International Association of Controllers

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Dear readers

The previous two issues of the ICV Think Tank's quarterly newsletter presented articles on servitization & controlling. We discussed from a theoretical and practical perspective how companies are expanding their business model with the help of various forms of services, and what changes this expansion entails for controlling.

In this quarterly we include further ideas for dealing with servitization & controlling. The first article explains how new initiatives can be measured via customer value (see also the reading tip). The second article describes the reorganisation of controlling at SARTORIUS. In the third article we conduct an interview that discusses how servitization changes controlling.

We hope you enjoy this issue.

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Reading tip

Stefan Rech's **Dienstleistungscontrolling** (English: Controlling Services), published in 2020, provides a comprehensive concept that contributes to the theoretical, conceptual and empirical foundation of the topic. The theoretical-conceptual frame of reference integrates previous approaches, takes behavioural aspects into account and is characterised by service-dominant logic. The empirical study provides insights into the development status of service-specific controlling systems. Companies that are transforming into service providers receive an orientation framework for the practical design of controlling.

Kundenwert: Grundlagen - Innovative Konzepte - Praktische Umsetzungen (English: Customer Value: Foundations – Innovative Concepts – Practical Implementation), a book published by Sabrina Helm, Bernd Günter und Andreas Eggert (4th edition, 2017), applies the results of research into customer satisfaction and customer retention, as well as financial approaches by renowned authors, to analyse the building blocks of customer value and discuss the calculation methods. It also provides reports on experiences from actual practice.

The right KPIs for new business models | Controlling via customer value

The Haufe Group has successfully mastered the transformation from a publishing house into a digital company by boldly investing in digital solutions. The resulting business models are controlled separately from the core business via customer value.

The Haufe Group has transformed itself over the past several decades from a pure publishing company to a provider of basic and advanced training that also renders digital workplace solutions and services. Its offerings include services in law, business and controlling that make it easier for companies to deal with these areas or to outsource them to Haufe altogether. Customers of all sizes, from freelancers to DAX corporations, are addressed with various solutions. Back in 1993, for example, the Haufe Group acquired a stake in the software company Lexware to digitise travel expense accounting.

A key controlling metric that made the transformation possible and which aligns the company with its customers is the net promoter score (NPS). The Haufe Group uses the NPS as a component that enables a focus on the customer and not on the product or the contents. Customer requests and their use of solutions are also tracked in a structured manner by testing system variants, so-called AB tests.

New issues are making additional qualifications increasingly important in controlling. Besides the use of an ERP system, short-term analyses using spreadsheets are becoming more important. In addition, other metrics are used for new initiatives. Besides the NPS and financial KPIs, key figures that enable a customer view of investments and their return are also being applied, including customer acquisition costs (CAC) and customer lifetime value (LTV). As investments in digital business models can be planned only to a limited extent, customer-oriented key figures help to show the value of an initiative in the long term before financial results are achieved. These key figures help to convey an impression of the venture’s profitability, especially in planning, portfolio management and in cooperation with shareholders. In addition to customer-oriented key figures, the Haufe Group uses milestones to control the success and prospects of new business models. Milestones also help to plan market entries and manage portfolios. Although stage-gate processes or business plans also support communication, they do not meet the agile requirements of new business models because the details often appear only late in the process.

Figure 1 shows customer-oriented key figures for a fictitious new initiative. The marketing and sales costs relative to the new customers acquired result in the customer acquisition costs (CAC). Churn describes how many customers were lost in a year. The number of customers from the previous year combined with the new customers and churn results in the customer base. The average revenue per customer (ARPU) is calculated by dividing total revenue with the number of customers. The cost of revenue (cost to serve) per customer is shown alongside product development costs and overhead expense. The product development costs can be broken down into maintenance and enhancement. This breakdown could enable insights into the profitability that would result if enhancements were discontinued.

The customer lifetime value (LTV) is shown under the revenue and cost view. It includes a statistical determination of how long a customer uses the product or service (retention time). The number of acquired customers and the retention time result in a simple representation of customer value. This metric shows how much value the initiative has created for the company in one year, which often materialises only in the following years. An interest rate could therefore be assumed as well (not applied in the example above) to discount future cash flows to arrive at the customer value. The amortisation time of the customer acquisition costs can be shown by comparing the LTV and ARPU. The comparison of the customer value to the acquisition costs shows how much value is created per acquisition cost. Other calculations of the customer value are not based on revenue, rather on margin values per customer. This approach would enable the allocation of costs to customers.

Fig. 1: Examples of customer-oriented key performance indicators

KPI	Y1	Y2	Y3
Acquired Customers [#]	5.000	8.000	12.000
Customer Acquisition Costs (CAC) [€]	100	120	150
Cost Sales & Marketing [€]	**500.000**	**960.000**	**1.800.000**
Churn [#]	0	500	1.500
Churn [%]	0	10,00	12,00
Users [#]	5.000	12.500	23.000
Avg Revenue per Customer (ARPU) [€]	100	150	200
Revenue [€]	**500.000**	**1.875.000**	**4.600.000**
Cost to Serve [€]	500.000	600.000	700.000
Cost to Develop [€]	2.000.000	3.500.000	3.000.000
Cost General & Admin [€]	200.000	300.000	250.000
Cost Total [€]	3.200.000	5.360.000	5.750.000
Net Profit Before Tax [€]	**-2.700.000**	**-3.485.000**	**-1.150.000**
Retention Time (per Customer) [yrs]	5	5	5
Lifetime Value (LTV, per Customer) [€]	500	750	1.000
LTV Total [€]	**2.500.000**	**6.000.000**	**12.000.000**

From product to solution provider | The introduction of standard costs

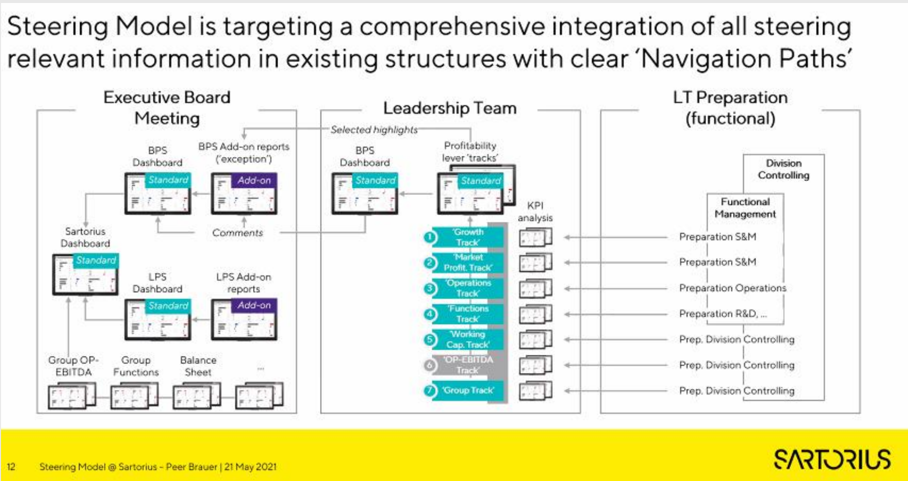
SARTORIUS AG has evolved from a supplier of products and services into a provider of solutions. In order to take account of this development in management and controlling, the company reorganised its management structure and refined its steering system. An integral component of this refinement was a new standard cost approach.

Sartorius AG is a listed pharmaceuticals and laboratory supplier with its head office in Göttingen. The company, which was founded in 1870, generated revenue of around EUR 2.3 billion in 2020 and employs roughly 10,600 people at 60 locations worldwide. SARTORIUS's two divisions, Bioprocess Solutions and Lab Products & Services, offer their customers from the biotech and pharmaceutical industry products and solutions associated with all aspects involved in the development and production of molecules and cells.

The Finance department, which acts as a business partner for the divisions, has defined six pillars for its work. (1) A dedicated contact person is determined for each division. (2) The Finance department drives the modelling and use of financial data. (3) Reporting is developed iteratively with the divisions. (4) Standard reports are to be used whenever possible. (5) More detailed analyses are created when needed and upon request. (6) The Finance department drives the automated generation of reports and data operations.

In addition to the development of these pillars, the Finance department conducted 1-on-1 interviews with executives to determine how it could enhance its collaboration with executives.

Figure 2: Reports in the new steering model



As SARTORIUS evolved from a product supplier to a solutions provider, one of the potential improvements that was frequently mentioned was steering from the divisions' perspective. This had to be adapted to the new management structure, which aligned the divisions more closely to their markets. A project on the steering model was therefore launched. In addition to a standard cost perspective and the associated improved transparency and view of profitability drivers, the Finance department aimed to improve the integration of the divisions' steering needs into the steering model in order to meet the department's six-pillar standards.

The first phase of the project involved defining not only the divisions' perspectives, but also five further steering perspectives. These were established to contribute to the achievement of these goals in the following areas: functions, business activities, customer groups and customers, platforms and operating units such as production lines or production locations. The income statement designed for this purpose was based on a standard cost approach that enables the presentation of operating variances at the business activity and operating unit level. This means, first, that a simplified gross profit is shown in terms of standard costs, and second, that the operating variances that lead to the actual gross profit can be analysed.

In the second phase, the Finance department developed the reporting of the steering model. This reporting standardised paths and drill-downs for various hierarchical levels in management. As formulated in the pillars, the goal was to achieve highly standardised reporting without having to forego ad-hoc reports. For this purpose, as shown in Figure 2, reports for various functions of operating management and controlling were defined and developed. In addition to sales and marketing, these reports summarized operating production figures and financial results. Extracts from these reports were then compiled for the management board, which, if necessary, has the opportunity to delve deeper into a KPI area. One effect of the Finance department's work with Tableau as a reporting tool was that this tool became popular throughout the organisation. The new concept could be built on this infrastructure. In addition to the conceptual development of the steering logic and the navigation paths, technical adjustments were analysed, designed and planned in the second phase. One change that was necessary for depicting gross profits was, for example, the introduction of a second master level in the ERP system.

Now that the concept for this steering model has been developed, SARTORIUS is currently working to implement it. The roll-out is scheduled to be completed at all levels of the company by sometime next year.

Understanding customers | More than just analyses and KPIs

In an interview conducted on 3 July 2021, Michael René Weber from the ISS International Business School of Service Management addressed questions about transformation through servitization, and controlling's role in this process.

The introduction of servitization has a lot to do with change and transformation processes. What need for transformation do you see in this regard?
Servitization is a process in which a company that previously manufactured products or goods will offer customers additional services in the future, from repairs to the operation of its own product on-site at the customer's facility. This transformation involves several development stages, and no company realises this paradigm shift in one step. It is important to recognise the steps as a transformation and address them systematically. Customer needs are always the trigger.

In the beginning it is not a transformation. Customer satisfaction is achieved with the sale of spare parts and through work that is not charged, such as training on the operation of the systems. The Sales department gives these services away in order to maintain the product price. Many companies must still overcome this mindset that their service is "for free".

Now the transformation begins: the change of perspective away from the company's own product to customer needs. Customers want technical support for their systems. The service function visits the customer site more often, initially without and later with longer-term service contracts. It gets to know the use of the products on site and how to avoid malfunctions. We begin to understand the customer and their interests better.

A company which now recognises that customers can also be supported in the use of the product, i.e. with the output of the systems if they have an added value, develops value-added services and thus services that are oriented toward the customer and no longer toward the company's own product. This is the paradigm shift; the supplier thinks from the customer's perspective. At the ISS we call this the "kangaroo jump". The aim is to support the customer's business and not just to maintain the company's products located at the customer's site.

A mindset change occurs in the company – that customers instead of products are the focus – and therefore that services rendered for customers can become a key source of revenue. This knowledge of customer concerns is a prerequisite for a further transformation stage, namely taking over the operation of the system at the customer site. The benefits of the system, i.e. the output, are sold; the system itself remains the property of the manufacturer.

What contribution can controlling make to take an organisation on this journey?
At the beginning: the internal and external benefits of the service function must be made visible and attributed internally to their source; then they must be billed externally. Many service departments continue to operate without their own profit & loss overview. Awareness of your own performance, regardless of whether it is profitable or not, becomes more refined only when you have an income statement. Once it is in place, self-motivation to become profitable will then be a driving factor.

Where service products already exist, controlling should support their development – in part oriented towards service-specific customer segments, with additional criteria for products.

In the case of services to support sales, the benefits for customers must be clarified. If this benefit has been identified, a "from-free-to-fee" process can be initiated. Controlling can therefore establish the platform for the development and expansion of the service business – or arrange for the cost of services to be rebooked according to causation. Ultimately, it is important to foster the paradigm shift. Does the organisation understand that knowledge of customer needs is a critical success factor, and how is this potential shown?

In the operator model, revenue is postponed. Service-oriented business models generate revenue from the services; the product is priced in and is, in effect, paid in instalments. In addition, the company must build up knowledge and skills to achieve an output as an operator that corresponds to the customer's requirements, and to take on the associated operator risk. Controlling is responsible for evaluating this risk.

How do servitization initiatives differ in their reporting from the day-to-day business? How meaningful are plans and business cases? How are they structured?
If a company aims to implement a service initiative and transformation process, it should have a business case with a transformation protocol so that learning outcomes are visible to everyone. Each function has its own categories, including controlling – and this is where new metrics appear, such as customer satisfaction (NPS), number of pilot projects and their results, as well as specific success factors (KPIs) defined at the beginning and usage of the generously funded transformation budget.

Applying traditional financial controlling to the servitization business case enables a clear determination of the current risks associated with the transformation. The servitization process also needs concrete plans. We learn from the deviations that become necessary during the implementation for the next sprint in the transformation.

How are decisions made about such initiatives? Which KPIs are behind it?

All roads lead to Rome; let me outline three possible triggers for servitization. The first trigger are customers who demand services. These are rendered so that the customer remains satisfied. At some point the costs rise, and when it becomes clear that the customer benefits from the services, this benefit is then also billed – first in part, then in full.

The second trigger is digitisation. Digitisation initiatives are doing a good job. Internally they have resulted in a 20 per cent increase in production efficiency. Data-driven solutions for the machines also bring good results – but unfortunately no revenue. Digitisation therefore needs a service business model in order to generate revenue from the benefits it creates for the customer. This means that digitisation and the service function will start collaborating more closely. In that way the business can be expanded even further based on existing customer contacts. Digitisation in this regard is a support function, involving a significant amount of special know-how and creating capabilities to accelerate processes. Often the corresponding function reports directly to the management board, in line with its current importance. The business activity is called “Service” with its analogue and new data-driven service business models for customers – and the responsibility for them must be clearly defined. Otherwise the controller does not have a contact person.

The third trigger is the management board, which brings a business case. A feasibility study is then commissioned and intensive work begins on the implementation. In each instance a business case is developed and calculated for the company itself. In all of the situations mentioned, well-founded assumptions are crucial and, in addition, the person who is ultimately responsible for it must be defined. The development of a business activity is an evaluation of an opportunity without a guarantee; it brings to paper an ROI, which is probably the most important KPI.

Servitization initiatives are successful when shareholders and the management board want them and convince employees that the customer is the benchmark for future corporate success.

How will the job profile for controlling change due to servitization?

Customer proximity and process competence for services will be crucial in the future for the success of companies. When asked “why is the customer using the product?”, it becomes clear that value arises only when it is used. And the value varies for different customers and customer segments. In the case of services, a “value-based” billing can take place, based on co-creation processes with partners and customers in the application and in consultation with the customer.

This is a fair approach that companies are often still reluctant to pursue. After all, it is true that this approach makes it more difficult to forecast results, although controlling can provide lower limits. Over time, however, empirical values will emerge that make this pricing process more secure. Good value-based models exist that offer customers a high degree of flexibility (cleaning or compressor market). Otherwise companies often use subscription solutions, which essentially means financing the sales price as an instalment payment over the course of the usage period.

In my opinion, it is crucial for controllers that they, too, understand customers and are familiar with the service business. One option in this direction is to go beyond the analysis of customer evaluations to visit customers personally and to exchange ideas with controllers of service organisations.

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