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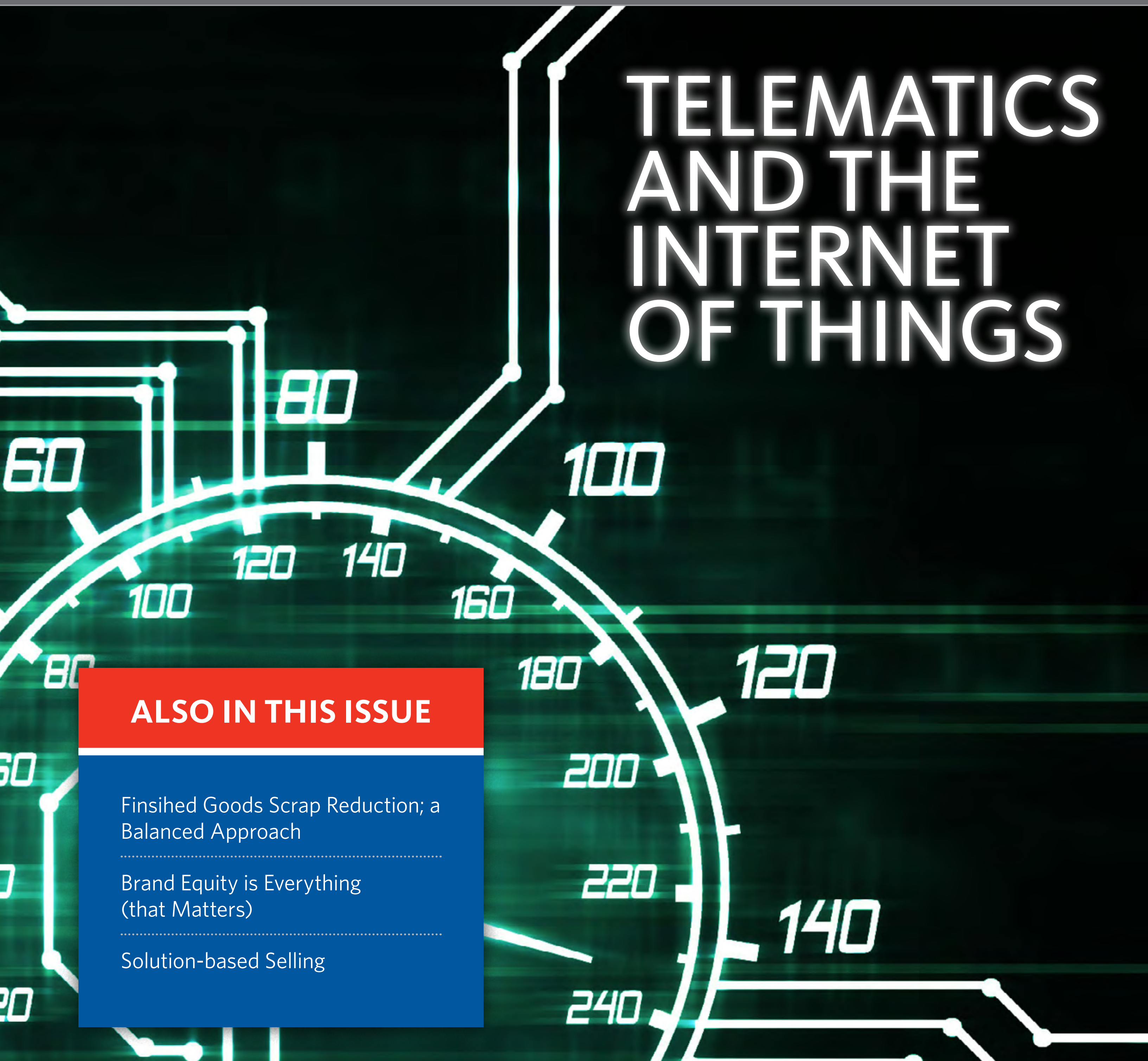


TELEMATICS AND THE INTERNET OF THINGS

ALSO IN THIS ISSUE

Founded in 1981, Kaiser Associates is an international strategy consulting firm that serves as a key advisor to the world's leading companies. We provide our clients with the unique insight derived from unparalled primary research capabilities to drive critical decision making and solve their most pressing problems. We are dedicated to helping leading corporations improve their performance and achieve sustained profitable growth.

Telematics and the Internet of Things: Value, Opportunities & Risks for Customers and OEMs

There is a lot of buzz about the technological capabilities of telematics and its prospective impact on business relationships and OEMs are starting to make progress in identifying the right business model to derive bottom-line value from these offerings.

IDEA IN BRIEF

- Telematics can provide OEMs and customers with considerable and valuable data on assets, which can add significant value to optimizing R&D, investment decisions, manufacturing, and operations
- Ongoing costs can be significant as the installed base grows, and companies need to develop new capabilities to manage service operations efficiently
- While the theoretical benefits are clear, including greater customer stickiness, OEMs have yet to overcome customer adoption hurdles and many are struggling to monetize their services

Telematics is the integration of machines, sensors, information, software instruction, and communications technologies, creating connectivity between machines or other hard assets, often with a central service. It has to some extent been popularized in the press as part of the "Internet of Things." Telematics was introduced into public consciousness with General Motors' OnStar service connecting the car to a GM service center, and although we are in the early phases of adoption, telematics exists today throughout the industrials value chain, from manufacturing line equipment to transportation fleets to production tools in the field. In the production facility, telematics is being used to create "connected" environments that can identify and address issues before problems occur, limiting down-time. Critical machines networked to the facility ERP have been able to alert employees of issues for some time, but two new trends are entering the factory. First, leading manufacturers are now networking the entire manufacturing line, creating "aware" factories. Second, individual equipment is connected directly to the OEM for monitoring, preventive maintenance alerts, deployment of service personnel and even remote service—creating a sticky relationship, feeding OEMs valuable data, and in some cases developing entirely new and profitable revenue streams.

Heavy equipment OEMs are also increasingly offering telematics services, particularly on equipment that is at risk of being commoditized, in hopes of creating value outside of the product's core function. The wealth of data generated by telematics enables OEM customers to track and monitor equipments' use and environmental conditions, and identify improvement opportunities for how the equipment can be better operated, which also impacts equipment maintenance, uptime, and useful life.

While the end-user value of telematics is potentially significant, some OEMs are reluctant to commit investment (think IT R&D) in these areas given uncertainty around the likelihood of adoption, questions on how to address conflicts between competing platforms, and a lack of clarity on how telematics will ultimately create top and bottom-line value.

Tracking and monitoring equipment can provide real-time benefits and long-term operational improvements. Tracking the location of equipment can ensure proper operation and compliance as well as drive capacity utilization and effective asset management. Over the long-term, data collected on the use of equipment can help improve efficiency and cost control. For example, an OEM reported that by tracking usage and location, it realized that equipment operators were idling machines for as long as two to three hours per day. Through a simple notification to operators to shut down the machines, it was able to save the customer $80,000 per year in fuel, and extended the useful life of their asset. However, data sharing requires that OEMs successfully navigate a number of customer concerns about data security and trust.

The benefits to equipment health and maintenance can be realized both in real-time and over the course of time. Machine sensors that track the temperatures of critical parts such as transmissions can alert the operators to any immediate impending issues, preventing costly breakdowns. Over time, fleet managers can track cumulative hours used and asset performance data to create sophisticated preventative maintenance programs, improving the lifespan of equipment.

The data that telematics generates also provides extremely useful customer insights for the OEM. The same use and maintenance information that the customer is using to better manage their equipment can inform improvements to the OEM's product design, production, innovation, and customer service. But many companies have yet to tackle the internal change to processes, and develop the internal capabilities required, to take advantage of these new data streams.

While telematics can potentially help OEMs develop greater 'stickiness' with end users and a more direct relationship with the end-user community, the prospect of this direct relationship with end users is one that raises a number of tricky issues. Distributors who have traditionally enjoyed the unique benefit of owning the customer relationships may push back for fear of disintermediation. Figuring out how to best include and engage the channel in the business model of telematics is a critical step in executing a telematics strategy.

Another common challenge faced by OEMs is determining whether, and how, to monetize their telematics offerings. Companies that base their investment and return expectations of telematics as a standalone offering often run into problems when they incorrectly anticipate sensitivity of market adoption based on variations in the revenue model and pricing levels. For example, a construction equipment manufacturer added telematics to their premium line of products as an optional value-added service. When the customer base resisted paying monthly for the service, the OEM built the cost into the sales price, hoping the increase in sales of the higher margin premium line would offset the cost. With limited resources allocated to their telematics service, customers using telematics were disappointed with the quality of service, forcing the OEM to allocate more resources to maintaining telematics, making it unprofitable.

For other OEMs, adoption of telematics on their machines is dependent on adoption of other products in the ecosystem. For example, a European appliance manufacturer recently added telematics to their household appliance line to differentiate their product from their competitors. After months of marketing, the OEM realized customers were not willing to use telematics for a single appliance in the household, as they wanted just one interface, one platform, for all their appliances. Unable (or unwilling) to negotiate a common platform with other major appliance manufacturers, the telematics offering was dropped. Dominant third party platforms (e.g., Apple's iOS) offers an intriguing option (and in evidence at 2014 CES) but cedes significant value to the owner of the platform.

There are challenges related to the natural rate of market adoption and how much OEMs can incentivize uptake. Although customers who want entire fleets activated immediately can engage third party suppliers, the cost-benefit analysis is not compelling for most and many will choose to slowly introduce telematics as older equipment is replaced with newer systems. These examples demonstrate that the drivers of adoption and perceived need for telematics differ significantly across industries and what drives value for the customer may go well beyond your company's offering. More critically, how you define and package technology offerings has great impact on outcomes.

Certain companies that have been successful with their telematics offering have faced a different set of "success disasters." For instance, many manufacturers fail to consider, let alone prepare for, the impact of a growing installed base. If you sell 100,000 units a year, in five years you wake up with a half a million connected machines, and all of the associated customer and technical support costs. Entirely new organizational capabilities and competencies are required (e.g., data analytics, data governance, IT support, liability management, etc.) and carry associated costs.

The technological potential of telematics continues to increase at astonishing rates as advancements in information and communications technology (including cost reduction) unfold on a daily basis. However, what may be more ultimately disruptive in the long term may not be the advent of new system capabilities, but the rise of new service innovations and delivery models that transform how industrial products deliver value to end customers. Firms that are able to more quickly recognize how telematics can vastly enhance their traditional product-based value propositions. Those that adapt their business / organizational models to deliver against these promises stand to gain competitive advantage relative to those that are slower to adopt, including the potential to materially shift market share even in tired and otherwise mature market segments.

In order to develop profitable telematics strategies, business models, and value propositions, OEMs should rely upon investigative primary research and analysis that answer the following questions:

- What does current state look like and what paradigms need to shift?
- What are true customer needs and how can they be best addressed?
- What do customers expect of an OEM and its telematics offerings versus that of the channel or third party integrators?
- What business models will prove viable and attractive?

Furthermore, OEMs are not alone. You can capitalize from others' experiences. Many firms have already tackled these challenges, developing unique and practical answers to the questions above (and painful lessons learned). Consequently, benchmarking how competitors and best-in-class telematics OEMs are managing these issues can shorten the time to implement and improve the confidence of management teams.

Lastly, external research can keep OEMs on top of technology developments in other parts of the industry ecosystem so that OEMs can determine:

- What technology standards are being used?
- How are competitors investing against different telematics challenges?
- How have technology challenges been met in similar circumstances?
- Who is leading the field in specific areas?

Kaiser Associates can help address these questions by leveraging our experience helping other clients tackle similar issues, conducting competitive studies, applying best practices and, most informatively, by conducting deep investigative and empathetic study of customers, customer circumstances and channels.

Given the growing importance of the connected machine in the industrial landscape, and significant client work in this space, Kaiser Associates continues to explore this topic and is launching an electronic survey to gather perspectives from industry participants. We would like to invite you to participate in a short nine-question survey, the results of which we will present in our next issue of Kaiser Insights.

We invite you to participate in our telematics survey and to receive an updated report from the survey, please click the following link:

http://www.kaiserassociates.com/primaryperspectivessurvey/

Finished Goods Scrap Reduction; a Balanced Approach

Effective finished goods scrap management can meaningfully contribute to the bottom line. Why do so many companies neglect this opportunity?

IDEA IN BRIEF

- Finished goods (FG) scrap is a necessary evil in nearly all companies that manufacture or distribute goods, but few best practices have emerged on how to best manage it (apart from the obvious "lean it out" response)
- In reality, tackling FG scrap means making tough trade-offs that can impact the effectiveness of sales force and marketing activities, and also relationships with the channel and customer satisfaction
- Kaiser's approach to FG scrap management treats this typically financial and operations only decision from a multidisciplinary perspective, incorporating perspectives from the diverse set of stakeholders who are affected by the decision

Finished goods scrap comes in many different forms. Everyone agrees that it is wasteful and costly. But consensus on how to best address is hard to come by. Two truths exist with regards to finished goods scrap: First, the further along the value chain scrap occurs, the more expensive it is; and second, scrap is inevitable but can be managed strategically.

A great case example of the impact of scrap on costs, as well as customer service, is a major medical device manufacturer that was evaluating its post-manufacturing operations (i.e., distribution, reverse supply chain, and return policies) and determined that it was incurring over $100 million in finished goods scrap on an annual basis. These were products that expired "in the field," and could not be salvaged[1]. Many companies in the Healthcare industry as well as in Industrials and Consumer Packaged Goods have days of inventory on hand (DIOH) measure — in distribution centers and on consignment on customers' shelves— of 180 days or more with products that have relatively short expiration periods. So the reaction of many at this company was that inventory should be cut back immediately. But what do you tell the sales representative who complains that its most loyal customers will no longer return calls after she was unable to deliver the right SKU in time to save a patient's life?[2] Maybe cutting inventory is not the best idea. And this desire for service is not limited to the life and death situations of healthcare markets—industrial producers with schedules or downed operations screaming to get back online certainly feel the heat.

In many circumstances, a certain level of scrap is necessary or even desirable, e.g., when a company has a high gross margin, and therefore great opportunity costs associated with lost sales. But what is the right level of inventory, and what is the right way to manage that inventory?

In order to answer this question for the previously referenced client, Kaiser performed a detailed benchmarking of our client's peer set (direct and indirect competitors), as well as a deep Voice of Customer (VOC) analysis. This analysis revealed three clear findings: First our client was not the only one struggling with scrap; second, a well-devised scrap strategy could be a source of competitive differentiation; and third, any strategy that was going to meaningfully reduce costs, was also going to require a sacrifice from customers.[3]

We co-designed with our client a program that leveraged several key insights on how to ease the pain of transition, develop customer advocates, and ultimately drive brand improvement. The results included a three-pronged strategy:

1. **Offering to Customers** – The analysis helped our client determine which aspects of its customer service strategy were ultimately most valuable (and most correlated with overall brand strength) and which could be sacrificed.
2. **Role of Sales Reps** – Sales reps would have to drive some of the changes and would have to be given the tools *and the incentives* to be successful in taking on a new role as inventory manager (on top of the current role of chief advocate for the customer). We worked with these reps to identify waste caused by current practices.
3. **Competitive Differentiation** – Through benchmarking we ensured that for areas identified by customers as critical, our client was performing at, or above, the level of competitors.

Ultimately, we determined scrap could be reduced anywhere from 30% to 60% by following these best practices, depending on the degree to which sales reps could be incentivized to better manage their inventory. Knowing the "size of the prize" and that they were the key points of leverage, sales managers were willing to join the cause. By using a coordinated, multidisciplinary approach to scrap management, our client was able to make a meaningful contribution to the organization's bottom line.

While scrap and wasted finished goods are an inevitable part of business, customer and competitive research can identify effective targets for reducing these costs, and the associated practices can maintain or improve customer service levels.

[1] In most cases they are simply donated to developing countries or altogether disposed of

[2] Or as one client might more emphatically put it, *"What do you tell the CMO when she calls and asks why it is that competitors are rapidly eroding share because your company is no longer considered reliable in customers' eyes?"*

[3] And a shift in the way that customers had been engaged for the last several decades.

Brand Equity is Everything (that Matters)

"Brand Equity" is all too often misinterpreted for being a distant cousin of "brand identity" and often neglected despite being one of the most important management tools. We set the record straight and explain its fantastic potential for the Industrial sector.

IDEA IN BRIEF

- Brand Equity has little to do with brand identity - in fact, it has little to do with the way *you* define or represent your company in the traditional sense
- Instead, Brand Equity is a measure of how *your customers and customer prospects* (and other critical key stakeholders) define your company relative to alternatives and relative to customers' key purchasing criteria
- Brand Equity is a quantitative diagnostic tool with a wide variety of applications for the Industrial sector, from strategic planning to acquisitions to new product introduction, and needs to be a primary input in resolving investment and budget decisions
- Brand Equity can be even more powerful to executive leadership, operations and strategy professionals as it is to upstream and downstream marketing professionals—and given the likely under utilization by those functions, likely offers even greater upside

The first questions you might be asking are whether Brand Equity is all that important, and what is its relevance to the work that you are responsible for? Brand Equity is a familiar concept to marketing professionals, and, in recent years, its utility has broadened and today is put to use by sales, operations, strategy, portfolio planning, corporate development and executive management. However, effective Brand Equity management is sometimes confused with brand identity management and brand motivation management. The key difference between these concepts is in how they interpret brand: in brand identity work, companies are assessed using brand representations (in the forms of a mark, a design, a phrase, a narrative, etc.) as a unifying expression of how the organization prefers or hopes the outside world will recognize the business or product. In Brand Equity work, you turn this concept around a full 180 degrees and examine the picture from the perspective of customers and other stakeholders. You measure this picture using a scorecard as a comprehensive assessment or an equity measure of how customers assess the value offered by a firm vis-à-vis its competitors and most importantly its needs and aspirations. Factors evaluated as part of standard Brand Equity assessments commonly include performance, function, quality, service and support, trust, and value. Brand Equity assessment begins outside the organization, and in best-in-class organizations resonates inwards—how will we change our actions, our plans, our behaviors, to improve perceptions of our brand relative to customer needs?

In stark contrast from five years ago with our work with leading Industrial sector companies, Brand Equity analysis is becoming the "go-to" tool for predicting future performance, informing strategic planning, performance improvement, portfolio planning, product planning, and go-to-market activities. One of our most successful clients in the space has made regularly measuring its Brand Equity among customers a standard way of life, mandating this work for all businesses annually.

Our approach to assessing Brand Equity consists of several steps. First, we assess components of Brand Equity based on a common set of factors that we use for all industries (allowing cross-comparisons and relative measures) and augmented by a set of factors that are industry or business specific and derived through experience in the industry, as well as initial customer interviewing. Next, using statistically significant sample sizes for critical market segments, we determine which factors matter most to the firm's customers (and customer prospects) when making purchasing decisions. Then, we collect customers' and the prospects' views (in a high-quant fashion) of the competitors' brands (including upstarts and alternatives) against each of the purchasing factors that matter. Among the factors that are universal is "familiarity",[1] which by itself could be valuable in helping determine a proper and complete set of competitors (it is always a powerful moment in our client meetings when our clients come to learn the full set of competitors that hold equity and intrigue from their core customers). Other factors that are universal include likelihood to recommend, having a reputation for being trustworthy, ability to deliver valuable innovation, product functionality and performance, and providing a product or service that meets needs. Factors specific to the Industrials space often include the degree of customization available, sales support, technical support and after-market service performance, project management ability, and others.

The degree to which Brand Equity factors are predictive of likelihood to purchase from a given organization differs by industry and changes over time, which is why every Brand Equity study (even if it's repeated annually) needs to assess the importance of each attribute. By weighting a client's performance on a factor by the importance of the factors and by segment of the customer base, we can arrive at an understanding of a client's strategic strengths and weaknesses, and help our clients avoid getting distracted by those strengths and weakness that are unimportant. **This piece of the analysis provides great relief to the organization as it resolves questions about where to not invest—preserving capital and budgets for the critical areas that will make a difference in market share and the top and bottom line.**

There are multiple applications of Brand Equity in the Industrials world, including:

- Supporting annual strategic and portfolio planning activities
- Serving as a forward indicator of market share performance—as well as serving as an instructive diagnostic on the underlying causes for the shift; these being extremely useful for managing product lines in mature as well as developing markets. The quantitative nature of the tool provides a powerful performance metric of how we stand up in the eyes of our customers and our customer targets
- Directing limited resources towards the highest ROI investments
- Supporting merger and acquisition processes; Brand equity is one of three critical components of commercial due diligence for the most successful strategic acquirers according to our Private Equity and M&A practice—many top financial investors in determining whether to pursue a buyout (or not)
- Preparing for new market entry: knowledge of the competitive brand landscape can be critical to effective positioning and channel planning for a new product
- Determining how much permission that you have with your channel and customer base to bring forward innovations
- Informing customer segmentation: building segments from Brand Equity clusters can be far more predictive than demographics-based segmentation

Of course, Brand Equity has its challenges. In particular, Brand Equity will be somewhat limited as a predictive utility unless it is measured with regularity and includes trending analysis. Without regular check-ins, analyses can only tell you where customer perceptions are and will not indicate where customer perceptions are headed. Additionally, when analyzed incorrectly, Brand Equity can identify false indicators of improvement opportunities for companies with substantial legacies. Think of Brand Equity as clay being molded by a combination of customer word of mouth, an organization's actual performance, and relative competitor comparisons, as well as advertising and other means of perception shifting. When new to the market, the clay is highly moldable—perceptions can be built, improved, and shifted rapidly. When a brand has been in the market for many years, it can become set (assuming it has not been regularly touched and molded in meaningful ways).[2] This is likely a mistake that Blackberry (formally RIM) fell victim to.

Considering another example, a multi-billion-dollar, highly acquisitive industrial conglomerate was recently considering an acquisition in the Oil and Gas sector. One of the competitors of the target company had a reputation built over 75 years, whereas the target had only been in the market for seven years. Both companies had similarly poor Brand Equity, but the target had the advantage of not having a legacy. As a key component of moving forward with the acquisition, Kaiser developed a 100-Day Plan to address critical brand issues for the target. In assessing the competitive response, we were confident that the legacy brand would be challenged to reposition itself effectively, and therefore would be unable to adroitly shift. The company would either suffer for trying, given the depth of the legacy, or be forced to find another means of response (which we predicted would be a pricing tactic and which our client could now prepare for). Generalizing from this acquisition scenario, anyone interested in driving performance through Brand Equity assessment needs to regularly ask: How easy will it be to improve in places where we are weak? And specifically, what actions will it take?

The strategic options made available by Brand Equity assessments differ based on the degree to which a brand maintains its pliability. In some cases, companies have recognized that Brand Equity has hardened, and must simply be reconsidered relative to a new brand if substantial changes must be made. This is what happens when companies neglect understanding their true and current Brand Equity. In our rapidly evolving economy, with greater and greater information flow and rapid innovation cycles, the speed with which customer selection criteria changes and Brand Equity shifts between competitors is astonishingly fast, and significant damage can be incurred. In a surprisingly large number of cases, however, brand recovery is possibly by directly confronting weakness.

A useful starting point for companies in determining their strategy to Brand Equity management may start with a thoughtful examination (and a properly aggregated quantitative measure) of a number of simple yet powerful questions:

- What do customers want?
- How do customers think?
- Who are we beating, and why?
- Who are we losing to, and why?
- Which segments are we winning with? Which are we losing with?

The bottom line: If leadership does not have accurate and nuanced read of the equity it holds with its customers, every other effort of management is at risk for dramatic under performance. In the end, the only thing that matters is what customers think today, and the actions they will take tomorrow.

[1] Technically, "aided and unaided brand awareness," or sometimes referred to as brand awareness (i.e., unaided awareness) and brand familiarity (i.e., aided brand awareness).

[2] Additionally, applying the heat of intense press scrutiny due to public issues, will have a similar ability to "set" a brand and make perception shifting more difficult.


C-Power

Solution-based Selling

Developing a clear understanding of who your true customer is and the critical needs that drive them to a buying decision is fundamental to developing an effective sales and marketing strategy

IDEA IN BRIEF

- While the practice of framing products and services around a customer's pain point is well known, companies often make the mistake of failing to confirm that their identified issues matter and truly motivate actual buying
- In cases where there is a clear customer problem to be addressed, the challenge is convincing your customers that you have the best solution; however, in other cases, the pain points may not be as significant, and the challenge is to determine the alternative factors that do drive the buying decision and to adapt the product or service to meet a broader requirement
- Depending on the varying circumstances of a potential buying decision, companies need to direct their commercial resources at the appropriate mix of purchasing agents, influencers, and end-users—both an art and a science that needs deep insights from the voice of the customer

Over the course of several years, a leading manufacturer of specialty engineered components in the Automotive sector had steadily diversified its business and product portfolio to serve an increasing number of adjacent end markets, primary of which was the Oil and Gas sector. While the company did not have a full portfolio of products to fully serve this market, it believed that the reputation of the limited number of current products they had in the market was strong and sufficiently differentiated from comparable competitive offerings. The company invested in a dedicated oil and gas end-market sales organization and embarked on an ambitious campaign to expand its market share. Its results were mediocre; while the company had managed to win a number of replacement sales with existing customers, the team had struggled to gain an audience with new customer prospects and steal share from incumbents.

This client recognized that it needed to develop a better understanding of the purchasing process across its value chain, key decision makers, and influencers at each step, and the pain points that drove the purchase decision in order to refine their go-to-market strategy. For this client, Kaiser embarked on an in-depth Voice-of-Customer exercise that included a broad cross-section of upstream oil and gas players ranging from exploration and production companies, drilling contractors, oil service companies, and rig yards. This analysis revealed a number of fundamental challenges to how the company was pursuing the market opportunity in terms of the customers it was targeting and how it was positioning its offerings.

One key issue revealed through the VOC research, which was shocking to our client, was that most customers did not perceive a significant problem or deficiency with their current products and suppliers. As a result, the company's sales team was not very effective at convincing customers why its products were superior and why they needed to replace their existing equipment in the first place. The VOC research revealed that most customers were simply purchasing equipment at regular pre-determined intervals (based on generally accepted practices) rather than going through a thoughtful process of pro actively evaluating needs, searching for solutions, and evaluating optimal vendors to provide those solutions.

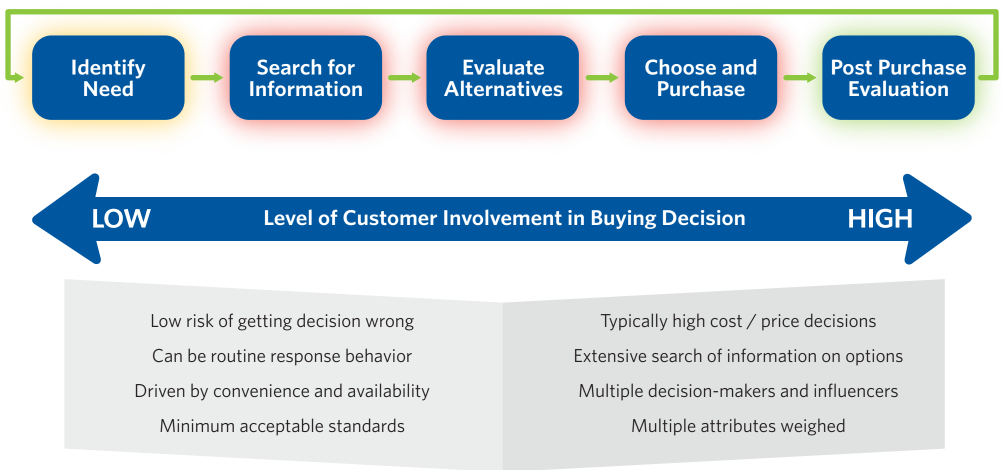
This highlighted a fundamental misunderstanding of who drove decisions for purchasing the company's product. As the company believed that its product offering was a critical element of upstream operations given the functions the product performed and the risk a failure could pose, it assumed that decision making would be held at more senior levels of its customers' organizations and within an engineering and technical department. In reality, the product was viewed as a lower complexity and lower risk commodity good and, therefore, buying decisions were being handled much further down the organization by procurement departments.

While the implications of these results were initially disappointing for the company, the research also revealed that there was an emerging opportunity for the company to reframe the customers' buying decisions around potential pain points and under served needs. With heightened scrutiny on safety across the industry and a greater number of oil rigs being bought and sold among oil companies, there was an increasing need for inspection, maintenance, and recertification services for oil rig equipment. By offering these adjacent services, our client had new opportunities to engage with a different set of stakeholders within their customers' organizations; stakeholders who were be much more aware of the potential needs associated with the type of equipment the company had to offer and were much more receptive to a discussion of alternatives.

The analysis served as an important reminder of a number of basic but fundamental and powerful principles of marketing, and reinforced how it is critical to answer several key questions:

- What are customers' pain points?
- What is the magnitude of the customers' perceived needs and challenges?
- Whose responsibility is it to address the issues?
- How well are these pain points being addressed by current offerings?
- How effectively does the offering help them get to the desired end state?

The answers to these questions provide insight into the extensiveness of the customer's involvement in a buying decision (e.g., how thoroughly will customers seek information on alternatives, how complex is the decision-making criteria). Based on these factors, companies are able to make much better choices on key decisions, such as customer segmentation, value proposition development, and resource allocation.



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