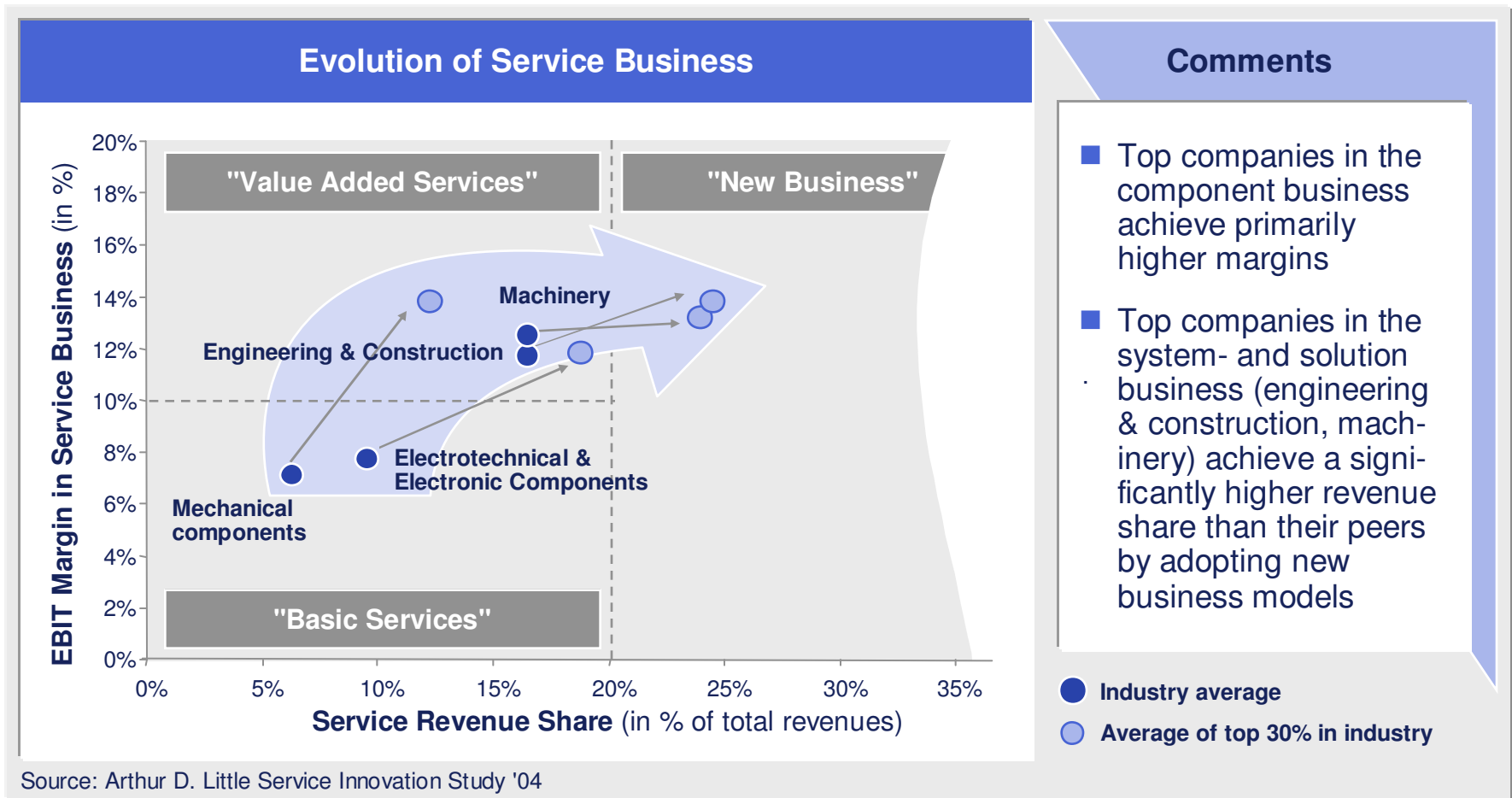
Growth Levers

## Support of the product business is still the most important objectives of service businesses

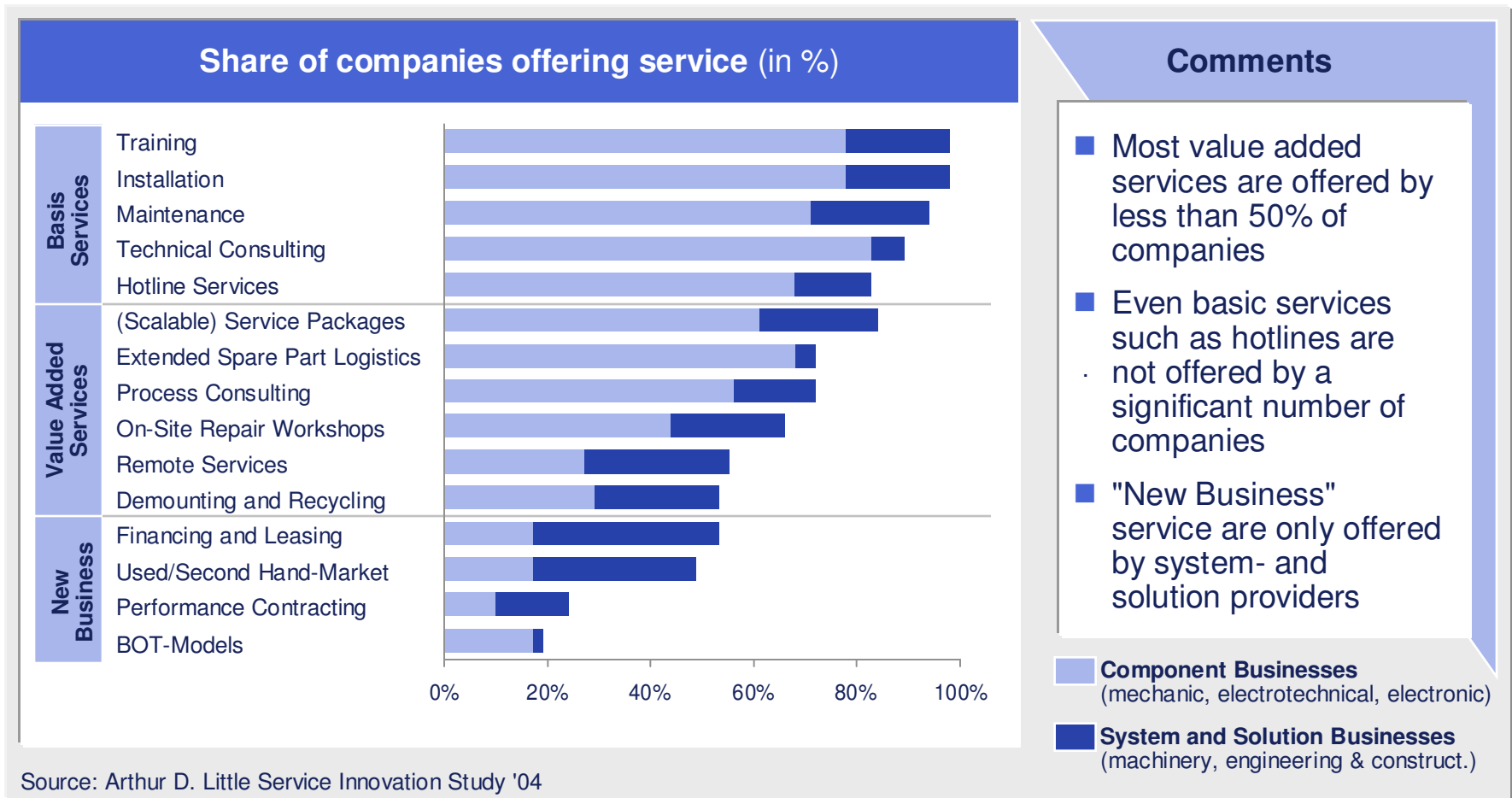


Source: Arthur D. Little Service Innovation Study '04

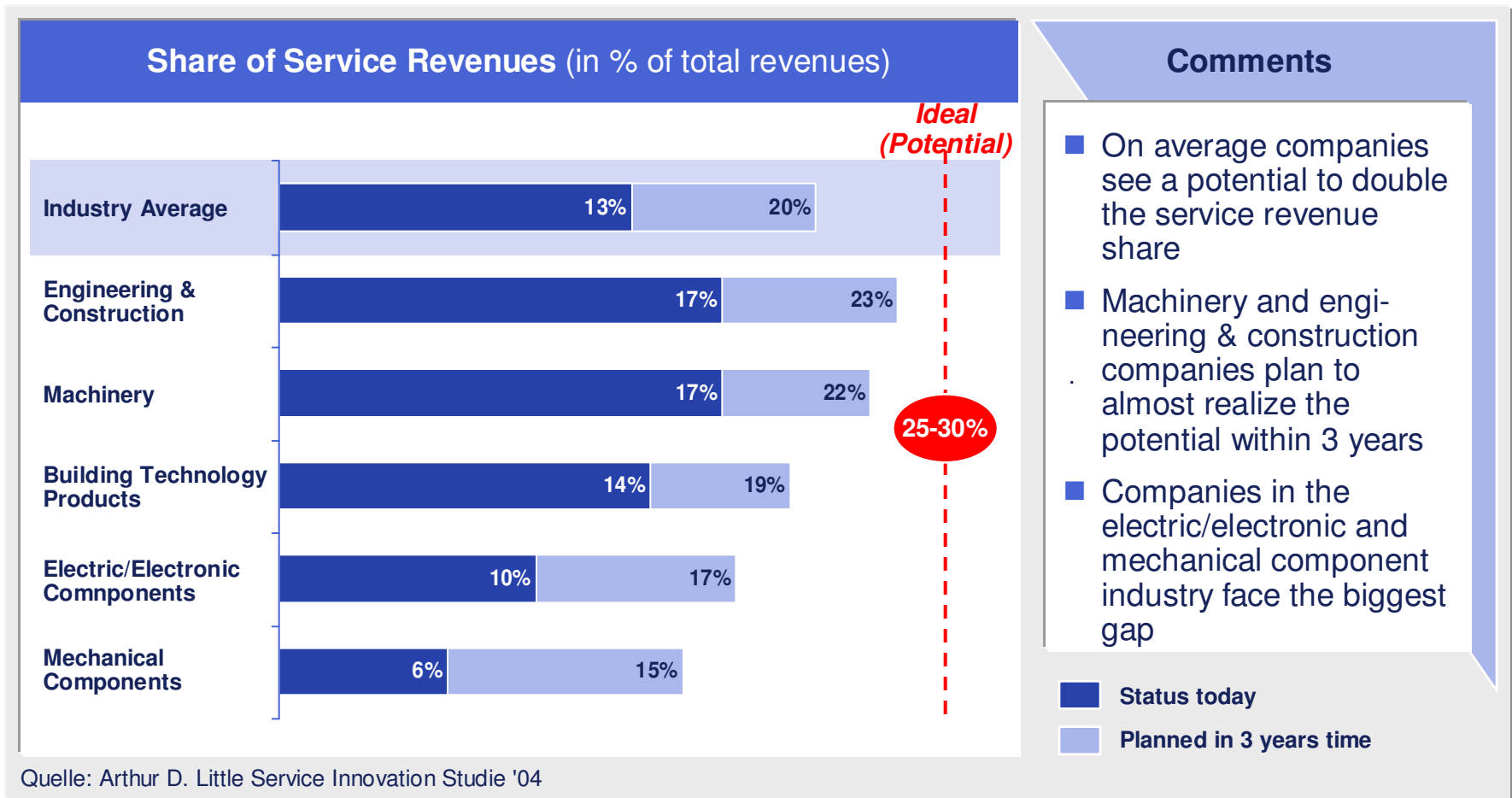
Top companies have moved much further on the typical development path towards an "independent" and profitable service business



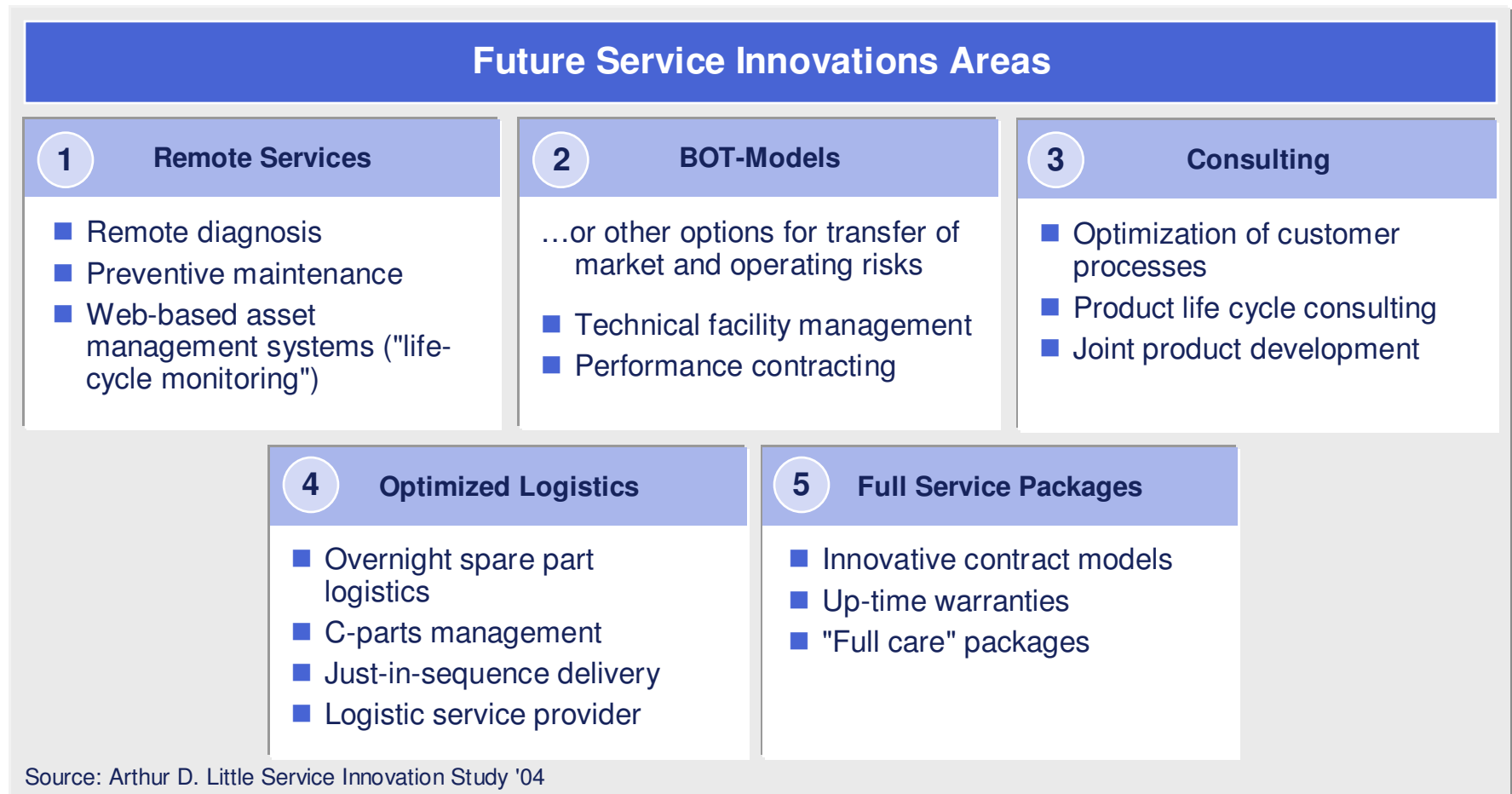
Currently, most service portfolios have significant gaps – companies do not exploit the full market potential



The importance of service will increase significantly – on average companies plan to increase service share of total revenue by 50%

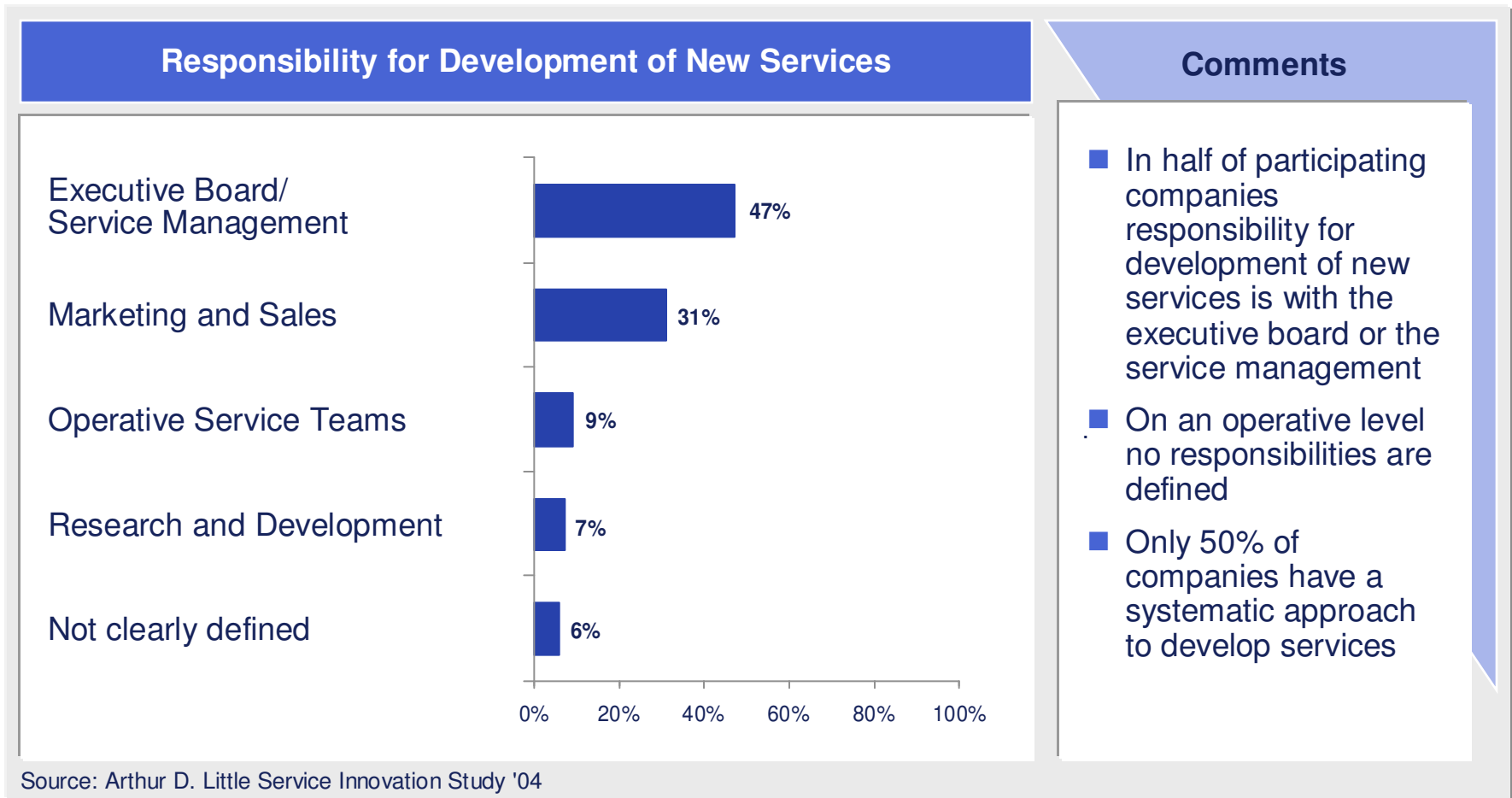


## Future service innovation will focus on five areas

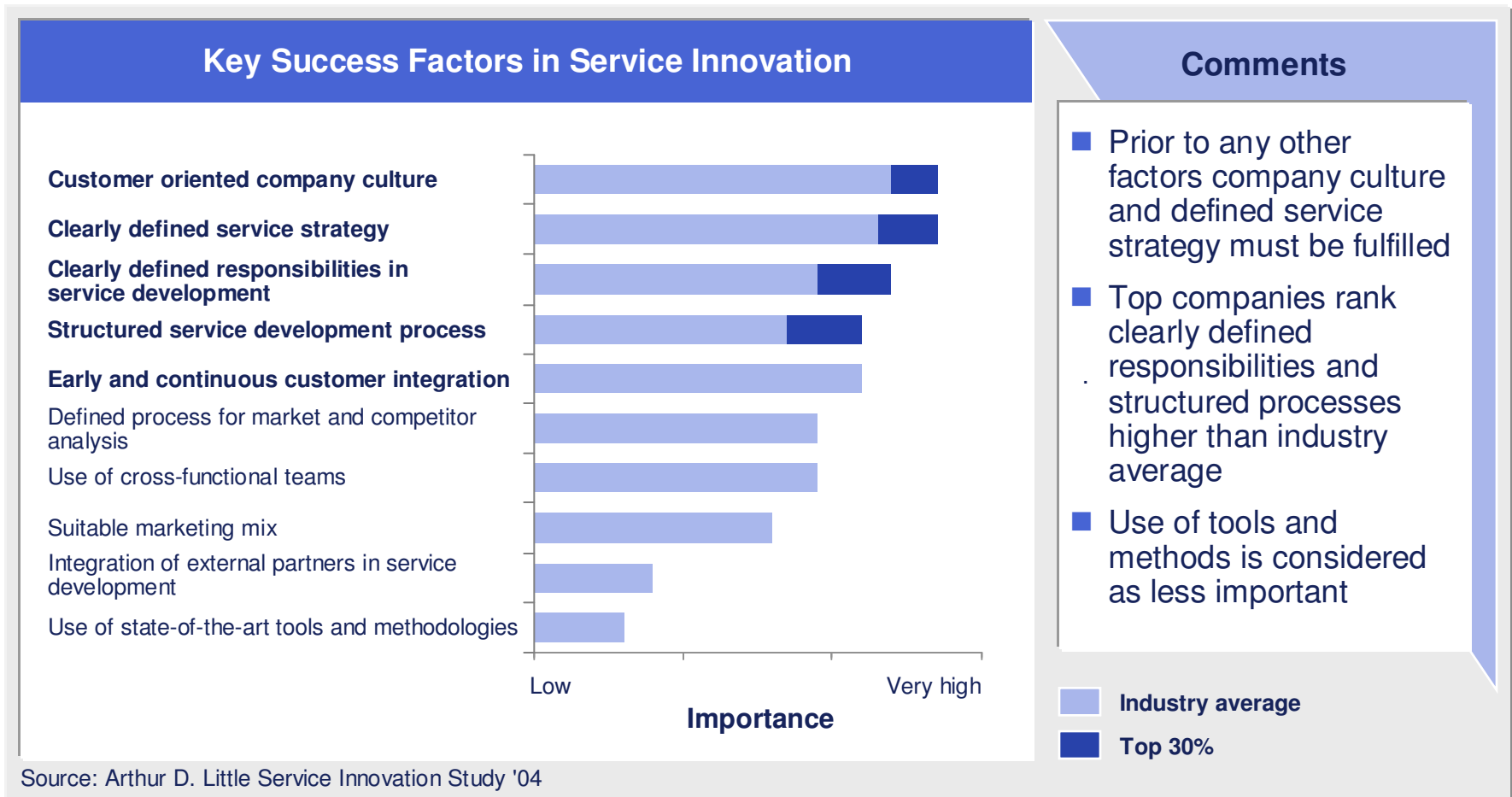




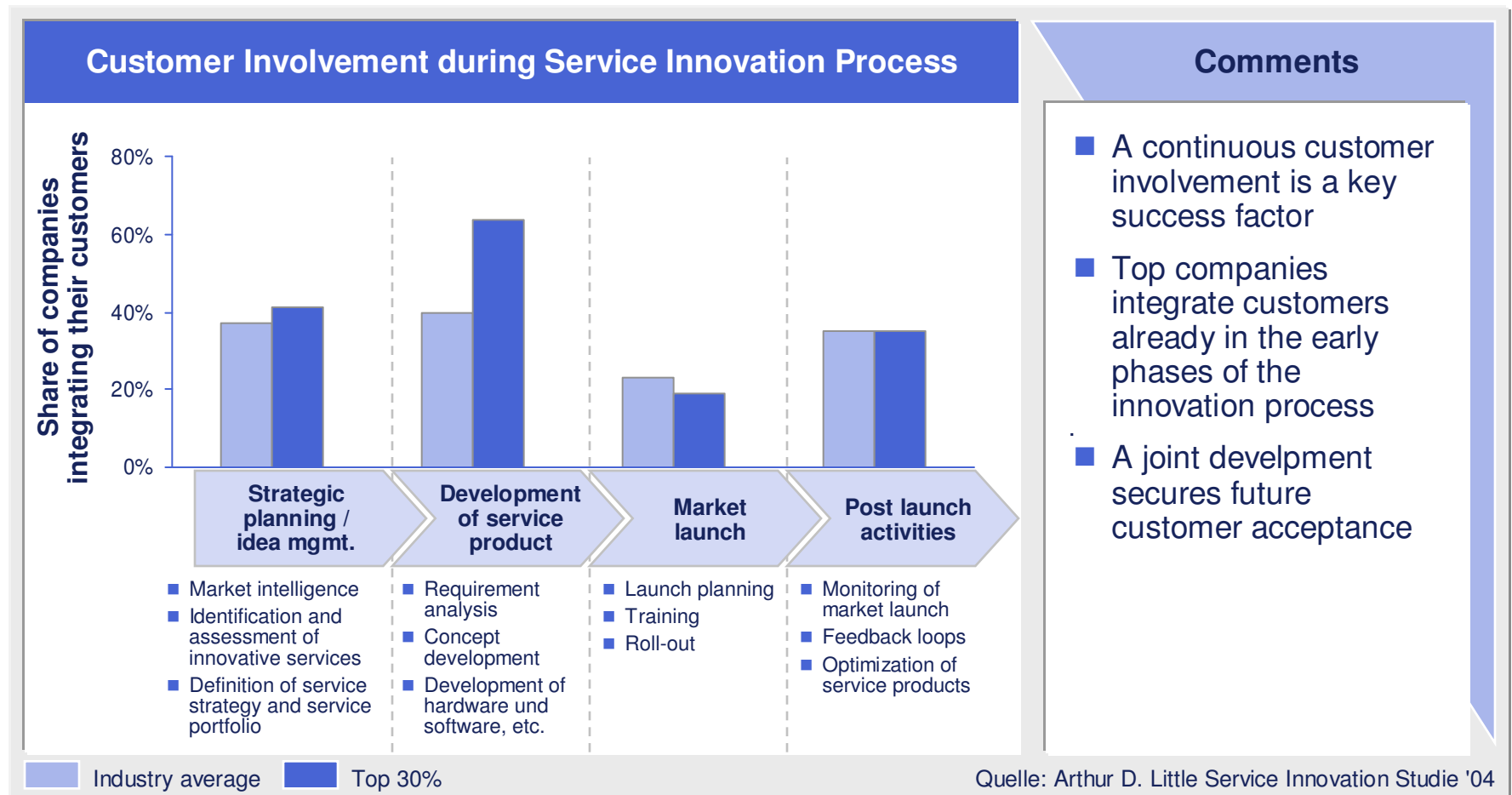
## Responsibility for the development of new services is often not sufficiently defined on an operative level



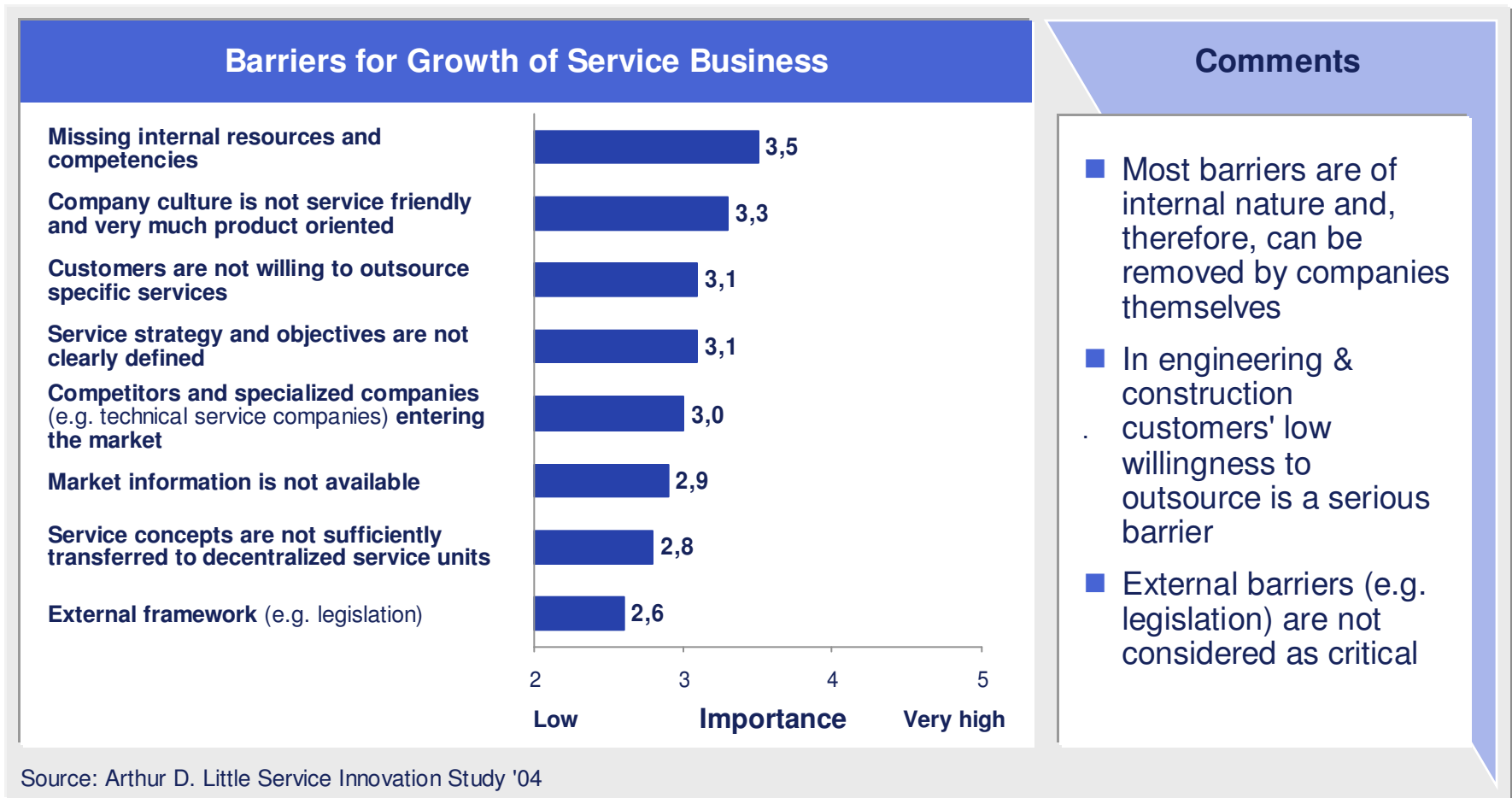
## Clearly defined responsibilities and a customer oriented organization and processes are key for the development of service offerings



## Successful companies integrate their customers during the entire service innovation process



## Companies consider barriers for growing the service business as relatively low – most critical are internal barriers



## Inhalt

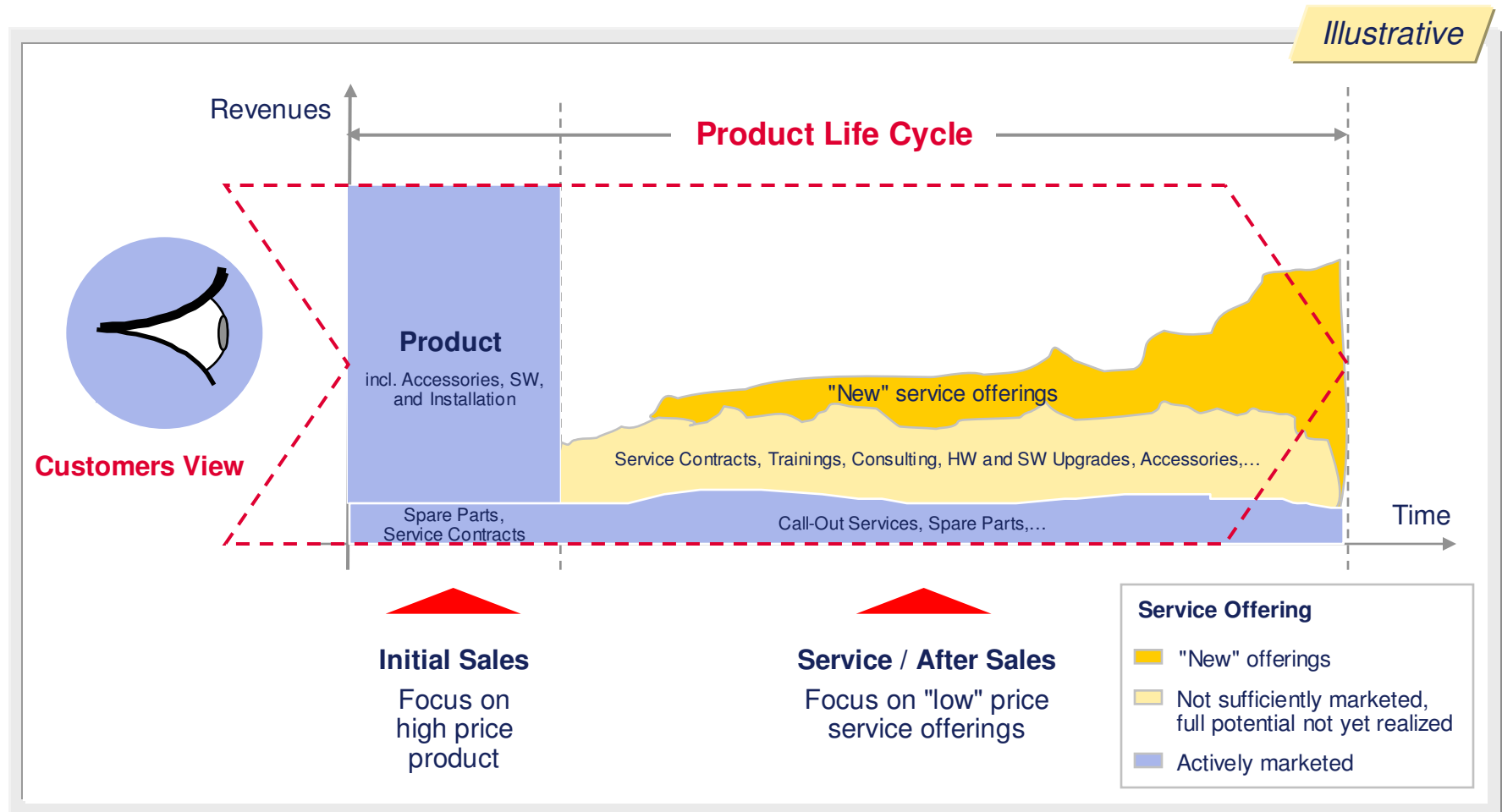
---

|          |   |
|----------|---|
| 1        | Arthur D. Little's "Service Innovation" Study |
| <b>2</b> | <b>Growth Levers</b>                          |

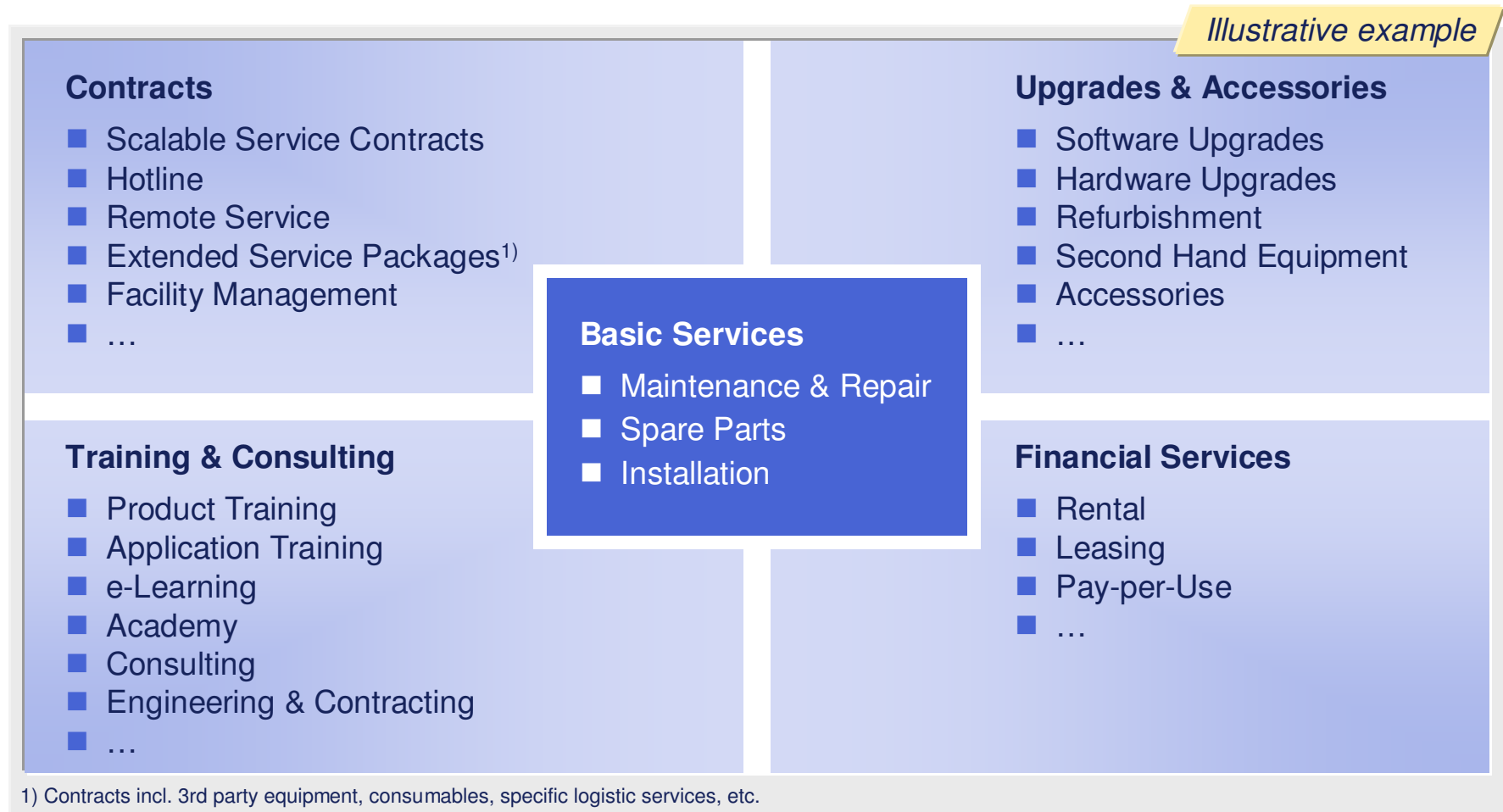
## There are 5 main levers to achieve growth in the service business



Companies need to put more focus on selling service offerings in order to exploit the full life cycle revenue potential of products they have sold



## A comprehensive and structured service portfolio combines basic services and different value added services



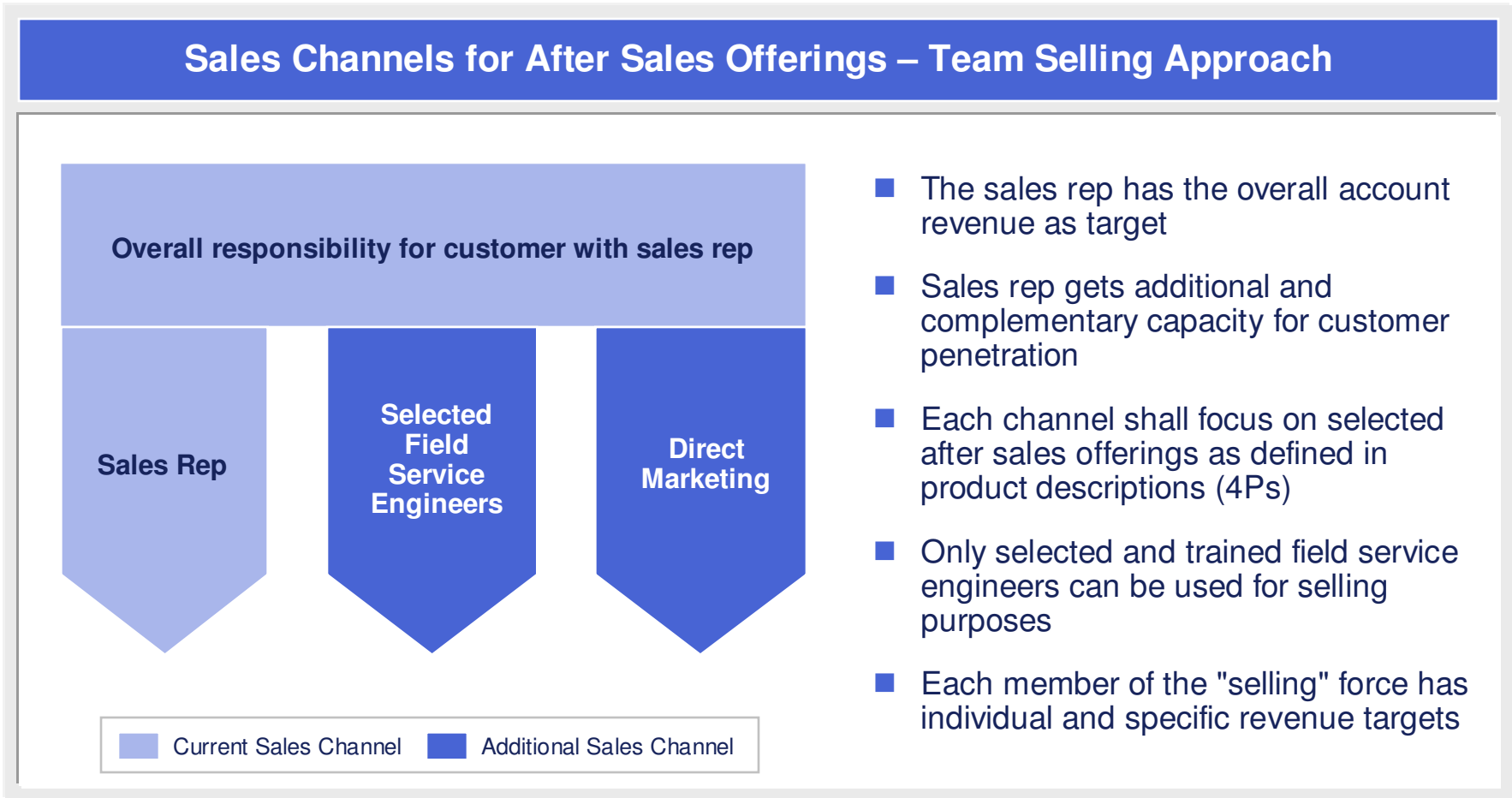


**Service products should be as clearly defined as physical products and systematically described in profiles which address all relevant issues**

*Example:  
1-Day Product Training (1/2)*

|   |                         |  |                                   |
|---|-------------------------|--|-----------------------------------|
| <b>Service Offering:</b>  | <b>Product-training</b> | <b>Owner:</b>  | <b>PM Training and Consulting</b> |
| <b>Description of Standard Offering</b>   |                         | <b>Available Options</b>   |                                   |
| <ul style="list-style-type: none"> <li>■ One-day training at customers site (9 a.m. to 5 p.m.)</li> <li>■ Participants shall not exceed 5-6 people</li> <li>■ Customers receive complete documentation</li> <li>■ First part of training is general</li> <li>■ Second part of training shall included customer specific Q&amp;A</li> <li>■ Training includes a certificate for each participant</li> <li>■ Training times Mon – Fri</li> <li>■ ...</li> </ul> |                         | <ul style="list-style-type: none"> <li>■ 2-day training: first day product and second day application training</li> <li>■ Special weekend trainings</li> <li>■ Access to special training workshops</li> <li>■ ....</li> </ul>   |                                   |
| <b>Pricing Rules and Discounts</b>  |                         | <b>Customer Target Group</b>   |                                   |
| <ul style="list-style-type: none"> <li>■ 1.100 Euro for one training day independent of product and region</li> <li>■ 25% discounts shall be granted if trainings (product &amp; application) shall be given at two consecutive days to the same customer (Other product or more participants)</li> <li>■ No other discounts</li> </ul>   |                         | <b>Customer Benefits</b>   |                                   |
|   |                         | <ul style="list-style-type: none"> <li>■ Optimal and efficient use of Leica products</li> <li>■ Better results in every day work</li> <li>■ Training customized to customer needs</li> <li>■ Preferential invitation to special training workshops</li> <li>■ ...</li> </ul> |                                   |

**Offerings should be sold through all available channels – overall customer responsibility remains with the sales representative**

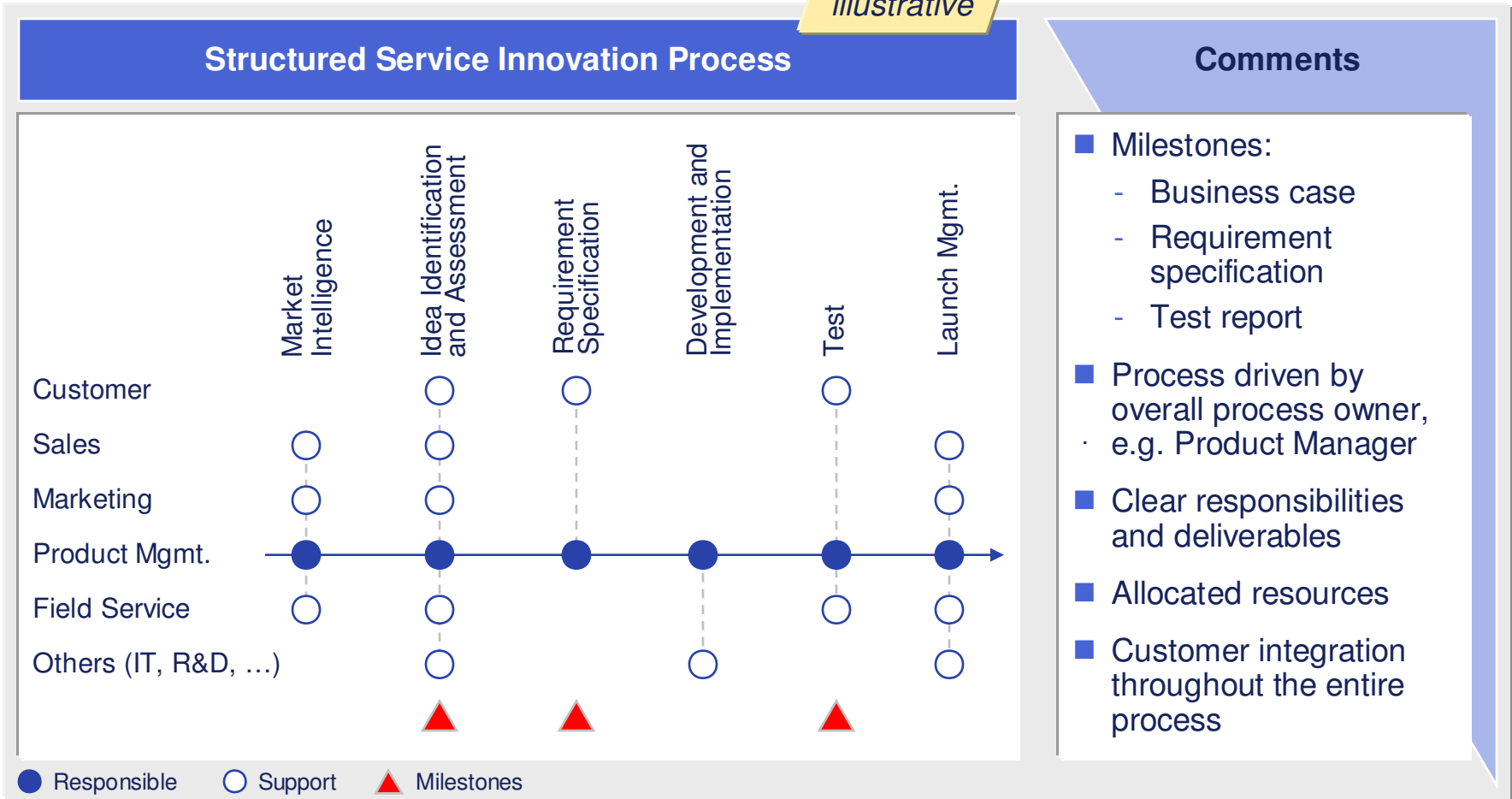


**After sales offerings need to be marketed as professionally as physical products – a distinctive strategy for each offering is required**



## Service innovation should be a structured process driven by a product manager as process owner

*illustrative*



**Life cycle models are powerful tools to elaborate sound estimates of service respectively after sales revenue potentials**

*Illustrative*

| Product Group C            |   |      |
|----------------------------|---|------|
| Product Group B            |   |      |
| Product Group A            |   |      |
| Service Offering           | Assumptions (per offering)  | k€   |
| Call-out                   | <ul style="list-style-type: none"> <li>■ Units which can potentially be sold during life cycle per product</li> <li>■ Sales price</li> <li>■ Percent of customers buying service (specific figures for each customer segments)</li> <li>■ Further deductions for clients which own multiple products</li> </ul> | ...  |
| Spares                     |   | ...  |
| Service contracts          |   | ...  |
| ...                        |   | ...  |
| ...                        |   | ...  |
| ...                        |   | ...  |
| Accessories                |   | ...  |
| Total after sales revenues |   | ...  |
| Initial sales              |   | .... |
| Revenue share after sales  |   | ...% |

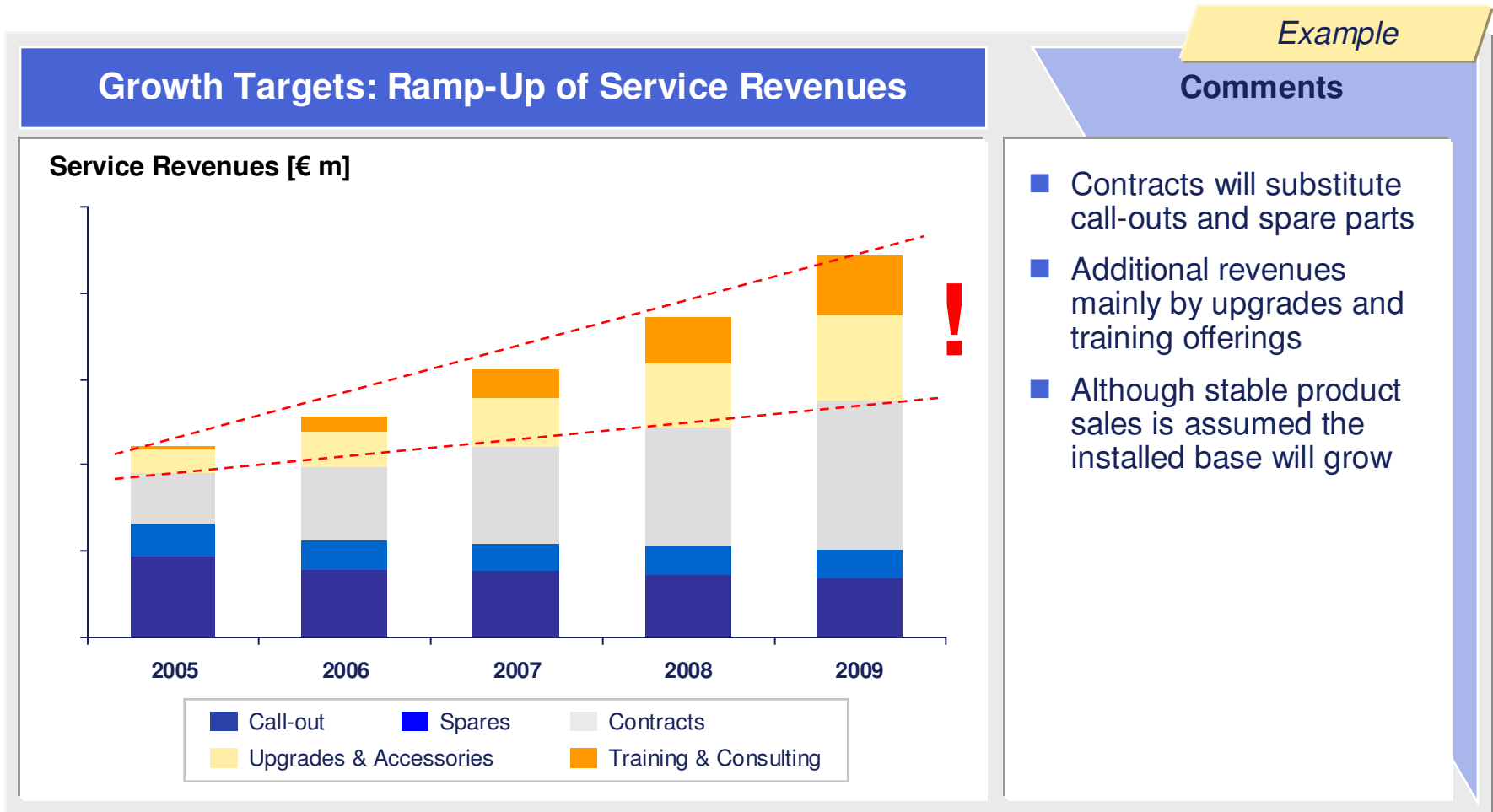
**After sales revenues are often as important as initial product revenues and can add-up to up to 50% of total life cycle revenues**

*Example*

| Life Cycle Revenue Potential – Extrapolation All Units Sold in 2005 |  |  |      |      |      |      |      |      |      |      |      |                      |
|---|--|--|------|------|------|------|------|------|------|------|------|----------------------|
| After sales offering revenues (k€)                                  | 2005   | 2006   | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total Life Cycle     |
| Product revenue   | 4.000  | none   |      |      |      |      |      |      |      |      |      | 4.000                |
| Call out service  | 2 call-outs during life cycle per unit (400 € per call out) – Reduction due to contract customers included                   |  |      |      |      |      |      |      |      |      |      | 500                  |
| Spare parts   | Spare parts for 2 call-outs during life cycle per unit (200 € per call out) – Reduction due to contract customers included   |  |      |      |      |      |      |      |      |      |      | 300                  |
| Basic contract  | 0 (warranty)   | Annual revenue potential of 200 € per unit for 40% of units  |      |      |      |      |      |      |      |      |      | 400                  |
| Comfort contract  | none   |  |      |      |      |      |      |      |      |      |      | 0                    |
| Premium contract  | 0 (warranty)   | Annual revenue potential of 1000 € per unit for 20% of units |      |      |      |      |      |      |      |      |      | 600                  |
| Product training  | 2 trainings during life cycle à 1.000 € for 25% of units (deduction of multi-instrument clients included)                    |  |      |      |      |      |      |      |      |      |      | 800                  |
| Application training  | none   |  |      |      |      |      |      |      |      |      |      | 0                    |
| Academy   | 4 training days in Academy during life cycle à 400 € for 25% of instruments (deduction of multi-instrument clients included) |  |      |      |      |      |      |      |      |      |      | 600                  |
| Consulting  | Assumption: Potential of 200 days application consulting à 1.200 €   |  |      |      |      |      |      |      |      |      |      | 100                  |
| Hardware upgrades   | none   |  |      |      |      |      |      |      |      |      |      | 0                    |
| Software upgrades   | One upgrade during life cycle à 200 € for 50% of units   |  |      |      |      |      |      |      |      |      |      | 100                  |
| Accessories   | Average annual revenue potential for accessories of 50 € per instrument  |  |      |      |      |      |      |      |      |      |      | 600                  |
| <b>Total after sales offering revenues</b>                          | <b>Average annual revenue potential of approximately 400 for all units sold in a single year (2005)</b>                      |  |      |      |      |      |      |      |      |      |      | <b>4.000<br/>50%</b> |

Note: Figures modified due to confidentiality reasons

**Arthur D. Little's experience shows that service revenues can be significantly increased short-term by focussing on so far "neglected" service products**



**The growth targets can only be achieved if the mindset of service and sales staff is changed by applying all available measures**

**Cultural Change Measures**

- Top management commitment and clearly communicated strategy and objectives
- Emphasising importance of service continuously ("Walk the Talk")
- Consistent objectives and incentive system
- Clearly allocated responsibilities
- Training of service and sales staff
- Build-up of cross functional teams, e.g. selling teams
- Understandable documentation about new service offerings for smooth roll-out
- Generation and communication of success stories
- ...



---

**Back-up**

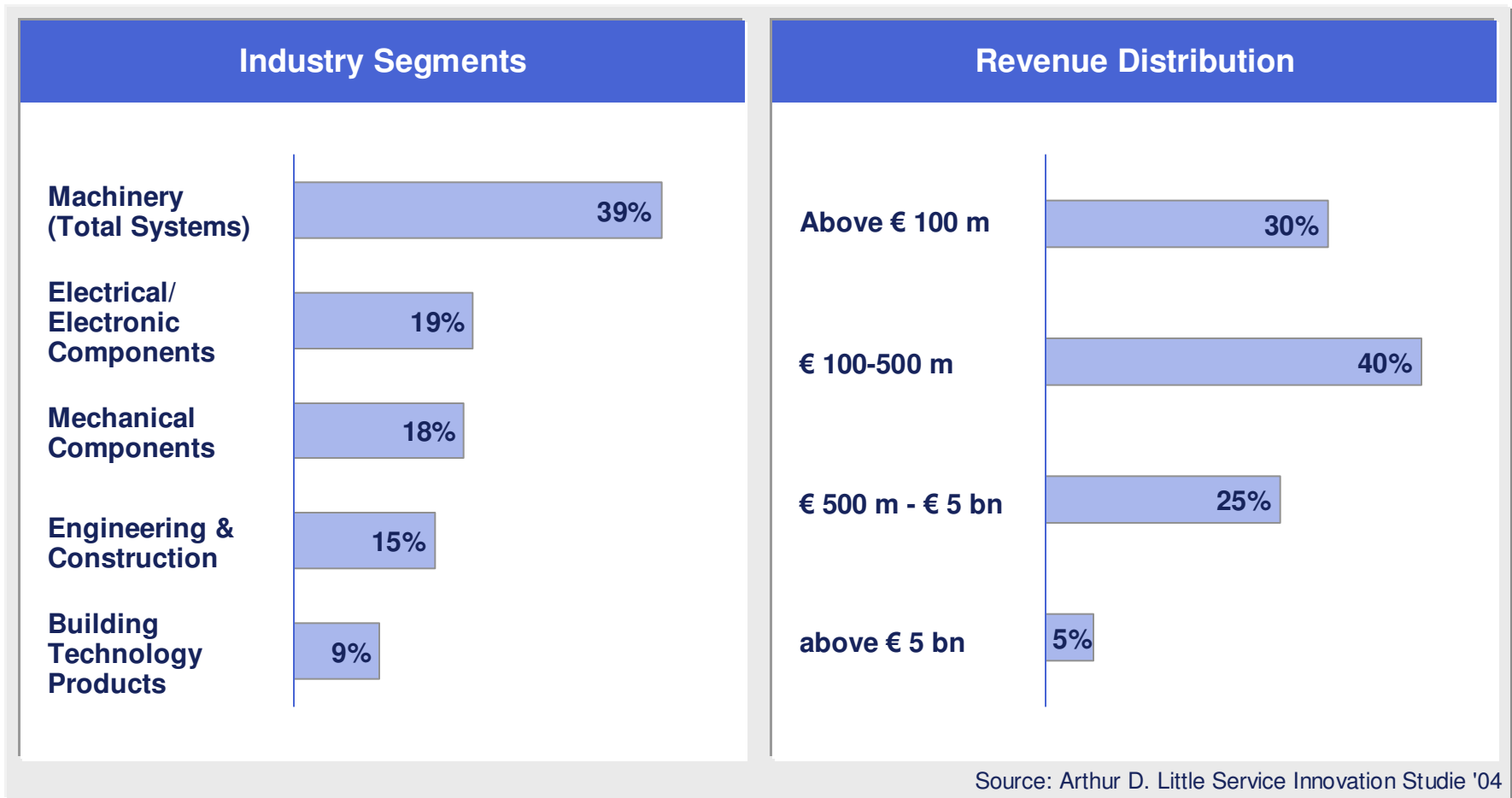
## Innovative service strategies offer a large potential for increasing growth and profitability in the investment goods industries

- In these mature markets competitive pressure is rising continuously and differentiation through physical products becomes more and more difficult
- Stagnation in domestic markets leads to additional pressure on margins
- Value added decreases due to relocation of manufacturing and in future other functions to low cost countries – service offers the chance to utilize freed-up resources and to keep employment in Germany
- In this situation service strategies offer an opportunity for good revenue and profit growth - but:
  - which services should be offered?
  - what are the strategies of and methods applied by successful companies?
  - how do these companies develop new services?

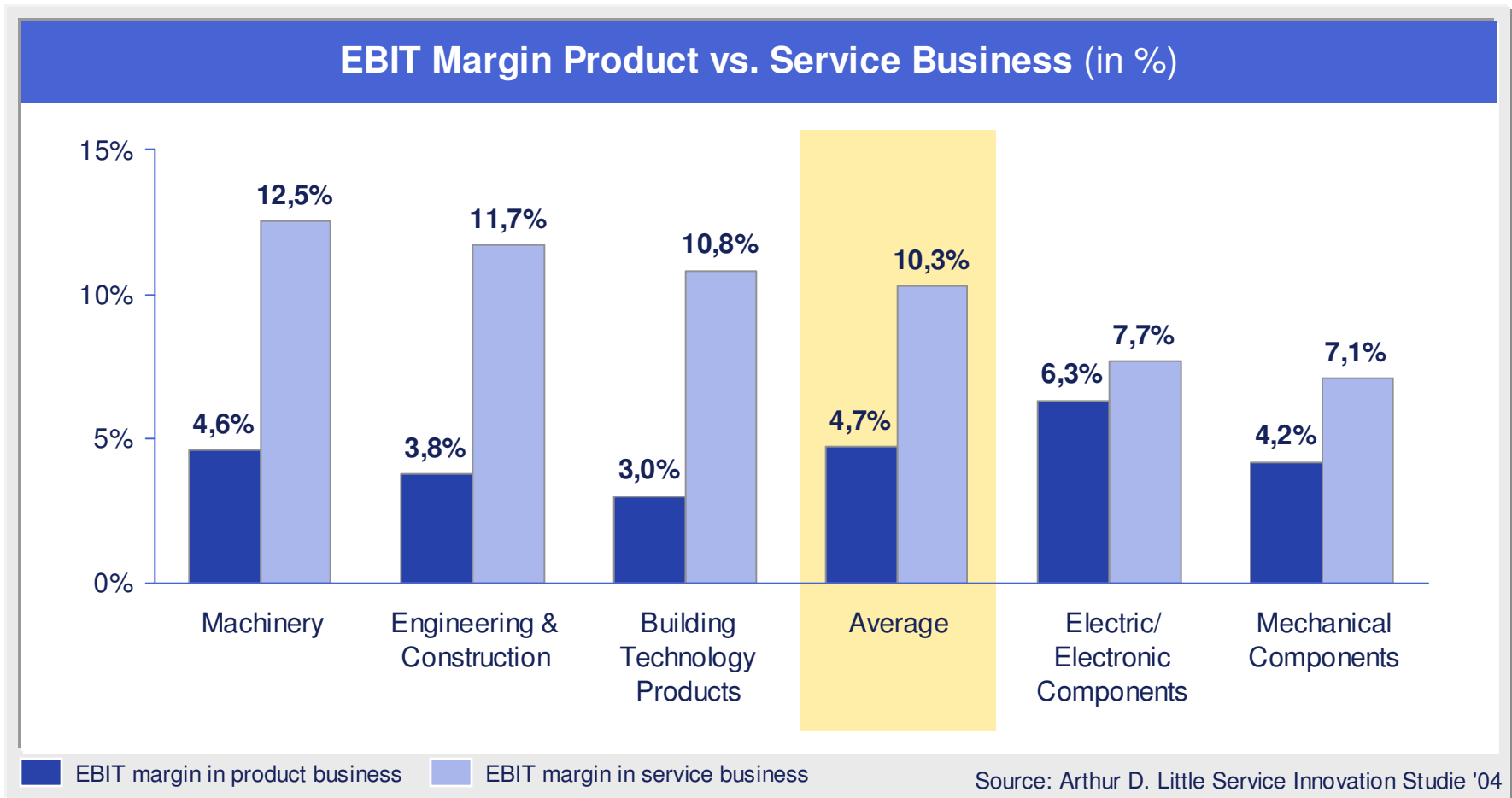


**In order to answer these questions Arthur D. Little has conducted the "Service Innovation" study**

## 100 German companies from various investment goods have participated in Arthur D. Little's "Service Innovation" study



## Profit margins in the service business are approximately twice as high as in the product business



## Companies generally acknowledge the large growth and profitability potential service offers – but most companies still act very defensively

- Main objective of the service business of investment good companies is still supporting the product business
- The importance of innovative services will significantly increase. On average, companies plan to increase the service share of total revenues by 50% within the next three years
- Profitability margins in service are twice as high as in the product business – system and solution providers (e.g. machinery) achieve 13% EBIT margin on average
- Currently, service portfolios have large gaps across all industry segments – system and solution providers offer generally more than component suppliers
- Top companies have a much broader service portfolio than their peers
- Barriers for growing the service business are considered as low, they are primarily of internal nature and can be removed by companies themselves
- The top companies have implemented a structured service innovation approach which clearly defined responsibilities and customer integration throughout the entire process

Source: Arthur D. Little Service Innovation Studie '04