Bridging the Services Chasm
Aligning Services Strategy to Maximize Product Success

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Introduction

Bridging the Services Chasm provides a comprehensive framework companies can use to make critical service strategy decisions that have rapidly become the difference between product success and market failure. Based on the analysis of technology providers, this book leverages a combination of public record, unique survey data, and direct interaction to clearly define the critical role services is now playing in the success of product companies.

In 1991, Geoffrey Moore published Crossing the Chasm. This seminal work framed and defined the specific challenges that companies face as they attempt to drive new product offerings to market. Since then, a new set of strategy challenges for product-centric companies has become evident. And there is a new chasm that companies must decide how to cross: The Services Chasm. Bridging the Services Chasm frames the services strategy decisions product companies can no longer afford to defer and provides a clear path for action.

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At this point in the journey, we have presented four distinct services strategies product companies have a tendency to assume. The previous chapters also provided examples of product companies crisply executing one of these services strategies. Cisco as a product provider, Oracle as a product extender, and IBM as a systems provider. However, product companies are not always so clear regarding their services strategy—especially when the needs of the market shift. This confusion in services strategy can make a product company thrash in a horrid place we call the services chasm.

**INTRODUCING THE SERVICES CHASM**

In Chapter 2 we mapped services-strategy profiles to market maturity. This picture is shown again in Figure 7-1.

In Chapters 3 through 6, the details of each services-strategy profile were provided. In that information, it becomes clear why different profiles are more effective in different states of market maturity. For example, it is hard to assume a product-provider approach when product sales are still emerging and no services partner ecosystem exists for your product. What was not discussed in Chapter 2 is how a product company manages its services-strategy profile.
Bridging the Services Chasm

as a market matures. There is a painful reality. As a product market matures, a product company will be forced to face a critical strategic decision:

**Does the company change market or change mix?**

In other words, does the company find a new, high-growth product market to pursue or does the company begin pursuing new service opportunities that exist in the maturing product market? This is a very difficult decision for executive teams to make. Pros and cons are associated with either choice.

If a management team decides to change markets, it must successfully identify a hot new product market to pursue. This may involve the pursuit of both new technologies and new customer relationships. What if the market does not mature quickly enough to satisfy the growth objectives of investors?

If the management team decides to change mix and pursue service opportunities, the strategy, structure, and culture of the historically product-centric company must be altered to support and value the pursuit of the services business. It is difficult to change the DNA of a company. Also, by increasing the percentage of total revenues coming from lower margin services, a change will occur to the overall financial model of the company—not an easy change for any company to endure.

Despite the challenges faced with either a “change market” or “change mix” strategy, the alternative is far worse. When a company does not make an explicit, well-defined choice, it will drift into a place we are defining as the services chasm. The location of this no-man’s land is shown in Figure 7-2.

Companies can thrash in this chasm for years. In essence, companies are lingering in the middle phases of the disruption-to-demise life cycle described

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**Figure 7-2 The Services Chasm**
in Chapter 1. During one quarter, a push to pursue service opportunities may be the focus. Six months later, there will be renewed hope that the next release will reinvigorate lagging product sales. For a study in this thrashing behavior, recall the antics of Siebel Systems as discussed in the Chapter 1. A review of the press releases associated with Siebel Systems, the once high-flying enterprise software provider that was bought by Oracle in 2005, shows a company deeply mired in the services chasm. With the economic downturn of 2001, Siebel experienced a dramatic decrease in product license sales. From total revenues of $2 billion in 2001, the company had shrunk to almost half that size by 2004. How should a company respond to this type of abrupt slowing in its legacy market? Should Siebel have developed new product or platform offerings to reinvigorate product sales (change market), or should Siebel have focused on adding higher value services to its existing and substantial installed base (change mix)? There are pros and cons to either strategy. What is not sustainable is to thrash between strategies. Table 7-1 documents the news headlines that clearly signal the indecision being exhibited by the company during its final year.

Siebel provides the perfect example of a company clearly caught in the services chasm, which is naturally created when a product market matures. However, it is not always so crystal clear when a company is actually in the chasm. The next section will provide some tactics for helping to identify when product companies are being sucked into this precarious place.

Table 7-1  Siebel in the News

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<tr>
<th>Headline</th>
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<tr>
<td>New Siebel CEO Shifts</td>
<td>October 14, 2004</td>
<td>AMR Research</td>
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<td>Company Focus from Products to Services</td>
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<td>Charting a New Course at Siebel</td>
<td>March 30, 2005</td>
<td>Business Week</td>
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<td>Siebel Is Stuck on the Seesaw</td>
<td>April 8, 2005</td>
<td>Business Week</td>
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<td>Siebel Board Ousts Chief as Market Share Declines</td>
<td>April 14, 2005</td>
<td>New York Times</td>
</tr>
<tr>
<td>Siebel Shows Off New CEO, New Products at User Conference</td>
<td>April 19, 2005</td>
<td>InformationWeek</td>
</tr>
<tr>
<td>License Revenues Sink Siebel</td>
<td>April 27, 2005</td>
<td>Internetnews</td>
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<td>Siebel Continues Its Slide</td>
<td>July 8, 2005</td>
<td>Forbes</td>
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<td>Oracle to Buy Siebel in $5.9 Billion Deal</td>
<td>September 12, 2005</td>
<td>Business Week</td>
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SYMPTOMS OF THE SERVICES CHASM

Product companies have a tendency to naturally experience a disconnect between their services-strategy profile and the actual state of their marketplace. It occurs because services-strategy decisions lag actual market requirements. We believe that as the technology industry continues to mature in general, more and more historically product-centric companies will find themselves facing this disconnect. To assist companies in self-assessing their current state, there are three tell-tale signs that indicate a product company is in or near the services chasm:

Mix ≠ Message

If the actual revenue mix of the company does not support the messaging to the marketplace, the company is in or nearing the services chasm. If a company is telling customers “We are a solutions company,” which implies a certain commitment to service capabilities, but it is geared like a hard-core product provider, the services strategy is not appropriately aligned. This scenario is common in two instances. The first is when the company has a new product that requires a significant amount of services to drive initial market adoption, but the company does not want to provide these services. In other words, the market is looking for a solution provider, but the company is geared like a product provider. The second instance is when a market is maturing, product revenues are slowing, and the product company begins promoting services capabilities to secure new revenues. In this scenario, the company is promoting itself as a product extender or systems provider but may indeed still be geared like a product provider.

Mix ≠ Market

As a market matures, many customers turn to product providers for one-stop shopping. Customers want one place to purchase both the products and services required to maintain a particular business solution. When this occurs, cheetahs must decide if they are willing to transform into lions or elephants to satisfy customer needs. A disconnect occurs when the product provider keeps pushing product enhancements that drive little incremental value to the customer and do not satisfy the requests for services. This motion pushes the product provider toward the services chasm as product revenues slow and new services revenues are not pursued.

Market ≠ Margin

Finally, as a market matures, product volumes could decrease, product margins could decrease, or both things could happen. If a company is geared
like a product provider, but the product gear is rapidly decreasing, the entire economic engine grinds to a halt. This motion slams the company into the services chasm. Top-line revenues decline and, more importantly, bottom-line profitability drops out. In this scenario, the product provider may desperately seek product refreshes in hopes of regaining higher product margins. However, not enough differentiation exists in the eyes of the marketplace, product margins continue to erode, and the company business model is no longer sustainable.

When these symptoms appear, why don’t management teams immediately become motivated to better align their services strategy? Why would companies delay their response and hold on to product centric business models that may be a dead man walking? For that answer, we have to turn to Wall Street. But before we drag Wall Street into the discussion, we need to provide one clarification to the application of services-strategy profiles. We need to highlight the difference between the overall company profile and the unique needs of specific business units or product offerings.

**MARKET VS. PRODUCT NEEDS**

The three common disconnects described previously occur when the overall services strategy of the company is disconnected with the needs of the major markets the company is serving. For example, if a majority of customers who buy storage are paying less for pure hardware capacity but are willing to pay more for services to help manage the storage environment, this market has crossed to the other side of the services chasm. A hardware storage provider must now seriously contemplate the change-mix or change-market decision. However, let’s say customers in the storage marketplace are still infatuated with simply buying lots of capacity (think 1999). At this time, a storage hardware provider launches a new product that has some neat features that no one else offers. However, the product is very complex to implement. For this one new product, customers are going to need a lot of implementation and integration assistance. Does that mean the company needs to change its services-strategy profile?

There can be real differences between the overall services-strategy profile of a company, one of the company’s business units, and the services needs of a specific product offered by the company. To visualize this landscape, think of the company whose services-strategy needs are documented in Figure 7-3. This figure shows a company that is, overall, executing a product provider profile. This is because the largest business unit in the company supports a product-provider services strategy. However, there is a second, much smaller business unit that is actually exhibiting a product-extender revenue mix. One of the products in this business unit actually requires a solution-provider revenue
mix. Getting lost? This is where those animal icons come in handy to help map the services needs!

Can one company simultaneously sustain so many diverse services strategies? Absolutely. Think of Hewlett Packard. It produces a wide array of products that range from simple printers to complex servers. These products have diverse services needs. The services-strategy profile of the printing and imaging business unit will look very different than the services-strategy profile for enterprise servers. When a company must support multiple services-strategy profiles, this framework is helpful at two levels:

1. Aligning the services strategy for specific products and business units
2. Aligning the overall (or aggregate) services strategy of the company

The first application is straightforward. Using the concepts introduced in this book, the company can assign the appropriate services strategy to specific products or business. The more specific taxonomy of services-strategy profiles breaks out as follows:

- **Company Profile**: The aggregate services-strategy profile of the company. Profile is based on total company revenues.
- **Business Unit Profile**: The services-strategy profile of a specific business unit within the company. Profile may be different than the aggregate profile.
• **Offering Profile**: The services-strategy profile a company has applied to a specific company offering. Profile may be different than the business unit or aggregate profile.

For a company with a diverse product portfolio, the second application is a little trickier. Does the overall services-strategy profile matter for a product company that, underneath the covers, is executing multiple services strategies? The short answer is yes. Product companies need to be as clear as possible regarding the overall revenue mix they expect to receive from products vs. services. Overall, is the company a product provider, product extender, or a systems provider? The overall services-strategy profile provides “revenue bumpers” that set expectations for investors. This concept is visualized in Figure 7-4. Why are these revenue mix bumpers so important? The answer to this question lies with the perceptions of Wall Street analysts and how companies are valued—which is the topic of our next section.

**THE ROLE OF WALL STREET**

Since late 2008, Wall Street has become the popular scapegoat for many of our business woes. However, long before mortgage debts soured, Wall Street has had a very real influence on services strategy within product companies. Historically, analysts and investors reward high-growth product companies with high price-to-earnings ratios. Hence, it behooves product company executives to have their companies assume a product provider profile. This gearing is optimal for driving high-margin, highly scalable product revenues. Yet even though the highest market capitalization for a company will occur on the left
side of the services chasm, the long-term revenues and profits will occur on the right side of the services chasm. Think of IBM with a typical P/E ratio in the high teens, but revenues hitting $100 billion. What if IBM were to have remained focused on mainframes and PCs? Would the company ever have grown to its current size on the back of product revenues alone? Unlikely. Yet, a services-aggressive strategy for product companies is not viewed favorably. Turn back to the crazy days of the late 1990s, when every technology stock was overvalued—except IBM’s. Read the observations of a Business Week reporter, posted in December of 1999:

Total all three of these valuations (hardware, software, and services), and you get a market capitalization for IBM of $462 billion. IBM’s current market capitalization is $190 billion. That’s a 150 percent undervaluation, which means that if this exercise made sense in the real world, IBM’s stock should be worth about $250 a share, rather than $105.

Of course, this scenario doesn’t translate well in the real world. That’s because the three divisions aren’t separate, and IBM isn’t about to split them up. Even if they did get their freedom, no one can say the units will be as successful as an Oracle or a Sun. Still, it’s abundantly clear that IBM’s stock doesn’t get the same respect from Wall Street that its Silicon Valley competitors do.¹

For a more recent example of Wall Street’s reaction to a product company increasing services revenues, we can turn to HP’s acquisition of pure services company EDS. Here is how one Wall Street Journal blogger saw the transaction:

Why is the stock market so cranky about Hewlett Packard Co.’s $13.3 billion purchase of Electronic Data Systems Corp.? Investors have already knocked off about $12 billion in value of H-P shares since Monday.

What a crummy deal, right?

No. It’s got less to do with H-P the company and everything to do with H-P the stock.

It’s no surprise that H-P’s shares fell upon the announcement of the acquisition of EDS. An acquirer’s shares typically do. It is unusual, however for the acquirer’s shares to fall more than the purchase price of

¹ IBM Sure Is One Undervalued Net Stock at least compared to Internet pure plays. So how do you put a proper value on Big Blue? Here’s one attempt at www.businessweek.com/1999/99_50/b3659007.htm.
the acquisition. You can argue all day whether this is the right deal for H-P. In EDS, H-P is buying a domestic, low-growth “body shop”... But the market hates the EDS deal, because now it must confront the reality of what H-P has become: A behemoth with a projected annual growth rate of 5 percent acquiring another massive company with 3 percent projected growth, according to Capital IQ figures.

If H-P had bought Salesforce.com or another growth engine, H-P may have retained some element of mystery, no matter how much it may have overpaid. And it’s that element of mystery that keeps the momentum in certain stocks.  

Clearly this analyst would have been much more excited about an acquisition that would have accelerated product growth. The perspective from another analyst:

Clearly, the Street is not crazy about Hewlett-Packard’s (HPQ) plan to acquire Electronic Data Systems (EDS). In two days, the Street has knocked about 10 percent off HP’s stock price, chopping its market cap by about $12.5 billion, almost equal to the $13.9 billion deal price. The obvious question is, why?

And the answer is, there are several reasons. For starters, this is a large deal—EDS has 135,000 employees—and has the potential to create all kinds of distractions for HP CEO Mark Hurd and his team. Two, $13.9 billion is a lot of cash, and some people wonder if they are overpaying for a company that has not been a good performer in recent years. Three, there is concern about dilution of both revenue growth and margins. And four, there are some who wonder if HP might not have been better off beefing up its software arm, or snapping up an Indian outsourcing firm rather than adding a U.S.–focused body shop like EDS.

These analysts are very concerned about the dilution of margins brought about by increasing services revenues. Also, the low growth rate of services revenues vs. product revenues reduces the future potential for high growth. A

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way to graph this Wall Street bias is provided in Figure 7-5. Companies with revenue mixes appearing on the left-hand side of the graph are viewed as more scalable and more profitable. They are rewarded with higher stock price per earnings ratios by investors. Companies on the right-hand side are viewed as hard to scale and lower margin.

The question not adequately addressed by the Wall Street analysts concerns the synergy between product and service offerings. What if the purchase of EDS successfully positions HP to become a $150 billion systems provider as opposed to a $90 billion product provider? More importantly, what if the purchase of services know-how from EDS enables HP to transition from delivering customer premise equipment-based (CPE-based) product offerings to subscription and cloud services offerings? And what if annuity services revenues from long-term services contracts help offset a decrease in product revenues during a global economic downturn? These considerations do not map to the one dimensional mentality documented in Figure 7-3. All of those benefits are too long term. Those benefits speak to HP's viability beyond four quarters. Where's the exponential, high-product growth baby? The point here is that Wall Street perceptions can contribute to product companies extending their stay in the services chasm as they thrash around, desperately attempting to avoid any strategy that may involve increased services revenue—even if that is the appropriate strategy to pursue.
ECONOMIC CONSEQUENCES

Even though Wall Street has a clear preference for product companies to stay on the left side of the services chasm, that is not always an option. As the last section of this chapter will verify, markets do mature. If companies do not effectively navigate market maturity with crisp services-strategy decisions, company success is jeopardized.

Complete Failure

The failure pattern outlined in Chapter 1 occurs when companies delay their services-strategy decisions. This delay sends the product company into the heart of the services chasm, where the company thrashes. Eventually it makes belated services-strategy decisions that come too late to save the company from a downward spiral. As a reminder, the death march occurs in eight steps:

1. **Disruption**: Product market matures or disruptive technology enters the market making current product offering less competitive. This pushes the product company to the left edge of the services chasm.

2. **Denial**: Company focuses on old technology and old consumption models too long by staying locked in a product-provider profile, even though product revenues and margins are on a steep decline.

3. **Decline**: Top-line revenues stagnate or shrink, and operating income begins to shrivel.

4. **Services Focus**: In an attempt to shore up top-line revenues and profits, the executive management team belatedly announces a focus on services opportunities. This is a belated attempt to rapidly transition to a product-extender or systems-provider profile.

5. **Services False Positive**: Service revenues do become a larger portion of total company revenues, but that is largely due to continued maintenance streams on top of a shrinking product installed base. The company is a support-centric product extender with an underdeveloped PS gear.

6. **Services Failure**: Despite the belated focus on services, total company revenues continue to flatten or fall off. Support revenues are shrinking as the install base shrinks. Lack of significant replacement revenues from new product offerings or new services offerings cause total company profitability to tank.
7. **Demise**: Finally, there is an abrupt change in corporate direction. Services leadership or overall company leadership is suddenly changed. The company does one of three things: declares a renewed focus on product innovation, declares bankruptcy, or is acquired. In essence, the company has reached the bottom of the services chasm.

**The Services Buffer**

Fortunately, not all product companies find themselves strewn on the jagged rocks jutting from the bottom of the services chasm. Some companies muddle through services-strategy decisions in a way that allows the company to survive, just not in a financially optimal way.

Our benchmarking work in the industry associations allows us to model the revenue mix and margins of product companies. Using this real-world data, we can create example revenue scenarios. The classic scenario we can use to quantify lost revenue and margin opportunities is based on an enterprise software company. The scenario is modeled over twelve data points. These data points could be months, quarters, or years—it is not relevant for this example. In the first seven data points, the company is successfully growing license revenues. In the eighth period, the company begins experiencing a slight decline in license revenues as the next generation of the product is geared up for release. After four periods of declining license revenue, the new product does get released and license revenue begins increasing again. Throughout this twelve-period cycle, the company never invested aggressively in services capabilities beyond maintenance. The revenue mix for the company is shown in Figure 7-6 and the financial data is documented in Table 7-2.

**Figure 7-6  Software Company with Limited Services**
### Table 7-2  Software Company, Limited Services

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In this classic product-provider strategy, the software company exits its journey through the services chasm with revenues below $200 million. **As long as the next generation product gets traction, the company is not too much worse for the wear.** If the next release of the product does not gain traction in twelfth period of the cycle, the company will only have maintenance revenues to cushion the blow. Also, the company will not have internal services capabilities that could be engaged to accelerate adoption of the new product release. **In a sense, this is a high-risk strategy solely dependent on rapid adoption of new product releases.**

In contrast, we can look at the same type of enterprise software company, only this time the company invested in both professional and managed services to augment the product. The revenue mix of this company is shown in Figure 7-7 and the financial data is shown in Table 7-3.

In this scenario, the software company embraced a product-extender profile prior to entering the services chasm and leveraged that profile to secure over $200 million in additional revenues through the twelve-period cycle. In addition, the company exits the services chasm with over $250 million dollars in annual revenues as opposed to less than $200 million. These financial variances may seem subtle, but what is $30 to $50 million in revenue worth to a $200 million enterprise? Especially if the latest release of the product hits some bumps in the revenue road.

This type of modeling can be done for all types of products and markets. Obviously, some markets and technologies lend themselves more aptly to building value-added services. Regardless of the size of the services opportunity, the internal debate is always the same: Do we really need to mess with these services businesses? **Can’t we simply weather the dip between product**

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**Figure 7-7 Software Company with Services Buffer**
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<td>$91.50</td>
<td>$102.45</td>
<td>$114.05</td>
<td>$126.00</td>
<td>$139.50</td>
<td>$144.75</td>
<td>$152.00</td>
<td>$167.75</td>
<td>$1,212</td>
</tr>
<tr>
<td>Margin %</td>
<td>59%</td>
<td>70%</td>
<td>76%</td>
<td>79%</td>
<td>78%</td>
<td>77%</td>
<td>75%</td>
<td>73%</td>
<td>70%</td>
<td>69%</td>
<td>66%</td>
<td>66%</td>
<td></td>
</tr>
<tr>
<td>Service Margin</td>
<td>$4.10</td>
<td>$10.50</td>
<td>$18.50</td>
<td>$26.50</td>
<td>$35.00</td>
<td>$43.75</td>
<td>$54.05</td>
<td>$71.50</td>
<td>$90.50</td>
<td>$100.75</td>
<td>$113.00</td>
<td>$120.00</td>
<td>$688</td>
</tr>
<tr>
<td>Service Margin %</td>
<td>19%</td>
<td>26%</td>
<td>26%</td>
<td>27%</td>
<td>30%</td>
<td>33%</td>
<td>35%</td>
<td>41%</td>
<td>46%</td>
<td>48%</td>
<td>49%</td>
<td>47%</td>
<td></td>
</tr>
</tbody>
</table>
releases and take our lumps in short-term revenue loss? If product revenues always rebound, I actually agree with staying true to the product provider strategy. The challenge facing more and more product companies is that product revenues and margins do not rebound. Again, think Siebel, Sun Microsystems, Dell, and Xerox. When product revenue does not rebound, aligning services-strategy profile for flattening product-adoption curves can be the difference between viability and failure.

SERVICES STRATEGY IN SIX WORDS

The services chasm can create significant financial hardship for a product company. Misaligned services strategy can accelerate the failure of a product company. This reality is clear. To put a finer point on this discussion of aligning services strategy for product company success, I want to boil the conversation down to three services-strategy challenges that can face a product company.

On Friday, February 13, 2009 (yes, Friday the 13th), I experienced a moment of synchronicity concerning services strategy. Synchronicity is the experience of two or more events that are causally unrelated occurring together in a supposedly meaningful manner. In order to count as synchronicity, the events should be unlikely to occur together by chance. The two separate and distinct events that occurred that day were as follows:

1. I participated in a meeting where a person asked “What is your hypothesis regarding our services strategy?”

2. I listened to a podcast from NPR where they discussed the book *Not Quite What I Was Planning: Six-Word Memoirs by Writers Famous and Obscure*. This is a compilation of six word sentences provided by folks that summarize their lives.

These two disparate events came together in my mind when I realized that I can, indeed, boil down the successful application of services strategy to product company success into to six simple words.

The importance of services strategy to a product company presents itself in three distinct situations. For each situation, we can summarize the importance of services in six words:

**First Scenario: Getting Products Adopted**

*Great product, forgot services, company fails*

This six-word services strategy applies to the scenario when a product company needs services to help accelerate product adoption. The product is new
to the market and has potential, but customers need help gaining the benefits of the new technology. If product companies forget to create enabling services directly or through partners, product adoption languishes and the company can fail. Not because the product was not solid, but because the required services were not in place. In this scenario, the error is to pursue a product-provider profile when a solution-provider or product-extender profile is required.

Second Scenario: Buying Time

Old product, services buffer, next product

This six-word services strategy applies to the scenario when an existing product is beginning to mature and a lull happens before the next generation product is really taking off. This is the classic “s-curve” described by Everett Rogers in his 1962 book, *Diffusion of Innovations*. During the slow portion of early product adoption, revenues from the existing product are flat or declining. To maintain the top line, the company needs a source of revenue. That source can be services delivered to the existing install base. This phenomenon is simplified in Figure 7-8. In this scenario, the error is to hold onto a product provider profile when a product extender profile could have provided much-needed services revenues until the next product was ready for prime time.
Third Scenario: Changing Profiles

Old market, new services, new company

This six-word services strategy applies to companies that serve a market that is maturing. Despite new innovations in technology, customers are just not willing to pay more for the product. Think PCs, UNIX servers, hardware storage, printers, and so on. In this scenario, companies either find new product markets to explore or they create new ways to add value around commoditizing products. This shift in the value proposition creates a fundamental shift in revenue mix and a shift in the overall company strategy. This services strategy scenario has applied to many product companies, not just to IBM. Companies that have experienced “old market, new services, new company” include Xerox and EMC. The impact of this scenario on revenue mix is shown in Figure 7-9. In this scenario, the company may have been a product provider but migrates to becoming a product extender or systems provider.

This book covers the intricacies of setting services strategy within product companies. We cannot boil the essence of this entire body of work into three sentences, each with only six words. However, these three sentences accurately capture the three most common services-strategy challenges facing product companies.

Figure 7-9 Old Market, New Services, New Company
companies. It is very probable one of these three apply to your product company right now. If that is the case, how does your company agree to one of these services strategies and align the company to successfully execute the strategy? That is the topic of the next chapter: Bridging the Services Chasm.

**ENDNOTE: MATURATION OF AN INDUSTRY**

Before leaving this overview of the services chasm, I would like to close with a discussion of the current state of the software industry. Throughout our personal careers, the software industry has been predominantly focused on growth. Software companies are optimized to identify, attack, and dominate markets that can emerge overnight. However, the growth of software markets has slowed. Established and highly successful software companies like Oracle now grow by acquiring the install base of stagnant competitors. To emphasize this industry maturation, we can review a dataset assembled by Professor Michael Cusumano at MIT. He has been analyzing the product/service mix trends in the software industry. His team at MIT has identified 485 public software “products firms” under SIC code 7372 (prepackaged software). Reviewing the annual public financial reports of these companies from 1990
to today, Professor Cusumano’s team has aggregated 3,386 data points on the product/service mix.

Reviewing this dataset, Professor Cusumano has mapped the march of the software industry from a product-centric to services-centric revenue mix. He summarizes his findings in an article titled “The Changing Software Business: Moving from Products to Services” published in January of 2008 by the IEEE Computer Society.

A graph from the article maps how much revenue the software companies in this dataset have been receiving from products vs. services from 1990 to 2004. The graph is republished as Figure 7-10. As can be seen, since 2002, a majority of the revenue generated in the product-centric software industry is actually from services. We do not see this trend reversing. The Technology Professional Services Association takes a quarterly snapshot of the product/service revenue mix for the largest software and hardware companies in the industry. This quarterly snapshot corroborates the 10-year trend documented by Cusumano and shows software companies in that index, depending on the quarter, are averaging 56 to 70 percent of revenues from services.

The article also discusses software companies that are “stuck in the middle” regarding their revenue mix. These are software companies that are unclear if they want to focus on product revenues or services revenues. This observation by Cusumano is directly related to our observation of companies caught in the services chasm.

This analysis and article on the software industry by an esteemed MIT professor places an exclamation point on our belief that the technology industry in general is maturing. Now, for the first time in the history of the industry, many technology companies must be optimized to serve maturing markets. These maturing markets are often service intensive. Product companies must decide if they will cross the services chasm to satisfy these maturing markets or push that requirement to partners in the market place. If service requirements in aging markets are sent to partners, product companies must work diligently to identify new sources of product growth. To be clear, those product opportunities still exist. Complex business problems requiring product innovations will never cease to exist. However, historically product-centric companies must realistically assess their current abilities to capture a shrinking volume of explosive product markets.

In Chapter 1, I began by stating I have the following bias:

Effectively aligning a company’s services strategy to overall company strategy will become the defining discipline in any product company’s success.
Once again, I will remind the reader I am not claiming products no longer matter to the success of product companies. However, the approach of optimizing product economics in a vacuum devoid of services strategy is indeed outdated.

By understanding that common services strategies have already emerged, product companies can accelerate the process of mapping the appropriate services strategy to optimize product and company success. I also believe selecting the appropriate product/service mix has become critical to surviving in maturing marketplaces. In 5 or 10 years, we will know exactly how critical services-strategy decisions were to the technology industry players of today.