



A Strategic Whitepaper for Manufacturers and Channel Partners

Transforming the Service Business Into a Revenue Engine

*How the Combination of Technology and Business Process
Outsourcing Can Improve Service Sales Visibility and Efficiency
to Maximize Services Revenue*

THINK About This –

*Your company's ideal revenue stream is recurring; it's high margin; and it's from a captive source.
That revenue stream is possible today from your after-sale services.*

*The ideal way to maximize that high margin, revenue is to leverage an experienced business
partner: One that combines service contract sales experts and next-generation technology to
streamline your core service sales processes and give you continuous insight into your service
operations. This combination ultimately transforms how service contracts are sold — even
through the channel. This whitepaper will show you how you can achieve these objectives via
'technology-enabled business process outsourcing.'*

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A THINKstrategies Perspective Featuring Encover, Inc.

Executive Summary

With the economy rebounding, corporations in almost every sector are refocusing their energies on rejuvenating revenue growth that has been stalled over the past three years. In the quest for new revenue streams, one of the most profitable opportunities—after-sale services—is a key lever for new strategic growth.

According to a recent McKinsey & Co. study, 62 percent of new hardware product orders in the U.S., and 64 percent worldwide, include maintenance and support contracts. This means almost 40 percent of products sold today can generate additional after-sales revenues and profits if properly pursued.

The after-sale services business—including initial product maintenance agreements and service contract renewals—is a high margin revenue driver for manufacturers and their channel partners. Yet a surprising proportion of corporations are missing immediate add-on revenue and profit opportunities by failing to systematically pursue post-product sale maintenance agreements, warranty conversions or renewal agreements with existing customers.

Focusing on services is also timely because THINKstrategies believes the information technology (IT) industry is undergoing an ‘inversion’ process in which product technology-centric companies are fundamentally changing their go-to-market strategies and organizational structures to become services-led businesses that can respond to rapidly changing customer needs. Companies can take advantage of this industry inversion trend and substantially improve their financial performance, increase their account penetration, and strengthen long-term customer value by more fully targeting their after-sale service opportunities.

For many companies upwards of 75 percent of their operating income comes from services, according to ITMSA.

This is not only an opportunity for manufacturers, but for their channel partners as well. *International Data Corporation (IDC), a leading market research firm, states that nearly 60 percent of value added reseller (VAR) and distributor profits come from services.*

This whitepaper will take a close look at this under-utilized revenue stream, and examine the best method of harvesting this strategic business opportunity.

Industry Inversion Process Favors Services-Led Companies

Enterprises are increasingly frustrated with the cost and complexity of implementing and managing technology. In fact, 65 percent of enterprises question the effectiveness of their information technology (IT) in supporting their business goals and objectives, according to a new report by people3, a subsidiary of Gartner Group.

In order to successfully respond to the changing demands of enterprise customers, manufacturers must fundamentally change their business models from a product-centric to a services-led business orientation. This transformation process, or ‘inversion’ process, requires technology companies to turn existing practices and processes upside-down in order to achieve business transformation.

As a part of this transformation process, it is imperative that manufacturers and their channel partners more systematically pursue their after-sale service opportunities. The most competitive companies are performing ‘core vs. context’ analysis; focusing on their core capabilities; and finding trusted partners to handle the rest.

Manufacturers and their channel partners must undergo a transformation process to fully exploit their after-product service revenue opportunities.

As a consequence, enterprises are solving their business problems via services that can transform their businesses wherever possible, rather than acquiring more technology. The best method for achieving this

transformation process is a new **technology-enabled, business process outsourcing (BPO)** approach illustrated by Encover, Incorporated.

Encover has combined outsourced service contract sales with next-generation service contract administration technology to enable companies, such as Kodak Health Imaging and Xerox Corporation, to dramatically transform their service business and generate significant financial benefits.

Manufacturers and Channel Partners Looking to Services

For many companies, the inversion process must begin by treating their service business as a strategic asset, and not as a servant of their product units. A growing number of IT industry leaders—including IBM, Xerox, Hewlett-Packard, Cisco Systems, Eastman Kodak, General Electric, and Dell Computer—are undergoing this inversion process today to more systematically sell their services to drive greater product sales and greater profitability.

Cisco Systems: A poster-child for the inversion process.

Cisco is a prime example of how a technology leader can put systematic focus on services and leverage both technology and outsourcing services to generate billions in new revenue and hundreds of millions in new profits.

Cisco's Service Contract Center (SCC) uses a combination of service contract administration automation software and both internal and external specialized service sales teams to increase its service revenue by 65 percent. Cisco achieved this dramatic increase by aggressively pursuing initial after-product sale maintenance agreements and contract renewals.

IBM's transformation from a systems company to a services-led solutions provider has become a model for the entire IT industry. Over the past decade, IBM's services business generated over 80 percent of IBM's total revenue growth, and now equals almost half of IBM's \$89.1 billion in revenues.

Hewlett-Packard (HP) is aggressively moving to replicate IBM's success by consolidating two of its key operating divisions to form a new services-led Technology Solutions Group (TSG).

Dell Computer—well-known for its sophisticated low-cost product fulfillment capabilities—is trying to repeat Cisco's success by putting more emphasis on high-margin service revenue opportunities to compensate for falling margins that slid from 8.3 percent in 2000 to 6.4 percent in 2003. Dell's President, Kevin B. Rollins, reported in a Wall Street Journal article on November

11, 2003, that in the past Dell has generated far less of its overall revenue and profits from services than its rivals. Dell's own analysis found that 75 percent of its competitors' operating income came from basic installation and maintenance services.

An IDC study found that channel companies, including VARs and distributors, on average make more than half (58 percent) of their gross margins from services, greater than any other aspect of their business and more than double their total product margins.

Capitalizing on the service revenue and margin opportunity is also increasingly important to resellers and distributors.

Mike Long, President and COO of Arrow Electronics of North America Computer Products, a major distributor reported in a Computer Reseller News

article entitled, "Distributors Missing Out", that his company is putting greater emphasis on service sales because historically it only captured 70 percent of the attached service contract potential from its product sales.

Critical Service Business Management Systems

As do most business transformations, the inversion process requires three core pillars: *people, process and technology*.

One of the keys to effectively selling services is implementing an automated system for installed base and service contract management that includes service sales performance monitoring. Service automation software can help companies transform their contract sales processes by better managing their installed base and contract management requirements, and providing a powerful tool to monitor service sales performance and generating valuable, real-time business insights into the service business.

But to handle the inversion process, this technology must be specialized for the world of services. Many companies mistakenly believe they can solve their service business automation issues by simply

extending the functionality of their enterprise resource planning (ERP), customer relationship management (CRM) or sales force automation software.

These applications often have large functionality gaps when it comes to service and maintenance sales and renewal, and any capabilities they do offer, usually require extensive customization and substantial additional costs. These traditional applications also don't offer the collaborative architecture required to extend their service contract administration capabilities to channel partners and even enterprise customers.

The important benefits that the right type of specialized software offers include:

- *First and foremost, enabling multi-dimensional installed base management.* This includes the ability for customers and channel partners to participate in managing the service contract administration process.
- *Second, engaging both resellers and third-party call-centers in service sales processes by extending entitlement visibility to them.* On a tactical level, this includes letting service delivery partners know when support contracts are coming due, then automatically generating a service price quote specific to each customer's unique situation.
- *Third, permitting flexibility in defining service pricing and availability based on product, geography, service levels, term of service, or other "soft" factors such as type of customer or partner relationship status.* Further flexibility is provided by allowing additional discounts or premiums, as business needs dictate. Quotes can be automatically generated with multiple service level options so that the reseller can easily quote the range of available services to a customer based on product and location.

Because upwards of 65 percent of manufacturer and channel customer service data can be incorrect, according to AMR Research, automating the service sales and administration process is particularly important for companies that rely on third-party channels to sell their products and services.

AMR estimates companies that haven't automated their service lifecycle management processes are twice as likely to lose customers than companies that have automated systems in place.

Cisco's Service Contract Center (SCC), for instance, helped to raise customer satisfaction ratings from 4.01 out of a possible 5.0, to 4.52 after its implementation.

AMR also estimates that service automation can cut service sales and administration costs 5-15 percent, and increase margins by 25 percent. Yet, AMR found only 10 percent of manufacturing companies have fully automated their service businesses, and another 25 percent are only partially automated. Manual service management processes lead to lost sales opportunities and customer defections.

Implementing automated service contract administration systems can also enable manufacturers and their channel partners to create new service revenue opportunities, by making it easier to package, price, provision and manage new service offerings.

THINKstrategies has found an increasing number of companies are choosing to satisfy their service contract administration business requirements via a new form of outsourcing, called 'technology-enabled business process outsourcing'.

According to McKinsey & Co., "Best-in-class service providers are also adept at finding ways of maximizing income from parts and 'assessorial fees.'" Capitalizing on these new service-related business opportunities requires specialized service automation software that permits manufacturers and their channel partners to

systematically administer the sales and fulfillment process.

While an important part of the equation is service automation software, it is only one piece of the puzzle when it comes to growing a successful service business. THINKstrategies believes companies must have the right service sales skills and management best practices in place to build a strong and profitable service contract administration business.

Combining these skills and processes together requires a transformation that can be accelerated by teaming with a specialized service business management solution provider.

The Shortcomings of Traditional Outsourcing

In order to gain the greatest strategic, competitive advantage from increased service contract sales, companies must go beyond simply acquiring new service automation software or contracting for additional telemarketing services. They need to fundamentally transform the way they manage and execute their service contract sales processes.

Because service sales and contract administration are often seen as a secondary business opportunity, companies often dedicate their existing sales systems and staff on product sales, and don't fully focus on this important revenue stream. For companies with limited sales staff or automated systems, seeking an external partner that can deliver both the process and the technology, can be the best path to success.

In the past, many companies turned to outsourcing to transfer the burden of a costly in-house function to a less expensive outside service provider. THINKstrategies has found the critical shortcoming with this 'brute force' approach is it only focuses on reducing the cost of a corporate function, and doesn't attempt to gain greater benefits from the business function being outsourced by creating new processes, building new expertise, and putting new systems in place.

The simple act of transferring a business function to an outsourcer doesn't ensure a maximum return. Many companies mistakenly believe they can reduce the cost of service sales and incrementally improve their sales volumes by outsourcing this task to lower-cost, telemarketing firms. Yet many of these BPO providers rely on lower-cost personnel to simply reduce operating costs only, rather than utilizing a combination of skilled staff and software automation to generate new business opportunities.

Traditional telemarketing firms also generally lack the specialized sales skills and tight administration process controls to substantially improve a manufacturer's service contract penetration and renewal rates long-term. Instead, telemarketing companies aggressively pursue short-term contract sales without regard to customer satisfaction and future revenue opportunities, failing to produce long-term strategic benefits.

Business process outsourcing (BPO) has become popular because it enables organizations to improve their financial performance by utilizing specialized service providers to perform specific business functions, increase productivity, create new revenue streams and implement better cost controls.

THINKstrategies is often asked, *"Should I outsource revenue-generating processes, like service contract sales?"*

The reality is on average most manufacturers already outsource 50% or more of their product sales through their channel partners because it is efficient and reduces risk. Why not outsource service sales for the same reasons? Companies should focus on their core capabilities and find an expert partner to handle the rest.

However, simply outsourcing your service sales won't produce greater sales or profits, unless your service contract administration processes are properly automated, and your service sales partners have the right skills. This is even more important for companies relying on their channel partners to sell services.

Service sales through the channel can be dramatically improved through expert coaching, improved process and service management systems that exist symbiotically alongside existing channel partnerships.

Technology-Enabled Business Process Outsourcing

A new generation of outsourcers with specialized service sales skills, software tools and processes are transforming companies' through technology-enabled business process outsourcing (BPO) that increases

Technology-enabled business process outsourcing (BPO) combines specialized application software with specially trained personnel to allow an enterprise to automate and streamline a business function to produce new revenues and profits, and build a competitive, strategic advantage.

service sales productivity and improves cost management. These technology-enabled BPO providers empower internal sales teams and channel partners, without threatening or competing with them.

Leveraging best-in-class software applications, technology-enabled BPO automates the key service

sales and marketing processes. It also permits companies to offload the costly and time-consuming service sales recruitment, training and administration requirements to a specialized service provider with proven expertise and experience in the service business.

Technology-enabled service management BPO applies specialized skills and sophisticated resources to enhance a company's sales operations and ensure that the service sales and contract administration process is fully integrated. It also integrates the technology and business processes back into an organization, providing all the benefits of those processes and that technology, without requiring substantial additional investment.

Summary: Technology-Enabled BPO and the Revenue Imperative

Nearly every major industry is undergoing a fundamental shift in focus from selling products to service solutions as enterprises seek service-based, business solutions to meet their corporate objectives. THINKstrategies has found that service-led suppliers are gaining a competitive advantage over product-centric companies.

Service teams are often burdened with the responsibility of driving significant, high margin revenue from the existing customer base. However, research shows that IT companies often do not invest in the sales management systems, procedures and skills to systematically sell the full value of their services. Much of this is due to the classic focus on selling products...but it is rapidly changing as Fortune 500 companies and other corporations are looking for the right technology and process investments to drive service sales.

In order to invert their operations to place a greater emphasis on services, many IT vendors and their channel partners must fundamentally transform their operations. McKinsey & Co. calls this the "productivity imperative." But for companies, like Kodak and Xerox, that are inverting their service contract sales in order to drive crucial high margin revenue, the more accurate description is a 'revenue imperative.'

By leveraging technology-enabled service BPO, manufacturers and their channel partners can transform their service sales management processes to substantially increase both their immediate service and follow-on product revenues, and long-term profitability.

"[High-tech companies] must shift their focus and culture from a preoccupation with the next big thing and learn to emphasize the importance of process improvements as well."

*What High Tech Can Learn From Slow-Growth Industries
The McKinsey Quarterly, 2003 Number 4*

Encover's technology-enabled BPO solution has produced rapid and strategic value to Kodak, Xerox, Juniper Networks, Enterasys Networks and others. Encover's technology-enabled business process management (BPO) can help other manufacturers and their channel partners generate similar benefits by automating their service management processes and

delivering dedicated service sales expertise to achieve service business management best practices.

THINKstrategies' research shows that this technology-enabled BPO approach can increase sales productivity, improve operating efficiencies and permit manufacturers to focus their limited resources on their core business for long-term competitive advantage.

THINKstrategies recommends that companies follow the example of companies like Cisco, Xerox and others who are transforming their service businesses by using the kind of technology-enabled BPO services typified by Encover.

For more information regarding Encover, visit www.Encover.com.

About THINKstrategies

THINKstrategies is a strategic consulting services company formed specifically to address the unprecedented challenges facing IT managers, solutions providers, and investors today. Our mission is to help our clients re-THINK their corporate strategies, and redirect their limited resources to achieve their business objectives.

For more information regarding our unique services, visit www.thinkstrategies.com, or call us at 781-431-2690.