



How to avoid erosion of revenue and margin with digital services

During a fireside chat at the **Field Service Connect Virtual Event on December 3rd, 2020**, we discussed and shared views and practices on how to **Avoid Erosion of Revenue and Margin with Digital Services**.

Which is all about pursuing innovations which create new customer value and capture part of that value for new revenue streams.

How can you generate new customer value with digital services and solutions?

By Jan van Veen - moreMomentum, Holger Pietzsch - Hexagon Geosolutions and Rajat Kakar - IBM

<https://moremomentum.eu/blog/digital-services/avoid-erosion-revenue-margin-with-digital-service-panel-discussion-field-service-connect-virtual-event>

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Already before the Coronavirus hit us, we saw pressure on revenue and on margins. Not only for products business, but also for the services on the products. Most manufacturing companies were already on a journey of a digital transformation and innovating their services.

Panel Discussion: How to avoid erosion of revenue and margins with digital services?

Today, as the first crisis of COVID is behind us (eventhough we are still experiencing a major impact), it is a good time to take a broader view, a more strategic view on what further is ahead of us. What is going to be the lasting impact? What else is going to change in our industries? And how to adapt to that?

The question which plays up again, is: are we going to use digital technologies and digital capabilities to improve our current business models and current operations? Or are we also aiming for creating new customer value and capture part of that value to drive growth?

The central question of this discussion is going to be: How to stop the erosion, erosion of revenues and margins by advancing our digital services.

SUMMARY

Check out the following take-aways:

- In most industries, current business models are under increasing pressure, leading to erosion of revenues and margins.
- As more and more products and equipment are connected and produce data, we have new opportunities to create value for clients.
 - Not only by delivering improved services at a lower cost.
 - Also creating new value for customers by solving other and new “problems”.
- To be successful with innovations for growth through new customer value, we need adequate
 - Strategy
What are the strategic objectives and how does this align with the overall strategy?
 - Structure
How to organise the innovations and new businesses? How to protect these innovations which go beyond business-as-usual and follow new business-logic?
 - Process
What innovation processes and techniques to use for business innovation and service innovation? Manufacturers often have well established processes for product innovation, not for business innovation or service innovation.
 - People & Culture
What people do you need for domain expertise, new thinking and entrepreneurial innovation? How much talents from outside to add to the innovation teams?
- Final recommendations from the panel:
 - For new business initiatives, establish a separate entity with approximately 50% the people coming from the existing organization and 50% from outside.
 - Build new partnerships
 - Secure domain expertise as you expand the scope of your value propositions
 - Secure the ability and willingness to manage new types of risk coming with advanced services
 - Make the capability to drive radical business innovation a strategic priority. This is a critical success factor for any type of radical innovation and business strategy.

About Holger and Hexagon Geosystems

Holger Pietzsch is Vice President of Marketing Heavy Construction at Hexagon Geosystems.

Hexagon is a global leader in sensor, software and autonomous solutions. They are putting data to work to boost efficiency, productivity, and quality across industrial, manufacturing, infrastructure, safety, and mobility applications.

Hexagon’s technologies are shaping urban and production ecosystems to become increasingly connected and autonomous – ensuring a scalable, sustainable future. Hexagon’s Geosystems division provides a comprehensive portfolio of digital solutions that capture, measure and visualise the physical world and enable data-driven transformation across industry ecosystems.

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About Rajat and IBM

Rajat Kakar is Service Executive at IBM's Service Group Europe.

IBM is a leading cloud platform and cognitive solutions company.

With Watson, the AI platform for business, powered by data, we are building industry-based solutions to real-world problems.

TRANSCRIPT

Introductions

Jan van Veen

Welcome to this discussion here.

Now already before the Coronavirus hit us, we already saw pressure on revenue, on margins and the erosion. Not only for products business, but also for the services on the products. And also many manufacturing companies were already on a journey of a digital transformation and also innovating their services.

And now, today, the first crisis of COVID is behind us - not that everything is solved - the first crisis is behind us. It's also now a good time to take a broader view, a more strategic view on what further is ahead of us. What is going to be the lasting impact? What else is going to change in our industries? And how to adapt to that?

The questions which plays up again, is, are we going to use digital technologies and digital capabilities to improve our current business models and current operations? Or are we also aim for creating new customer value and capture part of that value to drive growth.

So, the central question of this discussion is going to be: How to stop the erosion, erosion of revenues and margins by advancing our digital services.

It is really a pleasure to have this conversation today with Holger and Rajat, both having an interesting experience and view when it comes to digital services and to innovation.

Holger Pietzsch, he is Vice President of Marketing for Heavy Construction at Hexagon Geosystems. Before, he was with Caterpillar, heading their business model transformation for services, marketing and digital.

Rajat Kakar, Service Executive at IBM. Previously, he was heading service of Fujitsu.

Holger, before we start, can you briefly tell the audience in what kind of business and market are you in?

Holger Pietzsch

Yes, I'd love to. Maybe let me just rewind a little bit in terms of what technology has been in construction for the last 20 years.

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It's been, I'd say, 2000 to 2010, it's been connecting people to the ecosystem, so that you and I can go online, and let's say all parts or surveys schedule, then the next 10 years has been about connecting objects to the ecosystem. And now we think that next stage is now connecting the rest of the planet. And obviously, that means you're not going to connect a river or a tree or a forest, what it basically means from a technology point of view, you now need to allow these people these objects to see their environment, to see the trees to see the river to place them in a geospatial kind of data field. And that data now, you can use, you know, for autonomy, to check in construction in terms of do I build the road where I'm supposed to.

So this gives birth to a variety of sensors, software's and, and data areas. That is what Hexagon does. And obviously, for us the question now is, as we go out there, are we going to be a hardware business? Are we going to be a software business? Are we going to be a data business? Are we go on to be a service business enabled by data, hardware and software? So this is a very interesting discussion, I think, for us as well. And I'm glad to share some of my thoughts on the topic.

Jan van Veen

Thank you Holger. And Rajat, maybe you can also share your business, what market you are.

Rajat Kakar

Absolutely, I think Holger's business sounds absolutely exciting, and so forth. You know. Where to build the streets, and so forth. And I was listening to the news this morning, actually. And it seems that most of the countries will be investing in infrastructure. So I think this is a an absolute, you know, interesting area that's going to be going forward.

So I'm currently - as stated - I'm working in IBM since approximately one year. And we are primarily doing services in the area for data centres, in the area for the systems that our customers have, whether it's in workplace or so. And those are the kind of services that we are providing. And, in effect, the way you can think about it as our policy is really not just to think about how do I provide as Holger so eloquently put it, connecting the people and then connecting the devices or objects, excuse me.

The objective is we talked about shift left. And here effectively, you need to start thinking about how do you bring in technologies. You know, IBM has a wonderful technology like Dr. Watson. There's other AI tools that are out there as well. So the goal is: you have the data, how can you start utilising that data in order to get into predictive in order to get into preventative? In order to even implement things like robotic processes to get some of those, you know, the value added for the future? How do you make that happen?

And those are the kind of things I believe also are going to be driving the world in the future of services, if the companies are playing it in, right. So, you know, prior to that, we were having some discussions, we discussed about the different stages of the customers are. Looking forward to have this conversation with both of you today.

Differences between sustaining innovation and radical innovation for growth

Jan van Veen

Excellent. So thank you very much. So as an introduction on the topic, maybe it's good to stand still for a while, what is actually the difference between the two types of innovation. The two types, is let's say the sustaining innovations are improving your your current business, versus creating new customer value and capturing new capture value. Soin your view, and experience Rajat what is, what is the key difference between the two?

Rajat Kakar

Well, let's look at it this way. If you have a traditional business model, that traditional business model, from a cost perspective, or, the customer price perspective, is degrading, right. So, whether you provide a data centre engineer for, let's say €100, €150-€200 an hour, or will you provide them for €1500, whatever the amount would be. The cost of the prices are going down. And effectivly, we also see in the market, that the customers are heavily focusing on reducing their costs, improving the cash flows. So all of these things are kind of coming into play. Therefore, we, from a services standpoint, have to think about how do we bring new value to the customers?

From one side, of course, you can think about how do I do my operational excellence? How do I improve my operations, right? So you get into, for example, predictive maintenance is, or you get into preventative maintenance. But in most of the industries, predictive and preventative maintenance is potentially have some revenue attached to them, or some possibility of revenue attached to them. But the majority of the cases is more dealing going into an area of operational excellence for delivery, which doesn't necessarily always means that you're going to be able to improve your revenue, your revenue stream.

So here, we need to now start thinking about the digital services, which are now available, how do you bring those around and make sure that you can, ensure that the customer is getting value and he or she is willing to then pay for that as well, right. And this is, this is now becoming the more and more interesting element for the companies.

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Jan van Veen

Maybe you can add to that, Holger. So digital capabilities are not only for, for your delivery capabilities. It's probably also about the way you sell and you market your services or products. So that is shifting as well. It's not only in terms of remote predictive and move to the left. Any views on that?

Holger Pietzsch

I think this is a very strategic question that a company should have some thought before they invest in their technologies, invest in their capabilities in their marketing. How do I create value for my shareholders as a result of this?

One model is the typical, Okay, I'm gonna create new types of services. So I have my traditional "widget", you know that for 100 years. I sold my widget, the customer disappears behind the curtain and might come back every so often for repair or apart or replace the widget. And now there's no more curtain right? The widgets are connected, I can see what happens with the widget, I can see what the customer does with the widget. The widget tells me.

That opens the door to kind of engage in new types of value creation where I can consult the customer and say: Hey, the way you operate this widget is not sustainably in terms of you know, and your operations could be cleaner, or they could be safer. And so that information now I can turn into into new types of value creation. But I can also go and analyse this data and say: The widget tends to have issues after 2,500 hours. So maybe I need to use this information to design my widget differently. Or I know that widget typically after 16 days of operation in freezing temperatures requires a new widget-fixer. So 16 days before I can kind of put that thing in a box and ship it to the customer, because I know what's going to happen.

So those are two different ways of creating value in terms of:

One - I help a customer achieve his or her goal.

The other one is - I deliver on my commitment to provide the widget with the lowest owning and operating costs.

So we have innovation on one side: I create new types of value. Or I improve my existing operations in terms of better design, better logistics, better supply chains. And and the question is: Is it both? Or is it one or the other. But I think they're both valid strategies, you just need to have a little bit of an idea which one you want before you start.

Jan van Veen

So, in summary, what I hear both of you saying - and I fully agree with that - is: In times where you see a lot of developments going on in the industry, in the technology, you have to have both trajectories. On one hand, you have to continue improve your current business model and operating model. And that may be some big changes. For example, if you go to performance-based maintenance contracts, which might be at lower cost, that is a big change of your offering and your capabilities. But in essence, you're solving the same

problem of your client, meaning they need to have undisrupted use of the equipment, for example. So you have to do that.

But on the other hand, that will not lead you to prosperity in the future. In the changing world, we also have to create other kinds of value to our clients, which basically means, you have to solve other kinds of problems or activities of them. And also make sure we can capture that value or monetize it and generate revenue streams from it.

We do still see that the majority of the companies tend to focus on sustaining innovation, improving the current model and find it difficult to create new value, new revenue streams, solving other kinds of problems for the client, and that they may be even expanding or shifting your business or your core value proposition.

Different challenges between sustaining and radical innovation

So Holger, let's dive into what is at in essence, the difference looking at how to do it internally in a different trajectories - sustaining or optimise your operating model and business model versus growing with creating new value. In terms of how to organise or run your innovation, what are what is in your eyes and experience the most important difference between the two to keep in mind.

Holger Pietzsch

Yeah, maybe I follow like a simple framework here in terms of Strategy - Structure - Process, People and culture. Right.

So the first one is Strategy.

Do I want to make more money with new value propositions with new customers? Or do I want to deliver my current value proposition more efficiently? And I think that's a very important question. Because let's say, let's just say you want to change your forecasting process, where for last 20 years, you ask all of your sales people at the end of the year, what do you think is going to happen next year, you roll it all up, and everybody knows the game. And now you say, well, we're not going to do this anymore, we're going to ask the widgets, you know, the widgets will tell us. Well, you know, that might or might not work. But you can only execute it if you have a fair number of widgets out there. And to get to that point, if you only want to improve your forecasting process, you know, your return on investment might be difficult, and you need to be very clear that this is worthwhile doing beforehand. But, the other strategy, obviously, to say: we're going to use this to create new types of value.

And then you have to put the Structure in place.

This is where you have the internal debate: Is this something that is separate to the core business? Does it need to be within the core business? It could be that your widget team finds out, the majority of customers buy for widgets. But if they were doing operating these widgets differently, they only need three. So that's great. You know, we can tell them and share the value of the one widget they eliminate. That might be great for the customer might be great for my team. But there might be a factory somewhere that is designed to create four widgets a day and if you suddenly find out they're only going to produce three there will

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create some interesting internal debate. So you have that structural part. Sometimes you need to protect that unit.

And then you have processes.

You need to rethink how you innovate. A lot of manufacturing companies have great processes on how to do technical innovation, but not necessarily business innovation, or service innovation. So where do they find that expertise?

And then you got to find the right people.

Is it your internal people? Is it external people? Is it the nice idea we have about these Silicon Valley kids, you know, that they run around in T-shirts, or we want folks like Rajat, you know, nicely dressed. These are kind of things you need to have some sort of a framework, you should think through all of these steps. very cautiously, I think from the start.

Rajat Kakar

So, let me just add to what Holger has stated. I'll put it on the lists of the People topic. Because this is something that we see currently happening in the industry: We see many of the CEOs shedding people within the organisations. The traditional model, if you think about it has always been, I reduce my headcount by 10%, or reduce my cost or my OPEX by 10%, or 15%, or 20%. And then I take a portion of that, and I reinvest into the new technologies. Where I see currently the best-in-class companies in the current level of time, right, because in the future, it will, it will change with or it will evolve, as well, where I currently see it as a 50-50 mix.

So, you need to start focusing on creating a separate division, or a separate entity, which is then bringing together approximately, I would say about 50% of the existing. If you have 100 people that you want to set it up this organisation with, bringing in approximately 50 people from the existing organisation into this new structure, into this new organisation. And bring in 50%, as Holger stated that the Silicon Valley types, or the the younger crowds, or the mindset is a little bit different, you know. Not the digital dinosaurs.

This way you can bring in the existing company DNA, the existing company, know-how and knowledge and infuse that into the new thinking, and how to drive this business. So that's the current mix that I see from the customers, from the organisations where we help out with our customers. And, and I think this is currently in the current stage of time is a good mix to have it. But don't say I reduced 10%, because this is something that usually gets fostered and organisations. In order to move forward, really treat this as a new operation, new organisation new structure, and a 50-50 mix, is what I would focus on.

Co-creation and collaboration

Holger Pietzsch

Rajat, you made me think of one thing now: The best services get co-created with customers. Services get consumed and produced at the same time. For example, you go to the hairdresser, and you don't properly communicate what sort of a haircut you want, you know, you end up like this. Because it's co-created, and you don't really know what you get till you actually have gone through a process of producing the service.

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Which is very different from a product. With that it I can look at before I buy. And so that co-creation, co-development, co-definition, and collaboration with customers is very important.

That customer intimacy is something that very traditional businesses lose. At the end, you're like the 3rd generation of customers and the 3rd generation of managers. And you develop your way of dividing what's mine, what's yours and recreating that joint vision of what do we actually try to achieve in the end? What does our customer's customer need? That is a capability I think that needs to be redeveloped in a lot of organisations both on the customer side as well as on the, let's say, supply side.

Rajat Kakar

And I think - just adding to what you're saying Holger: The way you need to start thinking about from a customer standpoint, from a people standpoint, when you're doing the co-creation, companies should not be ashamed of reaching out.

Because we are living in an age of collaboration. I see customers out there who say: Ah, I'll take a teeny tiny bit idea, and I'll try to work on it and develop everything myself, right. And I really also recommend to the companies, please don't be ashamed of going out and looking for collaboration partners, maybe even in the same field or same areas or so. Because a lot of the companies out there already have this as their core competence, right. And a lot of the companies are already far beyond where the companies might be able to deliver.

So, instead of focusing on, optimising one, teeny tiny bit of operational element over here, look at the ecosystem, look at the platforms you're working with, don't be afraid, in order to seek out a partner that you're about to collaborate together with. That's, you know, where you're co creation, I think it can be the most, most successful.

And focus on creating a structure and organisation, which is partly inside, partly outside, that is the secret to success. Happy to also connect later with anybody, you know, ping me on LinkedIn, or buy Jan, or, you know, the event organisation. And then we can discuss it. I really like this idea that you're discussing, and I think articulated well about co-creation. Seek out collaboration partners as well.

Create a safe harbor for more radical service innovations

Jan van Veen

If I may add to that - because I couldn't agree more with what you both are saying - if you start looking for new kind of value for your customers and generate new revenue streams from it, it often requires let's say new business logic about what your business is, what your clients are, and what the industry is.

The further that is away from your current business, the more you will be quite vulnerable. Because your current organisation is actually all focused and geared around protecting risks and defending that business. So all decisions on are going to the left or right, or we're going to follow that need or that customer segment is geared towards our current business, how we allocate resources, is geared towards priorities to protect and defend our current

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business. There you see often that there is no safe place for the new ventures and new innovations. And that requires that notion that that is a delicate thing that you have to take some other ways of approaching that in other kinds of decisions, by a separate entity, and have that more kind of entrepreneurial team and don't let the board be part of decision making are going left or right, that is their decision then.

And you need several of those kind of ventures because the chance of one is going to be successful, it's not that big. So you need several of those kinds of initiatives. So how are you going to organise that and then I think one of the key things manufacturers have to develop is that capability of driving business innovation, that is where all these ideas are going to float on. If you have that capability, then the ideas will flourish. If you don't have the capabilities, all the ideas will fail.

Final thoughts

So, wrapping up, I think it's far too short. But maybe you should organise enough discussion session to elaborate on the topics we've been talking about - also about co-creation. Maybe we can all conclude with, one bullet style kind of recommendation or takeaway for the audience? Rajat, maybe you can start?

Rajat Kakar

Sure. I think there's a lot of topics we have covered today, with regards to the topic of digitalization. And bringing it now to concrete points, again, as stated.

1. Focus on creating a new organisation or infrastructure, new division new department, how are we going to call that right?
2. Don't focus on I reduced 10%, and then I add to that.
3. Create a new organisation the right mix which which I currently see is 50-50 from existing and new.
4. Don't be afraid to look for co-creation partners, collaboration partners that are out there that are already subject matter experts in a certain field. Because this is something that will enable things go significantly faster.
5. And there's a lot of talent that's out there. Please focus on your regional talents, focus on global talents that are currently going to be enabling you to bring your processes and your service elements to success.

Digitalization is here, it's going to move forward. And you need to make sure that that's ingrained and embedded into your organisation at People level and Processes. Maybe Holger you summarise that. I really like that what you stated over here. Thank you so much.

Jan van Veen

Thank you Rajat. And Holger what would be your main recommendation or takeaway for the audience?

Holger Pietzsch

Thank you, Rajat. My experience has been, as you go out and want to change scope of what I've always been that was as an organisation. The two areas, I think, where you need to make a very, very careful decisions and investment is

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1. Domain expertise. How much to actually understand about the customer's domain. As in, I know everything about the quarter inch drill, but what do we need these holds for? So domain expertise is very important.
2. And the other one is your ability and willingness to manage risks. Because as you get into more of these outcome, customer based, co-created the value propositions and there is risk and return that comes with that. And the risk part needs to be carefully assessed.

Jan van Veen

If I may add one final thing is: Make it a priority and an urgency around escaping from business as usual. That's hard. And so that requires attention. So make that a priority.

And that starts by building a shared concern around the needs of that escape from business as usual as well.

How can you generate new customer value with digital services and solutions?

