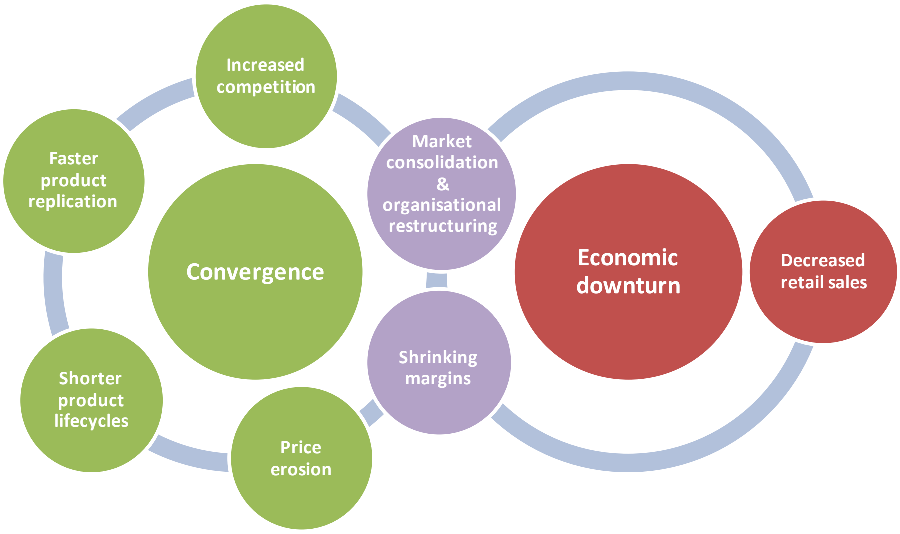
How do manufacturers ensure the sustainability of their service network?

By Will Fletcher

Today's environment

The rapid evolution and changing trends of the consumer technology market have been well documented. In recent times, traditional consumer brands have been thoroughly tested by a new set of challenges that have forced them to reconsider their position within the market place. Those manufacturers thriving today are the ones that have consistently managed to adapt to the changing landscape and be the first to meet consumer demands with the latest product innovation. They have delivered their product offerings in the face of increased competition from converging sectors and almost immediate product replication. As a result swift price erosion and shorter product lifecycles are a familiar pressure in today's environment.

Figure 1: the pressures of today's consumer technology environment



With the arrival of an economic downturn coupled with already shrinking margins within the industry, high technology manufacturers have fresh concerns about the sustainability of their business (see figure 1). Although they can readjust themselves to cope with today's environment, the survival of their service network is also of paramount importance to their own success.

While in the past manufacturers have directly sought to drive down the cost of service and reduce their warranty expenditure, in today's environment these consumer brands need to take a more pragmatic stance and work hand in hand with their service suppliers to realise benefit for both parties. In order to outline a practical approach to achieve sustainability, we need to consider the interests of both parties (see figure 2).

Business needs

Manufacturers desire network sustainability at an affordable cost

Manufacturers want to control their warranty budget while maintaining customer service levels and quality. The challenge for manufacturers is to understand if their repair tariffs are accurate and if they have the optimal service network model for their current and future business.

Service suppliers desire profitability and continuity of business

Service suppliers want to maximise profits while offering a high level of service in order to retain their customers. The challenge for many service suppliers is in running flexible operations in response to fluctuating volumes. Suppliers may need to drive down their operational costs to maintain their profitability.

Figure 2: sustainability depends on balancing the business needs of all parties

Solution

To tackle the growing concern of service network sustainability, MGH Consulting has developed a methodology with a two pronged approach. Firstly we take a high level 'top down' view considering a manufacturer's service strategy and warranty budget. Secondly, we take an in depth 'bottom up' view to benchmark the revenue, costs and performance of their service network and compare this to a perceived best practice model (see figure 3).

1) Manufacturer high level unit cost per repair

Considerations:
- specific geography
- sales forecasts
- cost of goods sold
- field failure rates
- average operational service costs
- predicted volumes per supplier

A manufacturer's service network model will be largely driven by their overall service strategy. It is fundamental that the chosen network model can be realistically supported by their warranty budget maintaining an acceptable warranty expense to revenue ratio (E/R %). Their high level unit cost per repair must fit with their expectations on warranty budget.

2) Service network benchmarking

Consider all operational costs related to:
- specific geography
- management
- labour
- space & site
- logistics
- service activity (in warranty and out of warranty)

Also take into account:
- complexity of repair activities
- product mix
- repair volumes
- service supplier margin
- number of partners within the network

Manufacturers also need to gain visibility and understand their service suppliers' business at a detailed level including the breakdown of their suppliers' P&L.

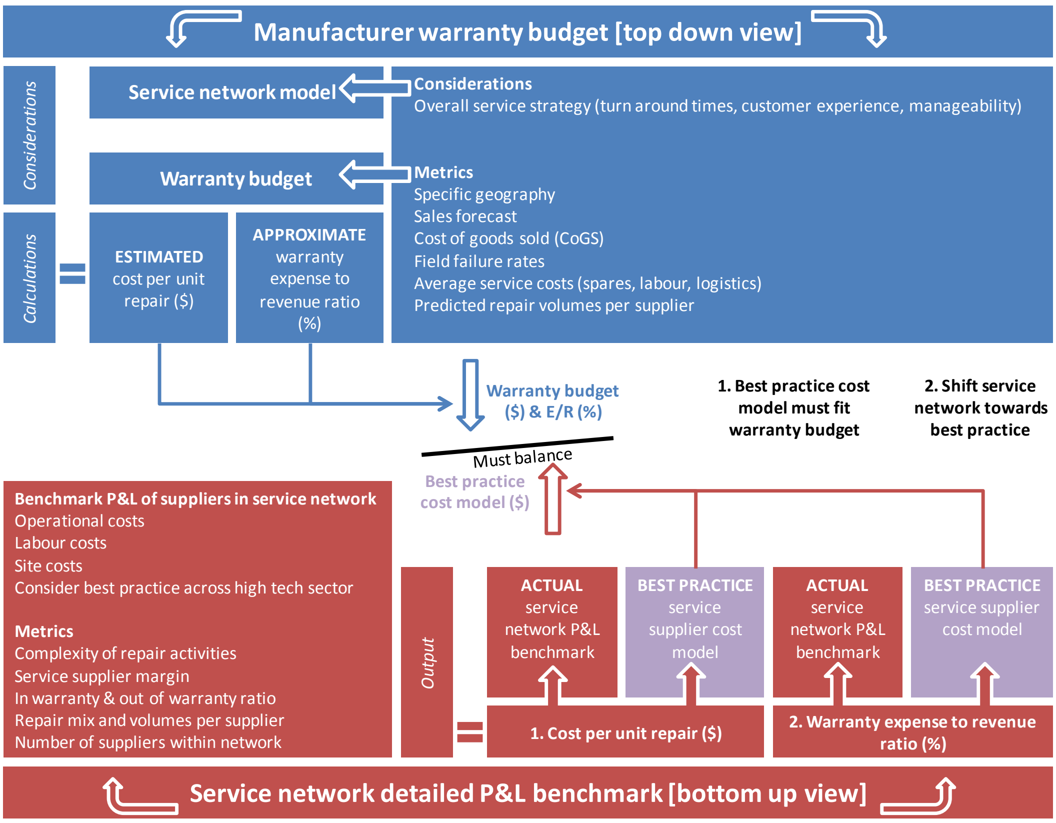
3) Best practice modelling

If a manufacturer can comprehend their service network's operational efficiency and running costs then they can begin to establish best practice in operational performance and build up a model P&L. In addition to collating their service network data, a manufacturer can also investigate optimal operational costs for comparable businesses across that specific geography. To further shape this model, internal company standards can guide best practice for technical performance and this can be sense checked across the broader high technology sector. This best practice cost model must fit into a manufacturer's expected warranty budget. If there is a gap then the network structure and cost model will need to be further refined to determine a realistic best practice that is achievable in terms of cost and service level.

4) Move service suppliers towards best practice

Once a manufacturer has settled on a best practice service supplier model, the challenge for them is to work hand in hand with their network to help suppliers realise this optimal cost of operations. The potential benefits to the service network are considerable and this activity reflects favourably on the OEM. Service suppliers have a manufacturer fully supporting their move towards best practice in operational performance and profitability, with a view to ensuring their sustainability as a business.

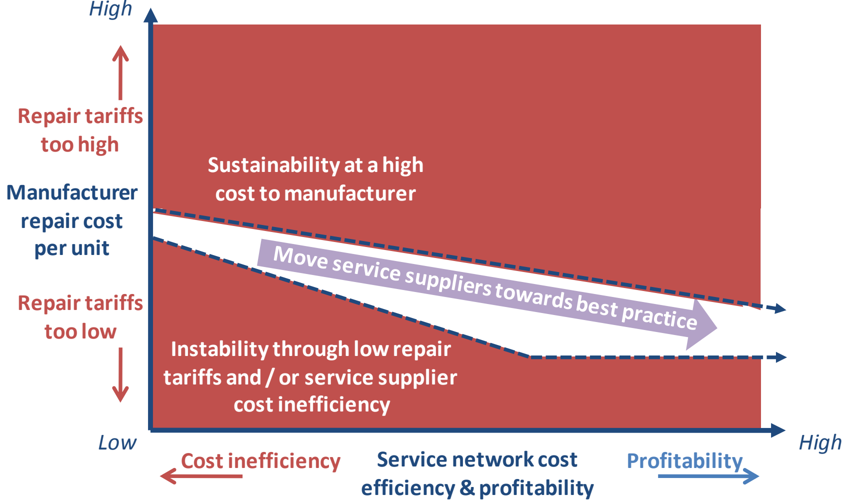
Figure 3: methodology for defining service network best practice cost model



Benefits

Following this benchmarking activity, manufacturers may have to expand or trim their existing suppliers in line with their chosen service network model. This network optimisation will enhance productivity and enable suppliers to operate more efficiently. This allows manufacturers to drive down their overall warranty costs while increasing their suppliers' margins, purely through reducing the actual unit cost per repair (see figure 4).

Figure 4: promoting best practice within the service network. Balancing sustainability at an affordable cost



Although warranty cost reduction is a welcome benefit there is also the possibility that, in line with the best practice cost model, manufacturers may have to increase their repair tariffs to support their suppliers appropriately. Although undesirable, if this is required then it merely endorses manufacturers' current concerns regarding the long term stability of their service networks. Furthermore, there are additional benefits to implementing a precise activity based pricing strategy. Through the creation of multiple tariffs it provides greater control for those manufacturers with vast product ranges and varying repair complexity. This enhanced repair cost visibility and information flow supports a number of functions including R&D feedback, service network auditing and repair profile analysis. All of these activities benefit the organisation by improving product reliability, fraud prevention and service network modelling for the future.

Attempting to ensure service network sustainability is a challenging responsibility for any high technology brand particularly at a time of economic uncertainty and industry change. However, this practical methodology provides a transparent tool for manufacturers to verify whether they have the optimal network model in place to support their future service requirements. It also provides a guide for their suppliers to enhance the performance and profitability of the service network as a whole. It fulfils both the need of the service supplier to reduce costs and maintain profitability and the necessity of the manufacturer to control their warranty expenditure, quality and customer service levels. In this way it enables manufacturers to promote the sustainability of their service network at an affordable cost.

Based on this practical methodology MGH Consulting have developed a functional Activity Based Pricing (ABP) software tool for manufacturers to calculate their repair tariffs across a range of product and repair complexities. The output not only provides an accurate pricing model but also enables the user to develop a full service supplier P&L for any repair volume in terms of manpower, facility size and operating costs. The tool can identify the cost efficiency gap between service partners' current delivery and a best practice offering thereby providing an invaluable asset to all service managers looking to promote best practice and sustainability within their service network.

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