The 3 Life Cycle Sales Events of a B2B Extended-Service Contract; Revenue Sources That Can Keep on Giving and Giving

By Ron Giuntini, CEO/Founder of G35 Software

B2B extended-services have been around for decades, also referred to as an extended-warranty, a managed-service, as well as a host of other terms. The following is the basic premise of an extended-service:

- A seller supports a buyer's management of the maintenance of its machine assets (i.e. operability performance level and adjusted asset value),
- During a defined period of time (e.g. 5 years),
- By delivering a portfolio of performance-assured solutions (e.g. correct-failure within 2 hours),
- For a fixed-fee (e.g. $1,000/month/unit).

The current US annual revenue generated by B2B extended-service contracts is an estimated $20 billion in support of $10 trillion of machines; from aerospace, to construction, to medical, to trucks and many more sectors.

The value proposition of an extended-service to the buyer is:

- Access to best practices developed by the seller;
  - Provide more efficient solutions than that delivered organically (e.g. reduce component shop repair costs by 35%).
  - Provide more effective solutions than that provided organically (e.g. increase parts availability by 10%).
- Shift of risks of unplanned costs to the seller (e.g. failure of a reparable part resulting in it being scrapped and replaced with a new part; a 40% higher cost than the planned cost of being repaired).
- Known cost obligations for several years; reduces employment of administrative resources in the annual budgetary process and eliminates financial performance "surprises."

- Conversion of some balance sheet investment into a period Operating Expense [OpEx]; increases ROI (e.g. parts inventory are not purchased, and thus not reflected upon the balance sheet, but bundled into a service at the time of the product purchase; may even be capitalized [CapEx]).

The value proposition of an extended-service to the seller is:

- Assured recurring revenues over a defined period of time; favorably perceived by owners/investment community.
- Profit margins, over the contracted period, are potentially higher than that of product sale margins; if the configuration and price of the contract is well designed.
- "Sticky" customer relationship; constant face time with customer over an extended period.
- Provides product sales team with another offering to sell; increasing commission potential.

Below are details of the 3 life cycle sales events of a B2B extended-service contract. Note that some of the terminology of these events may differ from industry to industry, but the events below cover the vast majority of situations.

1. **Create Life Cycle Stage:**
   a. **Attachment;** extended-service sale event applied with the sale of a never-employed or previously-employed product.
      This is by far the greatest source of extended-service revenue.
   b. **Post-Attachment;** extended-service sale event upon the pre-expiration/at-expiration/post-expiration of a limited product warranty. Usually occurs when the buyer has "regrets" of not engaging in an extended-service; as a result of the performance-assurances of the limited warranty not meeting the requirements of the operator (e.g. 24 hour part delivery promised, when 4 hours is needed).

2. **Revise Life Cycle Stage:**
    a. **Up-Sell;** extended-service sale event that increases the revenues of a contract by adding solutions/performance-assurances for the same machines.
    b. **Down-Sell;** extended-service sale event that decreases the revenues of a contract by reducing solutions/performance-assurances for the same machines.
    Note that this event should be initiated by the seller who acknowledges that the solutions under contract do not provide the intended value to the buyer.
    c. **Cross-Sell;** extended-service sale event that provides solutions/performance-assurances for different machine models.
    d. **Extend;** extended-service sale event that adds to the duration of an existing contract.
    e. **Modify;** change in buyer's operational environment impacts price drivers of original contract configuration (i.e. operational hours decrease by 30%). Seller and buyer mutually agree to change price.
3. **Renew Life Cycle Stage:**
    An extended-service sale event in which the buyer renegotiates an expiring extended-service contract; solutions/performance-assurances, contract duration and fees may or may not change.

Studies have indicated that less than 15% of all commercial machine assets on balance sheets are currently covered by an extended-service contract, and of the 15% covered, less than 50% of all maintenance expenditures of a buyer are supported by the extended-service; the remainder are either in-sourced or transaction-driven products and services. For example, total annual maintenance costs are $1,000 for an enterprise that is a buyer of an extended-service contract paying an annual fee of $400, covering only the correct-failure maintenance process. The remaining $600 of the buyer's annual expenditures are engaged in the prevent-failure and inspection processes, in which the buyer's enterprise employs its organic technicians and buys parts on a transaction basis.

It is estimated that less than 8% of all annual US commercial machine maintenance management expenditures are supported under an extended-service contract. One of the drivers for this low penetration level is the nature of most extended-services; they are "standard" offerings of "one size fits all." Most enterprises require customized offerings that address their specific maintenance management requirements.

Customized offerings materially raise the risk for the seller of an extended-service; smaller populations of machines covered under customized versus standard offerings has greater volatility in demands, with a probability of a higher variance in planned versus actual costs. Without a proper configuration and pricing quotation tool that has the ability to assess and mitigate risks, customized extended-services can often be a non-starter with a seller's financial leadership.

In conclusion B2B extended-services has the potential to be a much larger market, but there are many issues to be addressed; from sales event engagement management by sales teams, to configuring and pricing customized quotes, and to enterprise leadership developing confidence in managing risks.

As US enterprises evolve from an operator-access-machine-through-ownership/insource-maintenance business model to one of an operator-access-machine-through-lease/outsource-maintenance business model, customized extended-services will be the solution of choice of the seller to maintain the optimization of their asset values, as well as maintain the buyer's operability performance levels.

Ron can be contacted at ron@g35software.com or 570.713.4795