IBM GLOBAL BUSINESS SERVICES

The Innovation Paradox in the Telecom Industry

IBM Global CEO Study 2006

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in the Telecom Industry

"The business model we choose will determine the success or failure of our strategy."
– Global CEO Study 2006 telecommunications industry respondent

Introduction

As part of our Global CEO Study 2006, in which we interviewed 765 chief executives and business leaders on the topic of innovation, we looked more specifically at the views of the 46 telecommunications (telecom) executives who participated in the survey. Our findings show that telecom CEOs differ from their peers in other industries in two key respects: they put *much more* emphasis on new product development than business model innovation. And, they place *less* emphasis on their personal roles in spearheading innovation (see sidebar, *Organizational transformation*). Given that our analysis also shows a strong positive correlation between business model innovation and faster-than-average operating margin growth, telecom CEOs may therefore be underemphasizing an important means of adding value and increasing profitability.

Several factors probably account for the emphasis telecom providers place on product and service innovation. First, most of the industry leaders are making major capital investments in next-generation services over Internet Protocol (IP) networks and want to monetize their investments with new products and services as rapidly as possible.

Organizational transformation

Business model innovation is the transformation of an organization through the use of strategic partnerships and/or the realignment of an existing business model to reposition the business or extend its reach into new markets.

One such example is Apple Computers, which transformed itself from a PC manufacturer into a leading consumer electronics company at the start of the millennium, with the launch of the highly successful Apple iPod digital music player. It is now the world's largest digital music distributor through the Apple iTunes online music store. Apple managed this transformation not only through technology innovation but also by building partnerships with other organizations, including the major music studios and with some automotive manufacturers for the integration of the iPod with certain vehicles.

Second, they are typically large, complex enterprises with established cultures and operating principles, and in such environments it is very difficult to make or sustain far-reaching changes. They have already seen – and survived – the dotcom bubble, when numerous small companies launched new business models, only to go bust soon afterwards. Finally, they have moved away from doing fundamental R&D and have therefore relied on the leading equipment and application providers to innovate on their behalf.

However, as new entrants from the media, entertainment and Internet industries encroach on their territory and the competition becomes increasingly fierce, the incumbent providers will have to expand their innovation horizons. To a much greater extent, they will have to embrace new ways of doing business and collaborate with external partners – both equipment providers, and innovators in information and entertainment services.

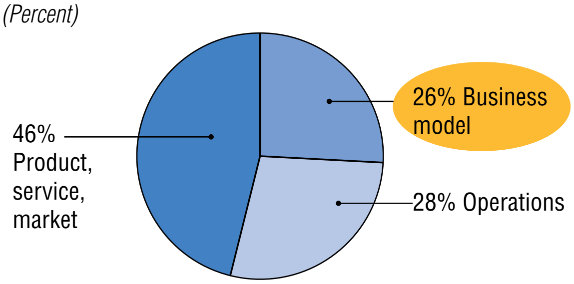
Business model innovation

The Global CEO Study 2006 shows that CEOs around the world still think new products and services are important and place less emphasis on business model innovation and operational innovation – that is, improvements in the effectiveness and efficiency of core processes and functions – which showed greater correlation with improved financial results (see sidebar, *Dramatically changing the business model*). Companies that have grown their operating margins faster than their competitors put *twice* as much weight on business model innovation as those that have underperformed their peers.

Conversely, telecom CEOs focus first on getting new products or services out of the door, even though 86 percent of those surveyed – more than in other industries – think it likely that a new business model from a competitor will result in radical changes to the landscape of the entire telecom industry. This suggests that there is an innovation paradox in the telecom industry: CEOs are *more* worried about the disruptive potential of new business models, but put *less* effort into business model innovation. They allocate only 26 percent of their innovation resources to business model innovation, versus 28 percent to operational innovation and 46 percent to the development of new products, services or markets (see Figure 1).

Figure 1. Average points allocated to the priority of business model innovation.

(Percent)



N = 46
Source: The Global CEO Study 2006.

Dramatically changing the business model
Bharti Airtel is India's leading mobile telecom service provider, with a subscription base that has grown from 8.2 million to 27 million over the past two years. Recognizing that, as the competition intensifies, it will need greater operational efficiencies and new revenue streams, the company has outsourced its IT and network management – which most telecom operators regard as core functions – to concentrate on marketing, sales and distribution.

The paradox is all the more difficult to explain when two other factors are taken into account. Focusing primarily on new product development is very unlikely to deliver a sustainable advantage because the leading telecom companies and their competitors have similar strategies and can therefore easily replicate each other's new offerings. It is only by focusing on business model and operational innovation that they can secure their future, as some of the most successful IT and consumer products companies (for example, Procter & Gamble) have been forced to do. Moreover, the industry regulators have generally favored players that enter the market with new business models.

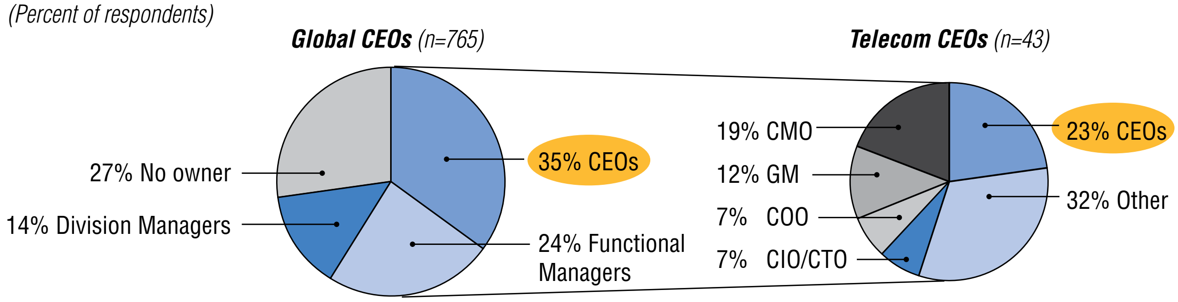
That isn't all. While telecom providers generally spend many months and years bringing new products and services with so-called "carrier-grade" performance to market, some of these new entrants act very fast and are prepared to experiment in a manner more typical of the consumer IT market. Google, for example, has succeeded in mobilizing users to road test, and sometimes enhance, early versions of its application offerings – clear evidence in support of the observation that innovation is often a trade-off between performance along dimensions the incumbent providers find critical (such as reliability), and benefits such as speed, simplicity, convenience, ease of use and low prices.[1]

Innovation requires orchestration from the top

Telecom CEOs also take less responsibility for innovation than CEOs in other industries. Only 23 percent of respondents say that they took personal responsibility for fostering innovation compared with 35 percent of the CEOs in our cross-sector analysis. Fourteen percent of telecom companies rely on committees and 14 percent on someone below C-level to manage their innovation, while nearly 5 percent do not assign responsibility to any specific individual or entity (see Figure 2).

Figure 2. Telecom CEOs assume less responsibility for innovation than their peers in other industries.

(Percent of respondents)



Source: The Global CEO Study 2006.

Yet business model innovation is the type of innovation that *most* needs the CEO's active involvement. Because it generally entails changes that are major in scope and scale, the CEO is the person best placed to initiate and sponsor such activity. This is borne out by our survey findings. Forty-two percent of the CEOs in our cross-sector study who rated business model innovation as their most important priority assume the primary responsibility for promoting innovation themselves.

External collaboration is indispensable

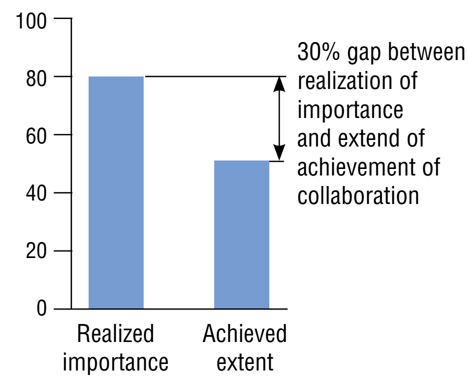
Telecom CEOs concur with their fellow CEOs in other industries that external collaboration is indispensable. Eighty percent of telecom respondents acknowledge the importance of collaborating with a wide range of external partners, especially as converging services and industries reshape the business scene. Indeed, they say that 51 percent of the ideas they develop come from external sources.

But are they as collaborative as they need to be? No. There is a marked gap between the significance telecom CEOs attach to collaborating with others and the extent to which they succeed in doing so. Only 50 percent say that they are strong collaborators (see Figure 3). They cite complex processes and inflexible infrastructures as two of the biggest obstacles their companies face in integrating new technologies and collaborating with external organizations.

However, if telecom providers are to deliver the full "quad play" of next-generation services over IP, they will need to manage a much larger portfolio of services than ever before and be more responsive to a broader array of customer requirements. This will inevitably require telecom providers to work with a much wider range of partners and suppliers, across the value chain. It will also require them to adopt a more collaborative approach to the integration of new technologies and embrace open standards.

Figure 3. There is a substantial gap between the perceived importance of collaboration and the extent to which telecom CEOs collaborate.

(Percent of respondents)



N=46

Source: The Global CEO Study 2006.

Conclusion

So how should the industry respond? Our global study produced five general recommendations for CEOs (see sidebar, *Expand your innovation horizons*). These can be translated into several industry-specific imperatives.

Every telecom provider needs to create a culture that encourages and rewards innovation, starting at the very top. It also needs to identify and design differentiated business models that are based on its core competencies and enriched by insights from other regions and industries. Lastly, it needs to integrate its technological and business infrastructure to create next-generation networks and operations that provide the flexibility it will require to close the collaboration gap. Only when it has done these things will the industry truly be in a position to realize the many exciting new opportunities for profit growth from innovative next-generation services and business models.

To find out more about this study or to speak with the Telecommunications Leader from your region, please send an e-mail to *globalceostudy@us.ibm.com*. To register to receive a copy of the complete IBM Global CEO Study 2006, please visit:

ibm.com/bcs/ceostudy

Expand your innovation horizons

- Defy collaboration limits. Collaborate on a massive, geography-defying scale. This will open up a world of possibilities for designing or redesigning products, services, processes and business models.
- Force an outside look... every time. Push the organization to work with outsiders more than insiders and embed the systematic use of external sources within the organizational culture.
- Think broadly, act personally and manage the innovation mix. Develop and manage a strategy that spans all three forms of innovation, particularly transformations of your business model.
- Make your business model deeply different. Find ways of substantially changing how you add value in either your own industry or another
- Ignite innovation through business and technology integration. Capitalize on new technologies by combining them with your business and market insights and using them to drive innovation.

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