Marketing: **Strategy**

Feature Article

Solving the solutions problem

Companies can earn higher margins or increased revenues by selling integrated offerings—if they don't merely bundle their products.

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Many product companies have tried to get more from their sales efforts over the past ten years by selling solutions—integrated offerings of products and services—rather than mere products. But this is more easily said than done: our discussions with 60 solutions providers suggest that while the winners pick up an extra 3 to 7 percent return on sales, three out of four companies see little gain.

The decision to sell solutions is usually based on either ambition or anxiety. Ambitious companies note that sales of solutions win fatter margins than sales of products and generate longer and more lucrative customer contracts, provide access to new markets, and even help procure a more favorable press. Anxious ones fear rapidly commoditizing core-product markets, pricing pressure from increasingly savvy buyers, and the appearance of aggressive new intermediaries.

But too many companies enter the solutions melee, and those that fail typically do so for one or more of three reasons. First, some companies think they are selling solutions when they are merely bundling products that create little value when offered together; they then have difficulty recovering the extra costs of packaging and pitching the products as solutions. Second, companies underestimate the difficulty of selling solutions, which cost more to develop, have longer sales cycles, and demand a wide knowledge of the customers' businesses. Third, many companies sell solutions much as they sell products instead of recognizing the need to rethink their sales teams, their performance metrics, and their approach to dealing with customers.

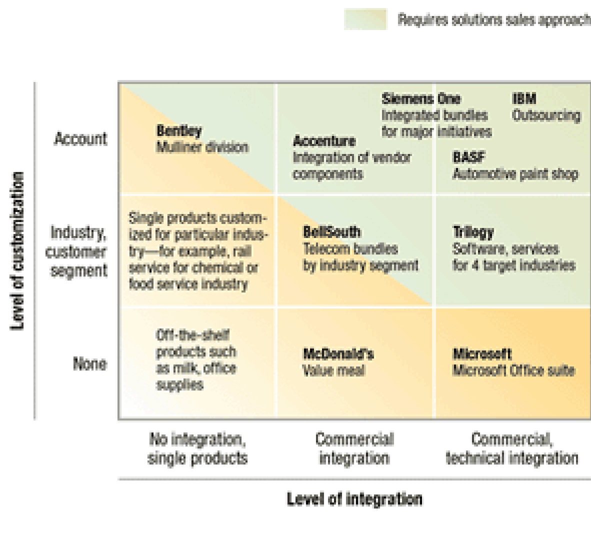
In short, many companies need to look more carefully before leaping into solutions. They ought to be sure that what they are offering really is a solution—that they have correctly assessed the degree of integration, customization, or both required to turn a bundle of products into a truly integrated package.

From products to solutions

Not every company has to sell solutions—many successful businesses offer products, services, or bundles of either or both—but companies intent on selling them must recognize that their economics, and thus their managerial imperatives, differ from those of product bundles. In the absence of such an understanding, vendors might invest in packaging a pseudosolution that competitors can disaggregate and bid against. The crucial first step is therefore to understand what a solution is and how it differs from products or bundles of products.

It is the level of customization and integration that really sets solutions above products or services or bundles of products and services

In the broadest sense, a solution is a combination of products and services that creates value beyond the sum of its parts. In practice, solutions are usually born when a vendor can meld a certain level of expertise with proprietary intellectual property—a method, a product, or an amalgam of the two—to handle a problem for a customer or to help it complete a step in its business.[1] More specifically, it is the level of customization and integration that sets solutions above products or services or bundles of products and services (exhibit). These two elements—customization and integration—are more than just the glue that holds the package together: the way the elements are integrated and the extent of the customization define the added value for buyers and earn the added financial benefits for sellers.



Consider the example of a fast-food restaurant. Customers can buy a hamburger, fries, and a soft drink separately, or they can get a "meal deal" that groups all three together. Either approach assuages their hunger, and the only extra value they get from the deal is that it is a bit cheaper—a discount the restaurant grants in exchange for higher volumes. The meal deal achieves commercial integration but offers no more than some incremental convenience to the customer, and certainly not the customization or the technical integration needed to deliver value beyond what is to be had by purchasing a hamburger, fries, and a soft drink individually. The restaurant thus can't charge a premium for its offering; on the contrary, it must provide a discount.

Commercial integration of this type doesn't take vendors past the simple bundling of products. But technical integration links the elements of the offer functionally—it makes the components of a given system interoperable—to create extra value: the parts snap together in beneficial ways, enabling vendors to charge a premium. A seller of call-center solutions, for example, might deliver an integrated call-receiving, -routing, -management, and -dispatch capability by combining communications equipment with server and storage hardware, application software, and training for service representatives.

Yet technical integration isn't the only way to offer solutions. Even commercially integrated products can be customized through tailored specifications, pricing, or service levels that create solutions commanding a premium. Boeing, for instance, builds jet airplanes to the specifications of its client airlines. In reality, many companies—especially larger, established ones—sell a range of offerings that involve relatively low levels of integration and customization. Offering bundled products that don't constitute a solution is fine, of course, if it is clear what is actually on the table.

Understanding the economics

When a company offers true solutions, its investment can pay off in several ways. Besides generating higher margins for itself and additional value for customers, it might find that it can build longer-lasting and more profitable relationships with them. Sometimes solutions open doors to new markets and even reduce or eliminate competition, in effect decommoditizing sales.

One vendor of commodity chemicals, for example, saw a chance to target smaller customers that wanted not just raw materials but also help with certain chemical mixtures and technical services. It provided technical support at its customers' facilities to ensure that processes were managed properly and had the desired result—a correct flow of resin. Setting up a new business unit to provide a total solution for this new market lengthened the sales cycle and was expensive: selling, general, and administrative costs rose to 14 percent, from 9 percent. But gross margins rose to 20 percent, from 9, yielding six additional points of margin.

Why do so many companies stumble when they try to offer solutions? Typically, because they don't really understand their offerings. In particular, they make the big investments required to assemble solutions but can't generate any of the benefits, such as access to new markets, higher margins (because more value has been delivered or prices are less transparent), or even larger deals. One hardware vendor, for example, thought it was selling a solution when it supplemented its usual products with software and services, but these were essentially add-ons—and not interoperable. Since customers could disaggregate the offer's components and source each separately, they expected a discount in return for purchasing all three from the hardware vendor. Instead of obtaining increased margins, it ended up discounting its products, while the investment it had made to improve its sales reps' skills (the better to sell the new so-called solution) raised costs, not margins.

One customer at a time

The economics of a solution differ from those of a product because of the high level of customization and integration—and the higher the level, the more troublesome and expensive the solution will be for the company that offers it. Sales teams must be more skilled, deals take longer to complete, and accounts require extra service before, during, and after transactions. The initial work involved in assessing the market and pulling together a solution can also be considerable. And if several business units package the solution, their need for cooperation increases interaction costs.

Consider a company that wants to offer a technically integrated product that requires customization for specific customers. Unless the expenses—for instance, the research and analysis undertaken to assess the customer's needs—can be offset by demand for a similar product elsewhere in the industry, the provider risks running up its fixed costs without achieving sufficient scale to bring down the cost of an average unit. A software company, for example, will often seek out a flagship customer for which it can tailor beta versions of its code. It then modifies that platform for other customers in the industry.

Would-be solutions providers should thus think long and hard about customizing any offer. They must ask themselves whether customization would allow them to charge a premium, generate additional business and larger deals, or create a platform that can be sold to others. This is no one-time exercise: the cycle must be renewed continually. A logistics outsourcer, for example, standardized its supply chain solutions, such as managing transportation, planning routes, and running warehouses. But because it failed to reinvest and innovate, competitors entered the same markets and matched its offers.

Distinctive solutions based on the customer's business metrics

What makes solutions valuable and distinctive is that they focus on results and are meaningful to a fairly broad base of customers

In general, vendors offer a solution when they can solve a problem by applying some level of expertise and, at times, a proprietary method. They must develop unique insights into the customer

and its industry and use those insights to create an integrated, customized solution that really works better than the available alternatives. What makes a solution valuable and distinctive is that it focuses on results and is meaningful to a broader customer base. Only then will vendors have the kind of offering—one delivering measurable value to customers—that is needed for a winning solution.

Such insights are generated by detailed technical and business information. Two months after taking the helm as CEO of IBM, in 1993, Lou Gerstner asked each of his top 50 managers to speak to at least five customers and report back on how to meet their needs. The 50 managers' immediate subordinates were encouraged to do so as well. Operation Bear Hug involved more than 1,000 conversations with customers and led IBM to change its thinking on their needs and then to create distinctive offerings to meet these needs—developments that led to the company's entry into the market for total business solutions.

Similarly, a manufacturer that had long supplied paints to carmakers used its knowledge of them and its industry, as well as its proprietary knowledge, to become a solutions provider. Recognizing that customers would place a higher value on a delivered service—painted cars—than on paint alone, it offered to take over their paint shop operations and very quickly helped a carmaker use 20 percent less paint per automobile. This distinctive offering enabled the paint manufacturer to become the leading provider of paint solutions to automakers around the world, with 70 percent of the market. In so doing, the company created value for its customers and changed its value metric from the product-oriented dollars per gallon of paint to the customer-oriented dollars per painted car.

What it takes to win

Companies can take their solutions to market when they understand their offerings and the associated economics. A typical product-based company must price its goods effectively and scrutinize how well the skills of its sales force fit in with the attributes of its wares. The recipe for selling solutions successfully might appear to be similar, but the higher levels of integration and customization they require and the challenge of communicating complex offerings to customers mean that their providers must cope with demands that sellers of products rarely confront. Moreover, the approach of companies that succeed in the solutions game differs in four ways from the approach of those that fall short. The first is essential to selling solutions; the other three, though not absolutely necessary, add value for customers.

Rethink your approach to sales

Solutions take longer than products to sell; typically, three or four times as many calls are needed to close deals. The longer sales cycle means that companies offering solutions to their customers must usually change their sales teams and selling styles—the bigger the problem and the larger the deal, the more people must be persuaded. In sales of a product, by contrast, only a single representative or team is typically needed to explain its value for the customer, and sales cycles are relatively short.

A team selling solutions must understand the business of the customer at least as well as the customer does while developing partner-like relationships with its senior decision makers. A technology company that revamped its sales and incentive structures to focus on solutions, for example, came to understand its customers so completely that when asked for a bid, it would submit two: the one the customer had requested and one it thought would actually meet the customer's needs.

Top performers track not only the revenues they generate but also the business value they deliver and the reaction of their customers

Many companies that succeed in moving from selling products to selling solutions replace up to three-quarters of their sales reps and often recruit high-level executives from the industry they are targeting. They typically structure account teams around a customer relationship owner supported by industry experts and technical specialists, target relatively small pools of customers with similar

business needs, and try to focus more on senior executives who have fiscal responsibility for business units and less on the buyers or technical managers whom product sellers usually approach. Having completed the sale, top performers track not only their revenues but also the business value they deliver and the reactions of their customers.

Incentives are tailored to compensate sales reps for larger deals and for working with unfamiliar decision makers through longer sales cycles. The incentives, based not on the sales reps' ability to close deals but on the business value the customer receives, go to the entire team behind the solutions effort, not just to the department that books the revenue.

The consequences for companies that omit these measures are exemplified by the fate of the aforementioned logistics provider, which manages warehouses, trucks, routing, and other products, facilities, and services for businesses and consumers. The company tried to sell solutions with essentially the same sales force it had used to sell its older offerings and therefore failed to acquire any new accounts for over two years. It hasn't increased its net revenue since it embarked on the solutions plan in 2000.

Base prices on business value

Selling solutions creates opportunities for value-based rather than cost-plus pricing. To start with, a solution creates extra value, and though the seller must decide how to share the pie with the customer, the pie is larger. Second, solutions are integrated, so it is hard for the customer to choose only parts of the offering. (Sometimes the seller realizes it has been marketing a bundle rather than a solution when the customer disaggregates the package and gathers competitive bids.) Finally, because the solution is customized, competitors find it difficult to bid against it or even to compare its price and features with those of their own products.

But solutions providers can easily miss such pricing opportunities. The commodity chemical vendor that provided technical services along with raw materials captured six additional points of margin over its old product business, but a diagnostic showed that value-based pricing could have realized a further seven to ten points of margin. Before setting prices, companies should tap the knowledge of their technical and operational people and of their customers to understand the total economic impact of their solutions.

For example, an optical-networking company that offers transport, software, routers, and servers to telecommunications companies felt that it had to re-price its flagship solution. To reveal its true value to customers, the company tested the capital savings, operational savings, and revenue enhancements generated by more than 20 elements of the solution and found that it yielded a six-year net-present-value gain of 12 times its cost. Since the exercise suggested that the software component was grossly under priced, the company raised the charge for it by a factor of 50 and increased overall pricing levels by 25 percent.

Realign the entire organization

The extent to which a company might have to reorganize itself to offer solutions depends on the scope of its opportunities, the level of integration they require, and its appetite for organizational disruption.

Trilogy, a supplier of business-to-business software, decided to change its business philosophy to focus on software solutions for four target industries. Because the company was privately held, it had the freedom to transform its entire organization, including product development, sales, and management, without worrying about quarterly earnings pressures.

Siemens took a different approach when it saw a chance to capture five to ten major solutions deals a year from airports, stadiums, hospitals, and high-tech campuses—not its usual market. Although the deals were substantial, they would have made up no more than 5 percent of the company's US revenue. Siemens therefore established an overlay group to play a facilitating and, in certain cases, a project-management role in the sales of solutions and in this way avoided disrupting its existing businesses significantly.

IBM set up an overall sales group that owns customer relationships and coordinates the development and sale of solutions across existing product groups. And a large chemical company set up an independent business unit to sell its chemical solution to a specific customer segment, because the new business didn't overlap with its product-based accounts.

Supply one throat to choke

Providers of products need only offer good ones at competitive prices—perhaps with innovative features to secure the deal. Solutions providers, however, must combine the product and service elements of their offerings in more economical and efficient ways than their competitors do. That could mean bringing in third parties to flesh out offers.

Yet many of the best solutions providers size up the complexity and coordination costs of that approach—not to mention the delays and quality problems it might introduce—and decide to go it alone. The bar is higher when a company sells solutions, because it is responsible not only for the performance of its products but also for business outcomes. When things go wrong, customers prefer to have one throat to choke. If a solutions provider does enlist partners, it must take responsibility for coordinating their efforts—and, should the need arise, offer up its throat.

Solutions are tricky. Not every company can develop them. And they can deliver a higher return on sales only if the companies that offer them understand the real differences between their economics and those of bundled products and services and are willing and able to bring them to market in an appropriate way.

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Notes

[1] *See* Eric V. Roegner, Torsten Seifert, and Dennis D. Swinford, "Putting a price on solutions," *The McKinsey Quarterly*, 2001 Number 3, pp. 94–7.