

Dear readers

In the last three quarterlies, we have already taken a differentiated look at our current main topic, "Servitisation & Controlling". Even the work on the Dream Car report, which is to summarise our thoughts on this topic, which is new to us and at the same time so exciting, is nearing completion. This is to be published at the latest at the 46th Congress of Controllers, which is planned for 9 and 10 May - hopefully in Munich.

In this newsletter, we would like to take a closer look at some topics that have received little attention from us so far.

The first article focuses on the controlling of product service systems. The second article provides insights into various approaches to value-based pricing. The Quarterly is rounded off with an interview that once again underlines the importance of our annual theme (see also reading tip).

We hope you enjoy reading this Quarterly and wish you a stimulating read.

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Reading tip

The study **Beyond the product** by Porsche Consulting published in 2021 underlines the importance of our Ideas Workshop Year theme.

Increased global competition in the industrial goods sector is shifting revenue structures from the core product business to the software and service business. Digitalisation is changing the way services are designed and delivered. In this strategy paper, Porsche Consulting analyses the industrial goods sector, which is traditionally focused on the development, production and installation of capital goods. How do successful companies



manage their transformation towards a service-centric business model? The publication shows best-practice examples and provides answers for concrete implementation with a focus on the industrial machinery, medical technology and special vehicles sectors, including agricultural, construction and mining machinery.

You can also gain extended insights in the interview with study editor and partner of Porsche Consulting **Marc Ziegler** on the last page of this Quarterly.

Controlling of product-service-systems | Integration into service engineering

As part of servitization, the boundaries between physical products and services are blurred. Hybrid bundles of services or product-service-systems occur. This leads to a new basic understanding of products in industrial companies. The Controlling discipline follows this change with modified instruments. The integration of the controlling into the methodological approach to the development of industrial services is required. The established service engineering must therefore be supplemented by an additional controlling-oriented evaluation level.

Market cultivation is a critical success factor in today's hard-fought competitive environment for capital goods. Even insufficient technical service quickly leads to the customer will of changing the supplier. In the servitization transformation, product-related services ultimately become indispensable. In the final transformation step from a full-service provider to a provider of integrated services, it is no longer the product itself that matters, but the performance and/or the output of business models such as:

- pay per performance or
- pay per use.

are from now on in the foreground of the consideration.

The solution to **solve the problem of the customer** and no longer a single sale of an investment good should now be the focus of the provider. It is therefore not surprising that, accompanied by marketing research, among other things, the need for a systematic development and management of services has emerged. With the service engineering shown in Fig. 1, a framework has been available to companies for around two decades. Traditionally for this purpose,

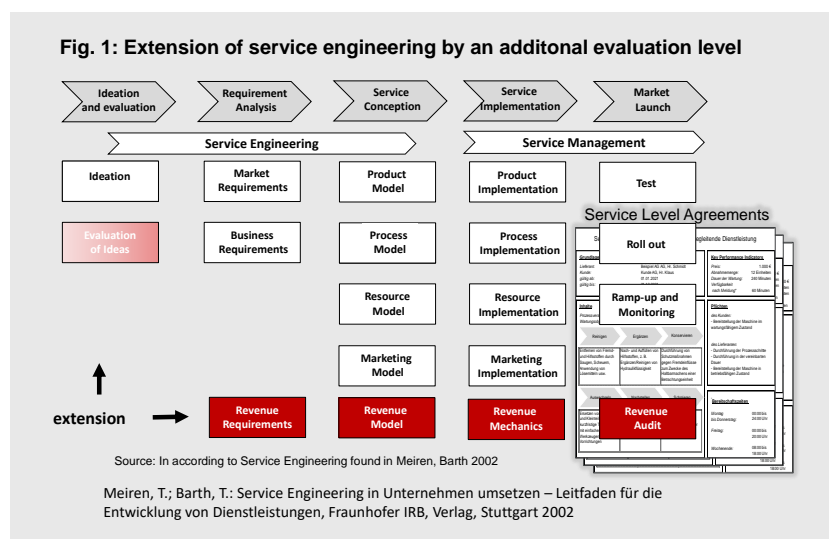
- the potential dimension,
- the process dimension,
- the outcome dimension as well as
- the market dimension

are considered by the service engineering. However, a **controlling-oriented assessment level**, shown in red in Fig. 1, was still missing.

This evaluation level is now necessary due to the general conditions of integrated product-service systems. In the first place to mention are **the significantly changed business models with strong focus on the customer needs**. While the consideration in the classic capital goods business often ended with the point in time of the sale and, if necessary, transfer to service business areas, **lifecycle-oriented operator models** (functional-oriented, performance and result-oriented business models or subscription models) now require a multi-period dynamic view. Cash inflows and outflows here differ significantly from those from the traditional sale of capital goods business. In addition to a **service-based revenue model**, which must depict this, the question of the appropriate expected capital return requirements arises for controlling. A return rate derived from the capital goods business must be revised and taken

into account in the cost of capital resp. discount rate of the investment analysis.

In addition to the fact that the assets remain in the own company or in the financing partner's third-party capital employed, this requirement is also faced with **increased uncertainty** due to the special nature of the service business. Here, for example, the integration of the customer as an external factor, the Uno Actu principle with its non-storability or the individuality of the services tailored to the customer must be considered. **Service level agreements** represent therefore an important instrument from the phase of the revenue model through to the revenue audit. The controlling have be involved in their definition. Appropriate *performance indicators* must be defined and included in the service level agreements. They can then also be the basis for the yield mechanics. This is particularly important when the



services are provided in an ecosystem with different network partners and revenue streams have to be distributed between them.

Lifecycle-oriented TCO models in combination with digitization approaches can form a good basis for this evaluation. If TCO models such as the VDMA Standard Sheet 34160 structure the forecast of costs in blocks over the life phases of the capital good, **smart services technologies** (sensors, data gateways and IT-platforms) and the relatively new **process mining approach can provide** valuable support in building an appropriate data and knowledge base.

Value-based Pricing | Approaches to servitization

The number of interaction possibilities with the customer within his value creation processes is enormous. This is exactly where the paradigm shift of servitisation takes place: While the focus is classically on individual products and services and marketing activities concentrate on initiating business and individual transactions, servitisation focuses on the entire interaction with the customer within their processes (Terho et al. 2012).

A suitable value-based pricing should be able to reconcile the value perceptions of provider and customer and express them in monetary terms with a suitable pricing system. The further the provider has progressed in the service transformation, the more the understanding of value changes from a product-centred view with a focus on the sales value to a service-centred view with a focus on the value-in-use that results from the use of a service. Basically, a distinction should be made between the product-centred understanding and the service-centred understanding of value-based pricing.

Product-centric suppliers try to gain competitive advantages through upstream value-added steps, e.g. through innovations in the areas of development, product quality, processes, cost structures or marketing. In this context, prices are positioned in relation to competitive products on the basis of product qualities and attributes. The focus of value assessment is on products, their attributes and their differentiation from the competition. Customer value mapping or economic value modelling can be used to quantify the value and differentiation from the competition (Johansson 2013). In these approaches, customer-segment-specific performance components of one's own product and the competitor's product are evaluated, combined into an overall assessment and compared to a price. Product-centred value-based pricing is excellently suited in the first phases of service transformation for additional offers in the aftermarket business.

A good example is the spare parts business with its high margin potential but also with high challenges in complexity management. With high variance and low standardisation of individualised machines and systems, the complexity of the installed base and its history to be taken into account increases over time. For the service business, this results in a large number of parts lists, design adaptations and article quantities for spare parts. The typically used cost-plus pricing and the resulting inconsistency and focus on internal costs cannot ensure price consistency and market-specific price optimisation. Rather, an adequate value-

based pricing approach can overcome these challenges. This requires a value concept with three dimensions (see Fig.2).

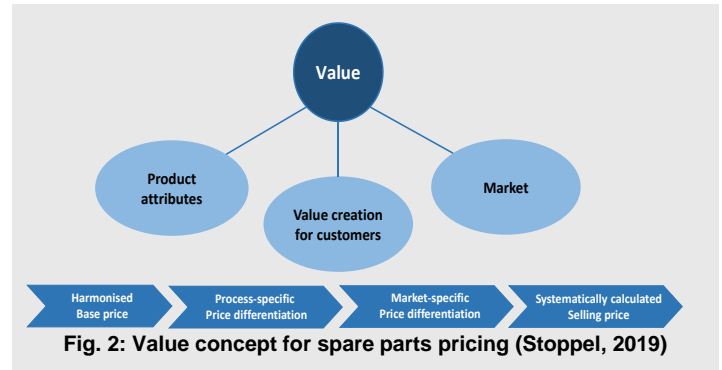


Fig. 2: Value concept for spare parts pricing (Stoppel, 2019)

Service-centred approaches to value-based pricing go beyond the presentation of service attributes. Instead, the focus is shifted to understanding the customer's business and how to support it (Terho et al. 2012). Service-centred pricing systems therefore require a new way of thinking about how value is created in the customer, how it can be captured and ultimately allocated using a pricing system.

Value capture tends to avoid pre-determining or anticipating value, as the actual creation of value only takes place in the use phase. Instead, the value is recorded approximately in the use phase on the basis of a measurable variable (reference value) and transformed into a monetary value with a fixed calculation mechanism. Stoppel/Roth (2017) distinguish in this context between availability-oriented, use-oriented, result-oriented and performance-oriented pricing systems. These are differentiated on the basis of the reference value used. Instead of products and services, the customer obtains his value proposition, depending on the price system, either through availability, use, the result of a use or the success resulting from the use.

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Beyond the product | How industrial goods suppliers increase their competitive advantage through servitisation

In this interview (10.01.2022), Marc Ziegler, Partner at Porsche Consulting, addresses questions about the transformation of the industrial goods sector through servitisation and the role of controlling in this process.

What exactly do you mean by servitisation?

Beyond the addition of services, servitisation is seen as the evolutionary development of a company from a predominantly product-oriented company to a service-oriented or even a pure service company. Even competition based on product specifications is evolving towards competition based on the fulfilment of a specific function of the customer or even the enabled output of that. Such a company-specific transformation path emerges through the development of new profit pools offered by the service play - enabled by digitalisation.

Why should companies - if they have not already started - start servitisation right now?

In the past, service provision was always heavily dependent on the cost and availability of human labour, which made it difficult to deliver services cost-effectively on a large scale. Today, technological advances allow access to a wealth of equipment and process-related data at low cost, regardless of the location of the equipment. Digitisation has thus fundamentally changed the way services can be designed and delivered, enabling easier scaling of the service business at low incremental cost. Whereas field maintenance used to spend much of its time travelling, ubiquitous sensor data provides near real-time data. In addition, a service can have a greater impact on meeting customer needs. Thus, services help companies to build sustainable customer relationships instead of competing solely on product specifications. While products can be compared on the level of components and assemblies based on their features and prices, services are much more difficult to compare - a differentiation opportunity for companies offering services.

What is the value of servitisation?

By transforming into service companies, companies can build economic barriers around their business: For example, through strategic differentiation, through a deeper understanding of customer processes, through integration into those customer processes, or through a competitive advantage by generating proprietary data that cannot be imitated by competitors. Porsche Consulting's research on Total Shareholder Return (TSR) has shown that service-oriented companies outperform their competitors by more than 50 percent in the long run.

What should be considered when defining a servitisation strategy?

First, it is important to define whether and how service-oriented value propositions to customers fit into the overall corporate strategy. Second, it is important to address the challenges of risk management in the transition to service business models. While the opportunities are tempting, taking value from customers requires careful identification, assessment and ongoing management of risks. Thirdly, it needs to be considered whether the company's current operating model is suitable to successfully support and scale a service business. Comprehensive service transformations require a dedicated operating model, as the DNA of an engineering-driven hardware company must change accordingly with the increasing degree of servitisation.

What contribution can controlling make to support the implementation?

The actual change process to a more service-driven company, which takes place in stages, must be tracked and evaluated via milestones reached in its implementation. The finally changed service provision must then be evaluated just as transparently as the pure (hardware) product world. For progress control, servitisation leaders use "Objectives & Key Results" (OKRs) in particular, which dovetail top-down and bottom-up goals. Classical controlling indicators can measure the CAPEX-to-OPEX transformation well and present it in the P&L.

How will the requirements profile for controlling change as a result of servitisation?

The classic controlling perspectives, such as concurrent costing and commodity group accounting, must be transferred with regard to the new service provision. This should be done in advance of pricing the new service offerings (e.g. product-software-service bundles) in order to be able to measure their success accordingly.

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