Servitization within a services firm?
The case of a payment solutions provider

Mari Heikkilä and Saara Brax

Aalto University School of Science and Technology, BIT Research Centre

This paper studies the servitization process of a payment solutions provider going through a unique transformation from an information systems operator to a competitive service firm. It faces a challenging transition process, which we argue is rather similar to ‘servitizing’ in manufacturing firms. This study suggests that exploring and understanding the firm’s history and its path dependencies enables identifying and further analysis of the organizational inflexibilities that form the main hindrance to servitization. Studying the path facilitates recognizing the firm’s competitive advantage and conquering the challenges related to the transformation process.

1. Introduction

The so-called ‘servitization’ (Vandermerwe & Rada 1988) research has mainly focused on manufacturing firms turning themselves into service businesses (Baines et al. 2009; Brax 2005; Oliva & Kallenberg 2003; Wise & Baumgartner 1999). Across all industries, firms are responding to the changing business environment and customers’ requirements by focusing on services (Vandermerwe & Rada 1988). In studying a payment solutions provider we recognized that something similar to the ‘servitization’ process of manufacturing can take place in pure service firms and within the traditional service industry, as well. Instead of fiercely competing in the B2B-services market, this company had considered itself more as an information systems operator and now recognized the need to become a service provider and compete for its institutional clients in new ways.

Currently, in the European market the main driver changing and developing the payment industry is the Single Euro Payments Area (SEPA), an initiative by the European Payments Council which removes national market entry barriers. Earlier the competition has not been able to match the versatility and scope of the payment solutions offered by the case firm, but the competitors can now improve their position in the market. Due to this pivotal change in its business environment, the case firm began to pay further attention on its work practices and processes to match the new competitive situation. In this paper, we describe this situation in more detail and analyze the historical reasons that have contributed to it. The understanding of the firm’s unique background and its organizational path dependencies allows us to identify ways in which the firm can facilitate the transformation in practice.

Through the analysis of the historical background of the case firm, we study the servitization process in the business-to-business services context. We will next present a brief literature review exploring this phenomenon and then we continue by reporting
the case methodology. We have organized the following case analysis section in three parts: description of the firm, explanation of its path dependencies, and analysis of the observed barriers to servitization. We end our paper by discussing the main conclusions: we argue that there are similar challenges found in the ‘servitization’ process of both manufacturing firms and ‘pure service’ firms; the theoretical concepts developed for servitization have applicability beyond manufacturing; and the concept of path dependence may provide new insights in servitization.

2. Literature review: the phenomenon of ‘servitization’

The strengthening of the service business activities within the manufacturing industries and firms has been recognized as an important research area and captured through various concepts. Among the most popular ones is the term ‘servitization’, coined by Vandermerwe and Rada (1988), which they defined as increasing value by adding services to the firm’s core offerings. Oliva and Kallenberg (2003) depicted this change through a continuum in which a firm moves away from perceiving services as add-ons to its physical goods towards viewing goods as add-ons to their core services. Studies focusing on manufacturing companies going though servitization have reported the challenging nature of this process, as product-focused organizational structures, practices and mental models act as barriers to successful service business (Martin & Horne 1992; Mathieu 2001a; 2001b; Oliva & Kallenberg 2003; Brax 2005).

Mathieu (2001b) provides a typology of the service ‘maneuvers’ of manufacturing companies (Figure 1). In this typology the different modes of servitization are categorized along two dimensions. The dimension of service specificity describes the product strategy associated with the maneuver, distinguishing three levels: 1) customer service, 2) product services, and 3) service as a product. Customer service refers to activities that facilitate product sales and, in general, are not charged for. In the product services mode, the company attaches service modules to its physical core products, but the modules are part of the bundle and cannot be purchased and consumed separately from the physical product. In the mode of service as a product, services are sold as independent offerings, meaning that their consumption is not coupled with the purchase of a physical product. (Mathieu 2001b.)

![Typology on servitization modes](image-url)
In the framework by Mathieu (2001b), the dimension of organizational intensity describes the strength and the scope of the service maneuver to the provider firm. The distinguished three levels are: 1) tactic, 2) strategic, and 3) cultural. A tactic maneuver is "limited to specific actions within the marketing mix of the firm, specifically, on its product mix" and "its impact on the organization is limited." The next level, a strategic maneuver, "aims to add some key competency to a firm’s portfolio, without changing its mission or its basic values". Finally, a cultural maneuver "reshapes the mission of the firm and has the potential to modify some fundamental characteristics of the organization, including the underlying belief system", meaning that it has the potential to reshape the organization’s culture. (Mathieu 2001b, p. 454.)

The arrows in the framework chart (Figure 1) show how benefits and costs can be expected to increase, whilst they do not suggest any specific pattern along which a company should move in the process of servitization. In other words, moves, i.e. shifts between the grid positions, may progress upwards, horizontally, and diagonally or even take steps backwards. While the presented framework focuses on the (qualitative) differences and shifts between the positions on the grid, another important assumption of the servitization concept is the growth. Servitization literature typically assumes an increase in the volume of provided services as well as a broadening the coverage of the services purchased by a single customer (e.g. Anderson & Narus 1995; 2003; Sawhney et al. 2004). Moreover, shifts in the two dimensions typically require changes in the relationship between the customer and the provider, increasing collaboration between the two, and changing positions in the industry-level supply chain (Davies et al. 2003; Brax & Jonsson 2009; Holmström, Brax & Ala-Risku 2010).

The organizational aspects have been recognized as causing problems, challenges and barriers to servitization. While research on servitization typically addresses moves in the service specificity dimension through paying attention to the increased volume of services in a firm’s total offering, and a shift from emphasizing customer service and product services to perceiving the potential of services as productized offerings, it commonly lacks the insight provided by the organizational intensity dimension in the framework by Mathieu (2001b). In other words, servitization literature commonly assumes a firm simply moves upwards in the framework axis, but the need to move onwards from the tactical level is seldom discussed. On the other hand, the findings of some researchers (e.g. Brax 2005; Foster & Whittle 1992) indicate that successful application of the service as a product —strategy may necessitate moves along the organizational intensity continuum.

Although the presented framework, as well as other servitization studies, focus on and have their empirical material mostly from manufacturing firms becoming service providers, we see broader potential in the application of the typology. The typology is associated with a context of developing service activities around a manufactured product. In this study, we apply this thinking to a firm with a service core product. The original service processes of the firm, however, have many similarities to manufacturing processes as well as the industrialized model of service (Levitt 1972), most importantly the emphasis on the backroom operations as the main producers of value, and the firm’s current development needs have great resemblance to those of original manufacturers aiming at servitization.

Although servitization is perceived as both a lucrative business strategy and a trend firms can hardly choose not to participate in, the many challenges associated with its implementation have been recognized. Oliva and Kallenberg (2003) identify three
consecutive challenges in the transition towards service dominance. First of all, firms might have no faith in the economic potential of services. Then they might find that the attempted services are beyond the scope of their competencies. Finally they might fail in setting up an effective service strategy (Oliva & Kallenberg 2003). In the framework by Mathieu (2001b), these challenges are captured as political costs, the cost of running the cooperative option, and strategic costs.

A key success factor for servitization identified in the literature is moving towards balanced customer centricity, which means providing customers with more tailored and integrated solutions instead of plain products (Baines et al. 2009) and excelling simultaneously both in the goods and service dimensions of the servitization continuum (Brax & Jonsson 2009). This requires both a shift from the old transaction-based mode of service to maintaining a relationship with the customer and a shift towards end-user’s processes oriented services instead of product efficacy (Oliva & Kallenberg 2003).

In their multi-case study, Oliva and Kallenberg (2003) found that successful transformations included a systematic effort to change the organization. Likewise, Brax and Jonsson (2009) criticized the generic and straight-forward style prescriptions on how firms can execute the servitization strategy and argue that the transition should be understood as a complex and context-specific process on problem-solving, learning and development. Based on this logic, we assume that most barriers and hindrances to servitization can be understood through analyzing a firm’s current situation and how it has developed. This requires attention both to the firm’s background and its business environment.

Nevertheless, many of the identified barriers to servitization can be explained as reflecting organizational inflexibilities. Understanding better how firms get ‘locked in’ their organizational inflexibilities and how the past decisions affect the future decision making seems to gain more importance (Sydow et al. 2009). However, usually these path dependencies are not easily recognized, although they might help in understanding the sources of competitive advantage (Teece et al. 1997). The term ‘path dependence’ refers to “a property of contingent, non-reversible dynamical processes, including a wide array of biological and social processes that can properly be described as ‘evolutionary’” (David 2000, 1). Put simply, paths consist of strategic alternatives available to the firm and are influenced by earlier path choices (Teece et al. 1997). Since learning is closely linked to firm’s previous activities and this path shapes the organizational processes, the routines of practice and learning need to be taken into account when considering firm’s competitive advantage (Teece et al. 1997). The initial choices and actions are embedded in the routines and practices in the organizations (Sydow et al. 2009).

The constitution of an organizational path can be conceptualized in three stages. In the preformation phase without any significantly restricted scope of action as the choice of options is unpredicted, then with gradually establishing the path by narrowing the scope of action in the formation phase, and finally, leading to a strategically inefficient lock-in phase by a further restriction of the scope. (Sydow et al. 2009.) Next, after presenting our case method we continue to analyze the servitization process of our case firm implementing the concept of path dependence.
3. Methodology

In the first phase of our still ongoing research project, we have taken an internal provider perspective for this case. Our study is conducted as a single case study, based on the analysis of interview data and other documents, such as process maps, organization charts, and service descriptions. We thus carried out 20 semi-structured in-depth interviews between November 2009 and March 2010 in order to better understand the current situation in the case organization. The interviewees represented different business units and organizational levels of the firm. From the interviewees 11 were from the sales and product management department, two from service production, three from the IT department, two from the administrative department, and two from the executive board. All the interviews lasted about two hours and were voice-recorded. A summary of each interview was written by one author based on the recordings.

We systematically analyzed the data with the comparative qualitative analysis method (Eisenhardt 1989) first comparing the interviews. Then, based on the findings, we prepared a case description which we will summarize in the next section. We continued the analysis further by contrasting the case findings with earlier research literature. In addition, a workshop with presentation of preliminary findings was held with the firm representatives. The feedback received from the representatives suggests our findings support their perceptions of the challenges and that the case analysis is appropriate and accurate. Also, already a few months after the active field research period we found that the firm had actively further implemented the servitization strategy. The firm had made several developments that addressed the problems identified in this study (including a rearrangement of its organization to better align its processes) and this, we consider, provides validation to our findings.

4. Case analysis

The case analysis is structured as follows. We first describe the case firm and its historical context. We then continue by identifying the path dependencies, and finally look at how they can explain observed barriers to servitization.

4.1. Description of the case firm

The case firm provides diverse B2B-services in payment solutions in Northern Europe. In fact, the firm’s offering confirms to what has been termed as integrated solutions in the literature (Brax & Jonsson 2009; Davies 2004; Shepherd & Ahmed 2000). However, until recently, the firm has mainly considered itself as an information systems operator due to the system-intensive nature of its services.

The case firm is a cooperative offering currently versatile payment services including processing, monitoring, and reporting services as well as development of the payment solutions. Security is and has been a fundamental prerequisite for the service, and to ensure secure and reliable operations the firm develops long-term agreements
with its institutional clients. In the future, in addition to focusing on offering broader service for its current client base, the firm aims to grow in the regional markets nearby its current area of operation.

For the business unit focusing on services offered to the finance industry, which was the primary focus of our study, the past financial year was somewhat challenging. Besides the economic turmoil influencing the whole financial sector in 2009, a new business model was introduced positioning the case firm as a service provider competing of and with its customers. In this model, customers are able to do some of the service themselves and only ask for certain type of service from the provider. Thus, the case firm experienced pressure to design separately defined service components to compete with its offering. The firm had to clarify its cost-structure to determine profitability in the service component level, as its customers value cost-effective solutions. The situation was obviously challenging, because to proceed further with servitization, the firm had to redefine its services, prepare new, more detailed service descriptions, and develop its pricing strategy.

The case firm anticipated this situation two years prior to our field study and restructured from line organization to function-based. According to the respondents, these changes had accelerated the turn into a successful B2B-service provider but not sufficiently: the implementation of the organizational restructuring had encountered some problems as in practice much of the pre-existing organizational culture, work practices and processes appeared to have remained. In our view, it is the long and stable history with little demand to change that had made the organization relatively inflexible. To identify solutions that facilitate servitization, we next analyze these issues in more detail.

4.2. Explaining the path dependencies

According to Sydow et al. (2009), the organizational path can be studied through the process of three phases. First, in the preformation phase, there are multiple options to choose from. When the firm was established, the call for more efficient and reliable payments resulted in shared processing techniques and payment methods. One alternative for them in this situation was to develop their own payment instrument, which presented the first automated payment solution. This can be seen as the first restricting scope of action in the history of the firm.

Focusing on the payment solutions proved to be a successful strategy, and by gradually establishing its path in the second phase of formation, the firm launched another payment instrument. This directed the firm to focus on services built tightly around the payment instruments (i.e. ‘add-on’ services) rather than the development of new ones for new customers or markets. Generally, the second phase is characterized with a “pull of the evolving path”, directing the firm to continue further with similar type of decisions (Sydow et al. 2009, 693).

The third phase in the process of constituting an organizational path is ‘lock-in’, which implicates the replication of self-reinforced dynamics embedded in the organizational practices (Sydow et al. 2009). As it appeared, by offering full payment service with services closely related to the payment instrument, the case firm encountered very few competitors with same range of service in its main market area. In addition, the technical system acquired for payment instrument services meant costs for years to
come. However, the market pressure and constantly changing customer needs were now forcing the firm to develop new solutions. The market was influenced by the new harmonisation of the payments, as inexpensive cross-border retail payments were enabled by SEPA. Besides increasing the volume of transactions, this affects the case firm in two ways: firstly, it offers an opportunity to provide services across borders, and secondly, the increased competition provokes redesigning the service portfolio to ensure the competitive advantage. Customers, in turn, seek cost-effective, customized solutions. To ensure its competitiveness, the case firm needed new strategies to change the course of its path.

The fact that competitors were entering the market and customers were increasingly doing some of the services themselves directed the firm to pay more attention to the relationship factor and the surrounding business context to understand more about the customer’s decision making (cf. Brax 2005). The main clientele of the firm had been its owners, demanding a wide range of existing services. As the firm now had to look for new customers, discovering a customer-minded approach was demanding due to the dominant owner-focused perspective. The challenge was to get the concept of customership clearly understood throughout the firm, in which the dissemination of the knowledge of the Account Managers has been undoubtedly useful. In other words, the organizational mental models needed to change to shift the firm from perceiving itself as an information systems operator to acting as a competitive service provider based on a genuine service culture.

4.3. Barriers to servitization

A further analysis of the case suggests there are a few barriers that complicate the successful transition into service business. We looked into the firm’s history and studied its organizational path seeking some essential events that led to the current challenges. We identified three central observations shaping the firm’s path: 1) the lack of competitors providing such a varied service, 2) the dual role of the firm’s clients as owners and customers, and 3) the categorization of services as add-ons developed around the payment instrument, which is problematic since customers could internalize this core operation. These three observations are interrelated.

Firstly, the market has been difficult to enter for competitors because of entry barriers such as national payment restrictions and language issues. Thus, it is suggested that the dominance of certain competitive forces (cf. Teece et al. 1997) or, in this case, the absence of competition, has influenced the strategic approach adopted by our case firm. According to the respondents, the firm now needed to strengthen its market and competitor analysis activities. Historically, analysing the market was not prioritized due to the lack of competition, but this mindset had now changed.

Secondly, reflecting the organizational form, the firm’s clients were perceived as owners rather than customers. This had resulted in providing mostly highly customized services according to the existing customer needs. The analysis suggests that developing services to be sold as off-the-shelf type of offerings or creating service innovations has suffered from this narrow view of seeing the customers as owners. Instead of offering standardized service modules available to any customer, “full service” here means adjusting services according to customer needs in each separate case.
Thirdly, we recognized that the firm’s services had been designed mainly as add-ons to the payment instrument operations. Instead of being defined as independent service components, the firm designed its services to support the use and the security of the payment. In other words, instead of developing ‘services supporting the customer’, the firm was developing ‘services supporting the product’ (cf. Mathieu 2001a). This had led the firm to offer a highly integrated solution without much focus on productization of the service components as separate service offerings. This was considered no longer appropriate by the interviewees. As some clients have recently internalized their payment instrument operations, the original integrated solution package has to be unbundled. This is extremely difficult for the case firm with its more technically oriented background, as there were not that many pre-existing procedures for developing ‘services as products’ (Mathieu 2001b).

The interconnection of these three observations lies in the unique path of the firm. Until now, it had succeeded in providing mostly customized services case by case to its owners. Due to the pre-existing favourable competitive situation, the firm had maintained a strong focus on the development activities centred on technical innovation and, in line with this, had put less weight on the productization of its service offering. Thus, the firm had been developing mainly services that support the core offering which had been so vital for its success.

5. Conclusions and discussion

In this paper, we aimed to study the unique servitization process of a payment solutions provider and analyze the challenges in the process through literature and case firm analysis. Even within a pure service firm, gaining a genuine service culture and reshaping the inherent practices and processes comes with challenges. We suggest there are similar barriers found in a way of becoming a successful service provider in both the manufacturing and pure service firms. In addition, a look at the firm’s history and the organizational path dependencies seems to help in explaining the challenges the firm had encountered in the servitization process.

The theoretical part of the study was grounded on Mathieu’s (2001b) typology which conceptualizes servitization through the dimensions of service specificity and organizational intensity. We suggest that the transition is not a linear process across the framework diagonal but the shifts can take place to various directions along the continuums and the starting position of the transformation may also vary. Although the original servitization literature has focused mainly on manufacturing firms, our case shows that similar transition may take place in ‘pure service’ firms. This makes the typology more useful in a wider perspective, also outside the context of industrial services.

Interestingly, the case situation could be conceptualized as an example of “reverse development of integrated solutions”. For a long time, the firm’s main offering for the market has been an integrated solutions package based on the core service of payment solutions. Due to increased competition and the possibility for the customer to internalize the core process, the productization efforts now have to focus on unbundling the integrated solutions. As the firm’s offering has not been based on a modular
product strategy, breaking the solution into distinct layers and components that can be provided as independent service offerings is extremely difficult.

Earlier research has described this servitization-related development as a complex process of problem solving and organizational learning, rather unique for each firm and situation (Brax & Jonsson 2009). Therefore we considered applying the concept of path dependence as particularly suitable strategy in our case study. This allowed us to identify the firm’s three key challenges in the process of becoming a competitive service provider. We positioned these barriers with Mathieu’s typologies and recognized that the firm had focused on ‘services supporting the product’ instead of ‘services supporting the customer’ (Mathieu 2001a) and this hindered the firm to rise from the level of ‘product services’ to provide ‘services as products’ (Mathieu 2001b). Although these typologies were originally developed to describe the servitization of manufacturing firms, with some modification we found them useful in this broader context.

According to Sydow et al. (2009), breaking the organizational path dependence requires understanding of the drivers that led into it. In this case study, the analysis showed that the main contributors were the relative lack of competition, the perception of the clients’ role rather as owners not customers, and considering services as information system add-ons by nature. To go further in the process of breaking the path, the organization must understand the underlying self-reinforced, often hidden dynamics and the cause of a critical event that led to the critical turning point (Sydow et al. 2009). We consider that the critical turning point for the case firm was the emergence of the competition.

All our findings seem to be interconnected. The connection goes deep into a firm’s history and is shown to be an explanatory factor in the process of turning a firm into a competitive service provider. The interviews revealed that the organizational culture and old work practices were not fully changed with the reorganization of the firm. The challenge faced by the firm — difficulty to change culture, routines, and processes — can be connected to the favourable competitive situation in the firm’s history which has kept the business rather constant until now. A new mindset is now strengthening in the firm as the emergence of new providers offering parts of the service package is now a focal aspect of the firm’s competitive environment. Furthermore, we found the path dependence concept helpful in this case and consider it as a useful concept for firms to look into their history in order to identify possible strengths and opportunities.

On a more general level, our observations suggest that a so-called servitization process can be found within the traditional service industry — and outside its original context, manufacturing. Since this is a single case study, we cannot make conclusions about the prevalence of this finding within the service industries, and therefore we encourage further research on the subject. As our research project continues, we are following up on the implemented developments in the firm and expanding our internal provider perspective to study the customer processes. We believe that interviewing the customers will contribute to better understanding of the current challenges.
6. References


Authors:

Mari Heikkilä, Researcher  
Aalto University School of Science and Technology  
BIT Research Centre  
P.O.Box 15500, FI-00076 AALTO  
mari.heikkila@tkk.fi

Saara Brax, Researcher  
Aalto University School of Science and Technology  
BIT Research Centre  
P.O.Box 15500, FI-00076 AALTO  
saara.brax@tkk.fi

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