#IT_services_mindset
#product_value_erosion
#value_leakage

Product Value Leakage: The IT Services Mindset Problem

Nitin Kumar
&
Krishna Navalpakkam

Product Value Leakage: The IT Services Mindset Problem

One of the most underestimated problems in the Software Product business is how an "IT Services Mindset" can erode product value and eventually crush a business. The authors have spent their careers in both product and service organizations playing a variety of roles from running product businesses, operating service businesses, investing in products, consulting to product teams and fixing broken organizations.

Introduction

Over the past two decades, we have been extremely fortunate to work with some of the best product minds in the world, who make material impact on the world by building game changing products. We have also been asked to turnaround companies having products which lost their edge and plagued with execution issues. While there are a myriad of issues on why products fail, one of the serious issues we have seen is the "IT Services Mindset", often times the damage inflicted by this mindset is irreversible with companies leaking their product value and becoming custom IT services organizations.

IT Services mindset is geared to serve the needs of internal or external customers, delivering value and going out of the way to deliver satisfaction. The product mindset, on the other hand is developed to serve the company's external customers in ways that creates value to both businesses. The difference between both mindsets are very profound and drastic.

We have also seen companies conceptualize great product ideas, but the services mindset amongst other things alters the business model eventually transitioning it into an IT services business. The return on scale, unit economics and value drivers are quite different between these two businesses. Once a product business ends up with services economics, its valuation is materially lower even at the same revenue. This results in eroding investor value and shareholder returns. Let us examine the reasons of value leakage and how the value destruction occurs gradually as the problems compound themselves over time.

Value Erosion: Key Issues

There are multiple reasons for product failures, but the issues stemming from transplanting an IT Services mindset onto a product company create a multi-dimensional compounding effect are amongst the hardest issues to overcome. If the executives, founders, and management are a cohort from the same backgrounds, they typically live in denial and operate the way they always have. We have also noted, trying to crack this problem by bringing in one or two executives from product organizations has seldom yielded optimal results given their inability to battle prevailing mindsets. Most lateral hires leave quickly to create value from products elsewhere.

Figure 1: Product vs Services Culture Divide

Product Strategy

One of the key reasons of product strategy failure is the urge to deliver everything to all customers, stakeholders, partners. In services where there are bespoke and artisanal elements involved, it is possible to get creative and go out of the way to satisfy specific client needs. Organizations forget that product strategy is about a deliberate, logical, and iterative approach to address specific target customers that product teams need to focus on. It is a specific market, specific problem to solve for a specific buyer. Trying to please everyone could lead to incessant shift in priorities creating custom instances of the product and breeding complexities over time.

Customer Requests vs Product Requirements

Customers are demanding by nature and they always ask for stuff given they are using the product. We believe that every request should be analyzed thoroughly, but every request does not merit a feature build. It would be poor product strategy to take every request and start building it into the product. These requests have consequences, diverting valuable engineering resources, creating regression testing and technical debt issues which could take years to unwind. Features created for one off customers, also impact user experience of others and spawn variants of the product. Hence full impact assessment of requests before committing is critical. If you are undertaking features to please one-off customers or to comply with a one-off RFP, your product strategy is off track.

Product Management

CEOs and Founders who have grown up in IT Services companies typically do not place enough importance on the product management function. Hiring a weak product manager is one of the major reasons for product value erosion, when a company is small one of the prerequisites for product managers is to be directly exposed to customer pain points and just not take orders from sales, customers or other stakeholders. Spending time with customers is the only way to understand them, their pains, the problems and conceptualize solutions. The IT services mindset of saying “yes” creates weak PMs and eventually a blame game ensues with fingers being pointed to engineering talent, management, customers, as velocity slows while cost and complexity increases.

While there are many reasons why product companies get derailed, the baggage of the IT services mindset is one of hardest issues to overcome

Product Culture

Poor product culture lacks the ability to build a product strategy and create a system of being reactive by becoming order takers and destroying innovation. Good product strategy is ingrained into saying “no” more than saying “yes” if requests are not aligned with the strategy. In a product culture, one understands the specific problems the product is solving, their customer, features and experiences driving competitive differentiation and delivering value. In a services mindset, it is typically in a craft mode with creative solutions being applied to solve for the flavor of the day and drive customer delight through bespoke solutions. The services mindset when transferred into a product environment can create existential problems for products, some of which may not even see the light of day eventually.

Figure 2: A hive mind stifles innovation

Loss of Velocity

As the IT services mindset manifests on product organizations, they start incurring technical debt in incremental fashion. Often, the architecture impedes rapid evolution and adaptation with no easy overnight fixes. Lack of a strong product management function further slows down the velocity. Slower velocity, architecture issues laden with technical debt will shift the problems downstream resulting in much of the heavy lifting done in the form of professional services. Releases become sporadic and inconsistent with more scalability flaws being left for professional services to address. Over time, more revenue shifts from product to professional services, creating unit economics mirroring services businesses. Note, that this is not to be confused with the configurability of the product, it is common to have software companies rely on 10-15% of professional services for configuration, integration etc. The professional services revenues we are referring to create bespoke discovery, intake specific requirements and create a custom version of the base product.

Lack of Innovation

As customizations grow, technical debt increases, velocity slows, and more work is shifted to downstream professional services – more bugs come in from product variants and versions impeding product maturity or stability. This phenomenon burdens the support and engineering teams pushing them into a reactive and firefighting mode. As time progresses and the services mindset prevails, innovation slows, and products fall behind competitors and support costs increase. More firefighting and engineering bandwidth issues add more headcount to professional services altering the entire business model.

Inefficient Go-to-Market Motions

Downstream shifting of value and larger economic value being generated from professional services creates misalignment with the go-to-market motion and function effectiveness making it inefficient. As products fall behind, incur delays, and become uncompetitive, the sales force must migrate to a relationship-oriented approach to protect and nurture key customers. Direct go-to-market motions with a heavy relationship-only sales approach (not to be confused with Account Based Marketing approach) further increase costs, impede scale, create margin pressure, and erode value.

> Product thinking always begins with the user and the problem. Products are marketed, while services are sold

Lack of Marketing Focus

The Marketing function is the custodian of the brand, its promise of value, the positioning of the product and owner of the motion running in close partnership with Sales, Product Management and Executives. Typical IT Services mindset when transferred to product organizations undermine its importance and fulfil many one-off customer requests not aligned with strategy or brand. The misalignment with the brand creates confusion in the market with customers, partners, analysts and ultimately leaves the unfulfilled promises from value leakage. In an ideal world, products are marketed while services are sold. In product organizations with prevalent IT services mindsets, marketing is reduced to a very tactical function with an objective to feed sales a few leads, this is a completely misguided and counterproductive use of a function which can create strategic value for the product.

The Market Reach Myth

Many executives bred and baked in the IT Services world also tend to believe that having a large professional network can create market reach and scale. Nothing can be more misguided than this. The juice of one's rolodex can at best help in creating the first few customers, after that scale is created through a pragmatic go-to-market engine. Scaling a product depends on the stability and strength of the product, the size of the problem it solves, the product-market fit and efficient economics reaching customers where relationships cannot take you. This sort of misguided thinking about product distribution causes CAC (Customer Acquisition Costs) to increase over time, breeding inefficiencies in sales, masking initial problems with the product and the product-market fit.

The Value Gap

There is nothing wrong with a well-run services business - some of the world's best management consulting firms, IT service companies at scale run as well-oiled machines and add a ton of value to their clients globally. However, it is a fundamentally different business, with different levers, unit economics, scale rates and valuations. There is a vastly different value associated with well-run services organizations which customers appreciate. However, a product organization which has eroded into a service organizations will not be efficiently run when benchmarked to the metrics of services organizations. Specifically, because they are unintended byproducts of upstream product issues and therefore deficient on service unit economics as well.

It is one thing to start an IT services business, run and scale with the right levers, economics, skills, talent, size, culture and structure while it is a totally different thing to erode from a product design into a services organization. Nothing else can destroy more value for founders, investors, and employees. Based on our experiences, we have simulated the value erosion waterfall (Refer Figure 3) prevalent in the industry today.

The erosion is usually a gradual process with each action having consequences on organization value, people, culture, and unit economics over time. Once the market motions start becoming complex, reversibility becomes a lot more challenging and requires drastic steps. A posture pivot while

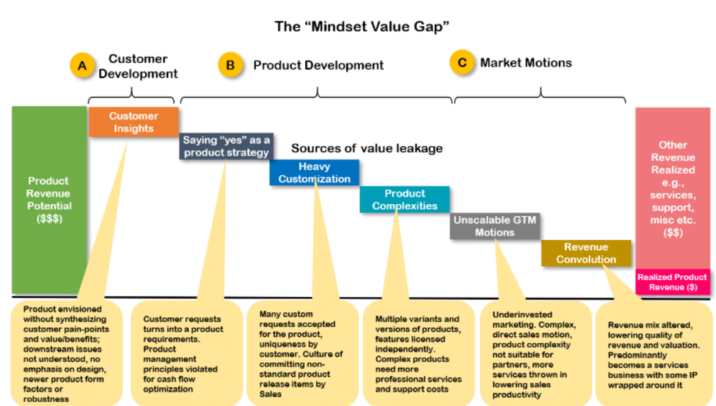

Figure 3: Leaking Product Value

possible, typically requires both talent and capital infusion.

Insights from the Industry

We also spoke to 30 executives, venture capitalists, board members, entrepreneurs, technology veterans and analysts and many of them corroborated our thinking stating many problems with product organizations can be corrected (of course the controllable aspects), but the baggage from an IT Services mindset and culture was very hard to fix. A lot of times, the extent of the damage, technical debt and value contamination was so high that things were beyond fix without a drastic overhaul and/or significant write-offs. There are of course early warning signs and symptoms which surface, one needs to quickly assess them, and course correct. With passage of time, some of these companies could be a lost cause on value.

Based on many of our conversations, we extrapolated common causes and frequency of observation from their point of view. Many of these observations overlapped with our observations while a few distinct patterns also emerged. We have outlined the findings from our network (Refer Figure 4).

Source: Based on surveying 30 VC, PE, Executives, Analysts and Entrepreneurs

Typical Root Causes	Industry Frequency[1]
Constant shift in priorities	Very High
Excessive technical debt	High
Founders disconnected from reality	Very High
Saying “yes” to every customer request	High
Ability of core leadership graduating from IT services orgs to unlearn and adapt	Very High
Lack of product leadership talent	Very High
Optimizing for cash flow, not value	High

Very High High Medium Low

Figure 4: Issues, Frequency, and Impact

It was also sporadically observed that these eventual services organizations or derailed product organizations were trying to brand a service or a framework with a trademark and trying to sell it as a product. However, for many of the reasons mentioned above, they did not scale or create value. The survey also brought forth a few other dimensions like lack of product manager empowerment, unclear roles, convoluted organization designs to safeguard the services mindset, misaligned incentives etc.

There is no magical solution to these issues, but to acknowledge the problem, identify solutions and confront them upfront. Many people brush off these issues as “typical start-up” hassles and by the time they understand the gravity of the situation, this mindset has usually eaten the business value.

We have observed that these issues could be reversible within a year or so of the company formation but get more complex with the passage of time and may become difficult to salvage. Investors need to perform the right due diligence upfront; boards need to address the issues as soon as they surface. A waiting game for issues to auto correct themselves almost never works.

Other Relevant Articles

- Anatomy of Software Graveyards
- Stalled Product Strategy: 8 Warning Signs
- The 'Product Vs. Services' Conundrum
- Product Management: The Art and Science of Hiring
- Anatomy of Go-to-Market Motions

About the Author(s)

Nitin Kumar is a two-decade veteran in the Hi-Tech industry. He has run multiple start-ups, scaled businesses in large organizations and run multi-billion-dollar P/Ls. He has spent half his career building and scaling products while the other half was spent scaling services business in large Management Consulting organizations. Nitin is also a Technology investor and board member who has closely observed the consequences of the value gap mentioned in the article. Considered a business builder, thought leader and pioneer of many innovative approaches. During his operating and consulting roles, he has turned around many software businesses and studied the software product declines closely.

Krishna Navalpakkam is an experienced business practitioner with a career spanning across the IT and OT industry sectors. He is currently the India lead at Schneider Electric's corporate venturing and business incubation initiative. Prior to this, he has held several positions at global companies based out of their offices in India, United States, France and Japan. His roles involved leading activities across the customer engagement lifecycle including corporate development, partnerships, commercial and business transformation and digital services. He holds a degree in Electronics & Communication Engineering from the University of Madras (India) and also has an MBA specializing in innovation and entrepreneurship from HEC Paris.