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Service transition: A viable option for manufacturing companies with deteriorating financial performance?

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ABSTRACT

When manufacturing firms venture into services, they often do so either in reaction to deteriorating performance or to further enhance their financial position. While extant literature argues that firms are most likely to succeed with strategic change processes out of a healthy position, the majority of manufacturers have started their service maneuver in reaction to deteriorating performance. To date, no empirical studies examine whether a healthy financial situation is a necessary requirement for successful service transition. Drawing on configuration theory and employing qualitative comparative analysis, the present study demonstrates that an increasing focus on services can lead to success for both types of firms. However, depending on their financial situation, firms should tap different resource and knowledge sources to implement the service transition: Whereas healthy companies should focus on customers as a knowledge source, companies in an inferior financial situation need strong links with suppliers to turn their services transition into financial success.

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1. Introduction

In recent years, many practitioners and researchers have promoted manufacturing companies' move toward service and solution providers (Evanschitzky, Wangenheim, & Woisetschlaeger, 2011; Ulaga & Reinartz, 2011). As a result, manufacturers increasingly pursue a service transition, that is, they move from an emphasis on products to an emphasis on services (Eggert, Hogreve, Ulaga, & Muenkhoff, 2014; Visnjic & Van Looy, 2013). This becomes evident in a growing share of manufacturers' revenues stemming from the services business (Fang, Palmatier, & Steenkamp, 2008). For example, Fang et al. (2008) found that the average share of service revenues increased from 8.9% in 1990 to 42.2% in 2005, indicating a strong prevalence of service transitions among manufacturing firms.

Manufacturing firms often regard services as an effective means to compensate for declining performance in their traditional product business (Penttinen & Palmer, 2007), and Cusumano, Kahl, and Suarez (2006, p. 18) observe that the majority of firms "migrate toward service[s] not by choice but because their product business begins to deteriorate." Several market developments in their traditional product business put manufacturers under increasing pressure; among them, commoditization, intensified international competition, and market saturation (Gebauer, 2008; Wise & Baumgartner, 1999). Against this background, manufacturing companies' transition to services seems to be a promising way to compensate for competitive pressure, react to declining financial performance, and realize future growth potential.

In contrast to many companies' tendency of venturing into services in reaction to deteriorating performance, literature on strategic change argues that deteriorating profits and financial decline is not the best point of departure for a successful change process (Haveman, 1993). Firms need sufficient resources and knowledge to successfully implement a strategic change in their business strategies, such as the service transition (Kowalkowski, Brehmer, & Kindström, 2009). In line with this notion, Fang et al. (2008) observe the importance of slack resources for turning industrial services into firm value. Resources enable the necessary alignment of capabilities and organizational structures within the firm. Because companies in a promising financial situation are more likely to allocate sufficient resources to strategic change than their counterparts that suffer from financial pressure, Salonen (2011) assumes that the service transition works best for manufacturing companies in a healthy financial situation.

To date, no empirical study examines whether a healthy financial situation is a necessary ingredient for successful service transition, an important question given that manufacturing companies often turn to services in response to declining revenues, profits, or demand in their core product business. Are these companies residing in a challenging financial situation likely to fail with their strategic move? Can differences in the financial starting position explain why manufacturing companies observe mixed results from their service transitions (Kohtamäki, Partanen, Parida, & Wincent, 2013; Visnjic & Van Looy, 2013)?

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This study explores whether a healthy financial situation, characterized by previous growth in revenues, profits, and customer demand, is a necessary precondition for a successful service transition. The research is based on configuration theory, which assumes that sets of conditions (i.e., configurations) rather than a single condition determine the outcomes of strategy initiatives (Meyer, Tsui, & Hinings, 1993). In addition to a firm's financial situation, this study accounts for three other context factors that influence service transition outcomes: firm size, customer links, and supplier links. These factors were chosen according to research on strategic change, which identifies sources of resources (i.e., financial situation, firm size) and knowledge (i.e., customer links, supplier links) as important requirements for successful strategy implementation (Haveman, 1993). Large companies tend to have more slack resources and can better manage the necessary alignments of organizational capabilities and structures (Gebauer, Paiola, & Edvardsson, 2010b; Kowalkowski, Witell, & Gustafsson, 2013; Neely, 2008). Links with external partners might also affect the success of the service transition (Eggert, Hogreve, Ulaga, & Muenkhoff, 2014; Ceci & Masini, 2011; Finne & Holmström, 2013; Turunen & Finne, 2014); manufacturing firms with strong links to their customers and suppliers may have access to resources, skills, or information needed to successfully grow their service business (Kohtamäki et al., 2013). Taking these conditions into consideration, this research investigates the resources and knowledge sources that need to be combined to achieve revenue growth with service emphasis.

This study offers three important contributions. First, it demonstrates that service emphasis is a viable option for both companies in a healthy financial situation and those suffering from financial weakness. This result contrasts previous literature that repeatedly emphasizes the importance of a solid financial situation to cope with the resource requirements of service transitions (Fang et al., 2008; Salonen, 2011). Second, we consider sets of conditions (configurations) that promote a service emphasis, providing a more comprehensive and realistic picture of the requirements that companies must meet to successfully promote this service emphasis. Apart from some notable exceptions (e.g., Ceci & Masini, 2011; Gebauer, Edvardsson, Gustafsson, & Witell, 2010a), previous literature mainly analyzes net effects of single variables, thereby ignoring the interplay among context factors. Yet, our results confirm that resources and knowledge sources are not relevant per se, but become important only in specific context situations, e.g., in a challenging financial situation. Third, the study employs fuzzy set qualitative comparative analysis (fsQCA). Although fsQCA coincides well with the assumptions of configuration theory (Greckhamer, Misanagyi, Elms, & Lacey, 2008) and is increasingly used in the strategy domain (see e.g., Fiss, 2011), only a few applications in marketing and especially service research exist to date (for some notable exceptions, see Ordanini & Maglio, 2009; Ordanini, Parasuraman, & Rubera, 2014). The current research thus further promotes this methodology in the marketing and service domain.

The remainder of this article is structured as follows: We begin with an overview of existing literature on service transition in manufacturing firms. Then, we present the theoretical framework and discuss the role of different resources and knowledge sources for successful service transitions. After introducing the methodology and describing the sample and measures, we report the results of fsQCA and discuss the findings and implications. The article concludes with limitations and directions for further research.

2. Conceptual background

2.1. Service transition in manufacturing firms

Industrial services are an increasingly important topic in business-to-business and service marketing fields (Jacob & Ulaga, 2008; Ostrom et al., 2010). At the beginning of the service dialogue, studies mainly focused on the competitive, economic, and customer-based explanations of how industrial services improve firm performance (e.g., Mathieu, 2001a; Oliva & Kallenberg, 2003). Another research stream explores the transformation from a manufacturing-oriented to a service- or solution-oriented approach (e.g., Kowalkowski, Windahl, Kindström, & Gebauer, 2015; Raddats & Easingwood, 2010), together with the organizational rearrangements needed to manage a service transition successfully (Davies, Brady, & Hobday, 2006; Reinartz & Ulaga, 2008). With a few exceptions, most of these studies are conceptual in nature or limited to exploratory research based on case studies or in-depth interviews (Jacob & Ulaga, 2008).

More recent research empirically examines the link between industrial services and firm performance (Antioco, Moenaert, Lindgreen, & Wetzels, 2008; Eggert et al., 2014; Fang et al., 2008). Yet these studies provide mixed results regarding the performance outcomes of service strategies. Some studies establish positive effects of service strategies on company outcomes, such as product sales, revenues, and profits (e.g., Homburg, Fassnacht, & Guenther, 2003; Antioco et al., 2008). Other researchers instead reveal a more complex relationship between industrial services and firm performance (e.g., Eggert, Hogreve, Ulaga, & Muenkhoff, 2011; Eggert et al., 2014; Suarez, Cusumano, & Kahl, 2013; Visnjic & Van Looy, 2013). For example, Fang et al. (2008); Kohtamäki et al. (2013), and Suarez et al. (2013) confirm a negative effect of industrial services at the beginning of the service transition. This effect becomes positive once the firm's service business reaches a considerable size – for example, if the firm's service share exceeds 20–30% of its total sales (Fang et al., 2008).

Empirical studies also test different context factors that support or hinder the success of industrial service strategies. They find that the success of service transitions depends on supporting organizational and environmental characteristics (Ceci & Masini, 2011; Gebauer et al., 2010a, b; Turunen & Finne, 2014; Windahl & Lakemond, 2006). With regard to *organizational characteristics*, Fang et al. (2008) identify the availability of slack resources as a supporting context factor of the service transition-performance link. Moreover, research confirms the critical role of inter-organizational relationships for profitably growing with industrial services (Eggert et al., 2014; Finne & Holmström, 2013; Kohtamäki et al., 2013; Pawar, Beltagui, & Riedel, 2009). Another context factor that receives some research attention is the organizational structure of the service business (Gebauer, Fleisch, & Friedli, 2005; Gebauer et al., 2010a). Few other studies concentrate on *environmental characteristics* (Ceci & Masini, 2011; Fang et al., 2008; Suarez et al., 2013). For example, Fang et al. (2008) demonstrate that the outcomes of industrial services are highest when the industry is turbulent and exhibits low market growth. Success with industrial services further depends on the degree of heterogeneity in the market (Ceci and Masini, 2011) and the industry lifecycle phase (Suarez et al., 2013).

The literature review on industrial services reveals two main research gaps. First, previous research has not explored the potential role of firms' financial situation when transitioning toward services. Doing so will provide actionable managerial guidance on whether and under what circumstances companies can successfully pursue a service transition when facing financial pressure. Second, we need to gain a better understanding of the interplay between different conditions that form a company's context situation. Extant research mostly considers the contingency variables of the service transition–performance link in isolation, without paying attention to their co-occurrence (for some notable exceptions, see Ceci & Masini, 2011; Gebauer et al., 2010a). However, variables that are causally related in one configuration can be unrelated or inversely related in another (Meyer et al., 1993). In our study, we focus on two types of factors that likely influence a manufacturer's service transition success: resources (from financial situation and firm size) and knowledge sources (from customer links and supplier links). We investigate whether these context conditions always need to be present to create revenue growth with service emphasis or whether they complement or substitute each other. Such insights can

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