

# Identifying service strategies in product manufacturing companies by exploring environment–strategy configurations

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## Abstract

Higher market complexity and increasing competitive intensity are forcing traditional product-manufacturing companies to change their position in the goods–services continuum by continuously extending the service business. However, the existing literature tends to be somewhat vague in defining service strategies for manufacturing companies wishing to move along the continuum. The purpose of this study is to identify service strategies that correspond with specific environment–strategy fits. Using an exploratory factor and cluster analysis for testing Western European firms, the study highlights four different service strategies. The four service strategies include after-sales service providers (ASPs), customer support providers (CSPs), outsourcing partners (OPs), and development partners (DPs). After-sales service providers concentrate on cost leadership and ensure proper functioning of the product. Customer support providers form a unique value proposition by investing in a strong product and service differentiation. Outsourcing partners combine cost leadership with service and product differentiation to offer attractive prices for operational services. Their goal is to assume the operating risk and full responsibility for the customer’s operating processes. Development partners provide research and development services to create a situation in which customers benefit directly from their development competencies. © 2007 Elsevier Inc. All rights reserved.

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## 1. Introduction

Increasingly, more comprehensive customer needs, higher competitive intensity, and the need to exploit new growth potential force Western European product-manufacturing firms to extend their service business (Anderson, Fornell, & Rust, 1997). Increasing competitive intensity with a corresponding erosion of product margins refers to the fact that achieving product differentiation is currently in a stage of maturity. In the machine and equipment-manufacturing industry, for example, product margins have dropped to no more than 1 or 2% over the last couple of years. In contrast, typical after-sales services such as repair, spare parts, or maintenance offer margins of more than 10% (Cohen, Agrawal, & Agrawal, 2006). Faced with stagnating product sales, services also offer additional growth potential.

Sawhney, Balasubramanian, and Krishnan (2004) indicate that considerable growth potential is manifest in both the primary customer activity chains and comprehensive or adjacent customer activity chains. This growth potential can be exploited either by adding *new* activities to a primary or adjacent activity chain or *reconfiguring* the structure and control of activities within the primary or adjacent activity chain. According to Wise and Baumgartner (1999), such potential in the field of service revenue often exceeds three or four times the magnitude of annual product revenue. On the customer side, pressure to downsize so as to create more flexible firms, use narrower definitions of core competencies, and increase technological complexity are driving forces behind the rise of service outsourcing. Additionally, customers wish to reduce the capital employed in their production sites. Instead of investing in an air compressor, for example, they want an “opportunity” to pay for  $xm^3$  of compressed air (Windahl, Andersson, Berggren, & Nehler, 2004).

Anecdotal evidence on the extension of the service business and the corresponding service infusion in manufacturing firms can be found in Jack Welch’s statement that “the [service]

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market is bigger than we ever dreamt” (Slater, 1999, p. 183), SIEMENS’ goal to generate 50% of total revenue through services (Simon, 1993), and IBM’s success in mutating itself from a pure mainframe manufacturer toward an outstanding service provider. Oliva and Kallenberg (2003) conceptualize the extension of service business through the transition line and/or the goods–services continuum. At the one extreme point of the continuum, firms achieve a competitive position as a product manufacturer. They produce essentially core products, with services purely as add-ons. Profits and revenue are generated mainly through the company’s core products and the contribution of services is quite low in terms of revenue, profit, and customer satisfaction. Services are only one of the main differentiating factors in the product-marketing strategy. At the other extreme point, products are merely an add-on to the services. Products represent only a small part of total value creation. The dominant share of total value creation stems from services.

Moving along the transition line creates additional competitive advantage for product-manufacturing companies, leading to a different competitive positioning. Although such positioning has been discussed extensively in the literature, and formed the basis of numerous classification schemes (Porter, 1980; Galbraith & Schendel, 1983; Robinson & Pearce, 1988), existing research remains silent with respect to various service strategies needed to move into a new position on the transition line. Common patterns of competitive positioning have included, among others, overall cost leadership, product differentiation, marketing differentiation, and focus (Kim & Lim, 1988). However, such patterns do not fully capture the extension of the service business as a response to decreasing product margins and changing customer expectations within Western Europe’s manufacturing industry. Morrison and Roth (1992), for example, argue that customer service is a typical dimension of the quality reputation of manufacturing firms. However, current service offerings in typical manufacturing companies do not only capture customer service. According to Oliva and Kallenberg (2003), service offerings also include services for the installed base, process-oriented services, professional services, and operational services. This extended breadth of service offering has not been included in the debate on service strategies in manufacturing companies.

Neu and Brown (2005, p. 5) argue that “firms that successfully develop B2B service will align strategy with conditions of the service business unit’s external environment and adapt several factors of organization to align with the newly formed [service] strategy”. That means organizational performance of manufacturing companies moving along the transition line depends on the proper alignment between environment, strategy, and factors in organizational design. The present study concentrates on explaining specific environment–strategy configurations to explore service strategies in manufacturing companies. It focuses on the following research questions:

- What strategy–environment configurations exist in the manufacturing industry?
- What service strategies can be identified with respect to these strategy–environment configurations?

- What performance level can be achieved through a service strategy?

## 2. Conceptual framework

### 2.1. Research on strategy–environment fit

In developing the framework, this study draws on research in the area of strategy–environment fit. This research addresses how strategy and external environment influence each other. According to contingency theory, for example, organizational performance depends partly on the strategy–environment fit (Mintzberg, 1979). Organizational theory has established several dimensions of environmental characteristics: uncertainty, directness, change, dynamism, homogeneity, complexity, and munificence (Aldrich, 1979; Andrews, 1996; Duncan, 1972]. Research on the external environment started with Dess and Beard’s discussion (1984) of the various dimensions of organizational task environments. They distinguish between the following three factors characterizing the external environment: munificence, complexity, and dynamism. Munificence relates to the scarceness of environmental resources that support firms’ growth within a given industry. Environmental complexity reflects the heterogeneity and concentration of environmental elements. Environmental dynamism refers to the rate of change and degree of instability of the environment. Rapid change, short product life cycles, and processes of creative destruction are typical characteristics of dynamic environments. Dynamic environments make current products and services obsolete, and require new competences to be developed (Dess & Beard, 1984). Miller (1987) uses the term *environmental competitiveness* to reflect the number of competitors, and of areas in which there is competition. Jaworski and Kohli (1993) use the term *competitive intensity*, which reflects the behavior, resources, and ability of competitors to differentiate their products or services. The market orientation view argues that organizational activities are not only influenced by competitors, but also by market turbulence in terms of changing customer product preferences. Kohli and Jaworski (1990), for example, propose a philosophy that directs firms’ activities toward understanding changing customer preferences and designing a strategy to satisfy those needs.

Strategy research has typically concentrated on exploring different strategy taxonomies. Starting with Porter’s (1980) classification of cost leadership, differentiation, and focus strategy, the existing literature provides a broad range of taxonomies. Kim and Lim (1988), for example, specify Porter’s model by distinguishing between product and marketing differentiations. Miller and Roth (1994) differentiate between various types of manufacturing strategies. Their taxonomy includes caretakers, marketers, and innovators. These strategies differ in their potential for creating competitive advantages such as low price, design flexibility, volume flexibility, speed, after-sales service, etc. Interestingly, after-sales service plays a critical role for marketers and innovators, but not for caretakers. Morrison and Roth (1992) argue that strategies for competition in global industries can be clustered into domestic product specialization,

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