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Product Companies: Don't Undersell Services

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The strategic use of services offers major opportunities for product companies to build real value and customer trust in three areas.

by Jonathan Byrnes

Many managers of companies that make or distribute products lose important profit opportunities because they don't capitalize on the strategic benefits of related services.

This is natural. They are very focused on managing their products. Consequently, they often regard designing and managing related services, such as express delivery, information support, and vendor-managed inventory, as almost an afterthought, a nuisance cost to be recouped if possible.

I recall discussing this topic in a meeting a few months ago. I was given some materials that in essence explained how best to deal with these services. There were two key points: (1) understand the costs of the services, and (2) offer a menu of services at prices that hopefully recoup the cost, and ideally turn a profit. This approach missed the big opportunities.

The argument reminded me of the situation in transportation about a decade ago, when most vendors sold their products on a "delivered" basis. When the customers looked carefully, they discovered that the vendors were often making more money by marking up the freight rate than they were making on the products' negotiated margin.

This practice added no value, and simply alienated the customers. It led many customers to create major freight conversion programs, in which they renegotiated product prices based on pickup at the vendor's factory dock. Customers generally viewed these programs as righting previous vendor wrongs. For years, they soured vendor-customer relationships.

The strategic use of services, on the other hand, offers major opportunities to build real value and deep customer trust in three areas: (1) new strategic advantage; (2) new account management and selling advantage; and (3) new cost reduction advantage.

Strategic use of services

Selling more products can give a vendor additional leverage with customers, but selling the right related services can give a vendor a new strategic positioning and a host of valuable benefits. This can be critically important in reversing a vendor's slide toward commoditization and price competition. Consider the following example.

Several years ago, a major hospital supply company developed a new set of related services that involved managing the ordering, inventory, and distribution of its products within its hospital customers. I described this pioneering vendor-managed inventory (VMI) system in my column, "Profit from Customer Operating Partnerships." This service enabled the company to change its competitive positioning and reverse its fortune.

In the past, the hospital supply company sold commodity products on a price basis to low-level purchasing managers. It had only limited relationships with hospital top managers. The new service, however, had a major impact on hospital costs and operations. Consequently, the company's top managers needed to have extensive dialogues with hospital top executives throughout the service development and sales process. Tight, trusting CEO-to-CEO relationships naturally evolved.

Importantly, once the new service was in place, the company's competitors were effectively blocked from developing similar relationships with top hospital officials. Simply selling more products never could have achieved this advantage.

During the process of developing the new service, a question arose on whether the company should distribute competing vendors' products through its new system. Predictably, the competing vendors objected, but the hospital CEOs required them to comply or lose the business. Interestingly, the company's own product managers strongly objected to using the new system to distribute competitors' products. They felt that the new service should be used to "push" their own product sales instead.

The company's CEO had the wisdom to override his product managers. He understood that the company's new strategic relationship as partner to the hospital CEO would create new value for the hospitals and deep customer understanding and trust. He saw that this would win out in the long run. In fact, this happened surprisingly quickly.

While providing the service, the company's in-hospital operating personnel formed close, day-to-day working relationships with the hospitals' operating personnel, including, importantly, the head nurses on the wards. It turned out that these head nurses had a key role in product selection. This built natural barriers to competitive entry based on customer knowledge and trust. As a result, sales increased by over 35 percent, even in the most highly penetrated accounts.

The new VMI service led to important cost reductions both for the hospitals and for the hospital supply company. The former was expected, the latter was a surprise. The unexpected cost benefits for the hospital supply company stemmed from three areas.

First, even with daily VMI deliveries, the company reduced its delivery expenses. Previously, the company had averaged about six deliveries per day to a typical major hospital to meet uncoordinated needs, often including several which required unproductive sales rep trips. Second, the company was able to stabilize the hospital order pattern, and dramatically improve its factory scheduling and distribution center efficiency. Third, because the company gained control of hospital internal stocking points, it could cross-source product from ward to ward. This enabled it to greatly cut down on its safety stock, which resulted in significant cost savings.

Managing related services
Product company managers have a clear opportunity to move quickly past dealing with related service provision and pricing from a tactical perspective. The key is to focus on both the crucial underlying strategic opportunities, and the non-incremental cost implications for the vendor. Here are the essential elements in developing and getting the most out of related services.

- Related services can change the fundamental strategic positioning of a company. This is especially important for companies whose products are becoming commoditized. By carefully designing these services, product managers can move upstream in their customers' decision-making processes. This can give them the ability to strongly influence product selection. Some services, such as VMI, can enable a company to effectively lock competitors out of its best accounts. The hospital company example illustrates this. Ironically, in this process, the larger the change created by the new services, the easier it is to sell the new relationship.
- Product managers can use related services to enable the customer to change its business, opening new avenues for value creation. For example, after the hospital supply company developed the VMI service, it approached the hospitals with the possibility of a new distribution service that would support the hospitals' development of a network of scatter-site clinics. The hospitals alone could not have managed the logistics of this service.
- It is important to integrate related services into the account planning and the account management process. (For more on this, see my last month's column, "Account Management: Art or Science?".) Some services, by their nature, allow account managers and operations personnel to build relations and trust with customer managers throughout the customer's buying center. Once this trust is developed, they can influence customer product selection in a comfortable and natural way.
- Beware of developing and offering services as simple profit centers in the absence of the broader strategic, competitive, and account management context. The grave error of the vendors who alienated their key customers by charging phony freight rates illustrates this.
- Vendor managers must be prepared to say "no" to good accounts that don't "fit" the service package, e.g., due to geographic location. There must be one or more fallback packages that also offer value.
- Very often, related service costs are not incremental. Consider the example of the hospital supply company. While there was a measurable incremental cost to offering the VMI service, this cost was more than offset by unexpected vendor cost savings in the areas of delivery, product flow, factory scheduling, and safety stock. And, beyond this, the VMI system led to major sales gains.
- A channel map, which is a cost model spanning the vendor and a few customers, is an essential analytical tool. (See "Manage Your Suppliers as a Resource" for a description of the channel mapping process.) A channel map can be estimated in a few months. It will help the vendor identify the full costs and benefits of related services, and will help surface opportunities to create new

related services that provide significant value for the customer and advantage for the vendor.

Related services must be a critical element in the product manager's portfolio. Handled well, they offer rapid and lasting strategic, account management, and cost reduction advantages. Not only that, but they yield quantum increases in product sales as well.

See you next month.

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