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Preliminary analysis of the 2007
Telecom Industry Survey

Executive summary

Telecommunications



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Telecom switches emphasis

Preliminary analysis of the 2007 Telecom Industry Survey

By Stuart McIntosh and Ekow Nelson

Business model transformation is emerging as one of the key drivers of future value for telecommunications (telecom) providers. This is a change from 2006, when telecom executives in the IBM CEO Study 2006 placed less emphasis on business model innovation, concentrating instead on products and services innovation. Business model transformation will demand new, very significant distinctive capabilities. Therein lies perhaps the industry's greatest challenge: 2007 Telecom Industry Survey respondents still point to traditional sources of competitive advantage rather than some of the newer dimensions that will determine success in the markets they are now entering.

Some of the anticipated business model changes include: extending current capabilities to serve new adjacent markets created by the convergence of IT, media and telecom; varying traditional revenue models based on subscriptions for pre-integrated telecom services; and altering the operational model of telecoms to allow for more collaboration with external partners.

Business model transformation will encompass a re-definition of the scope of the traditional telecom market, alternative revenue and enterprise models and for each provider, a set of differentiating capabilities to match.

However, in describing their "distinctive capabilities," telecom executives continue to emphasize traditional strengths: it is perhaps doubtful, whether these will be sufficient to establish a competitive advantage in many of the new anticipated business areas.

As telecom providers increasingly deliver content services, there is an expectation they can gain a share of advertising revenues. Telecom providers have yet to establish how best to do this in practice; most executives in the survey are planning to partner with established online aggregators, such as Google and Yahoo! for advertising.

Overall, telecom executives expect the “revenue mix” to shift substantially over the next five years toward video, content/convergent services and advertising. However, revenues from broadband access and “voice” are also expected to remain critically important.

Network transformation and migration to next generation networks – critical to the delivery of convergent services – continues apace with only 7 percent of respondents saying their programs are either not on schedule or unlikely deliver the desired benefits.

Telecom executives also expect to drive revenues through improved customer service. The majority of executives in the survey are

focused on providing a consistent, high quality customer experience across all channels and enhancing their retail operations to attract new customers while increasing spending levels among existing ones.

Our 2007 survey highlights the telecom industry’s increased focus on new business models and business model innovation: both are required to drive the projected shift toward video, IT, content and advertising-based services and revenues. Perhaps not surprisingly, migration from the old to the new remains “work in progress,” with the ultimate outcome still very uncertain.

The 2007 IBM/Economist Intelligence Unit (EIU) Telecom Industry Survey

IBM and the EIU polled 252 executives from the telecom industry to obtain their views on some of the current business themes in the industry. These themes included future sources of value, customer service and revenue growth; the role and significance of advertising; the “distinctive capabilities” of the telecom provider; delivering on next generation network; service management as a differentiator and the future of global sourcing.

Forty percent of the respondents were drawn from Western Europe, 30 percent from North America, 20 percent from Asia-Pacific and 10 percent were from the rest of the world.

The majority of respondents were integrated telecom operators (32 percent), closely followed by mobile operators (32 percent). Fixed-only operators made up 11 percent of the sample and ISPs accounted for 8 percent. The remainder included Voice over Internet Protocol (VoIP) service providers, virtual network operators and others.

Almost a third (30 percent) of the survey sample came from the C-suite. Sixteen percent were senior vice presidents, vice presidents or directors. Another 8 percent described themselves as “head of business unit” and 14 percent as “head of department.” Sixty percent of the companies polled had global annual revenues of over US\$1 billion.

IBM and The Economist Intelligence Unit jointly developed the survey and EIU’s editorial team conducted the survey in June/July 2007.

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A change in focus for telecom

There is a perceptible shift in the telecom industry's focus away from cost reduction to business model transformation and revenue growth. Whereas only 34 percent of telecom providers singled out business model transformation as a source of value five years ago, 69 percent now believe it will be the primary driver of value in the industry going forward (see Figure 1).

Globally, revenue growth takes second place, with 65 percent seeing it as an important source of value. In North America and Asia Pacific, however, business model takes second place to revenue growth as a key source of value.

Many more firms globally also expect to reap synergies from mergers and acquisitions over the next five years than in previous years.

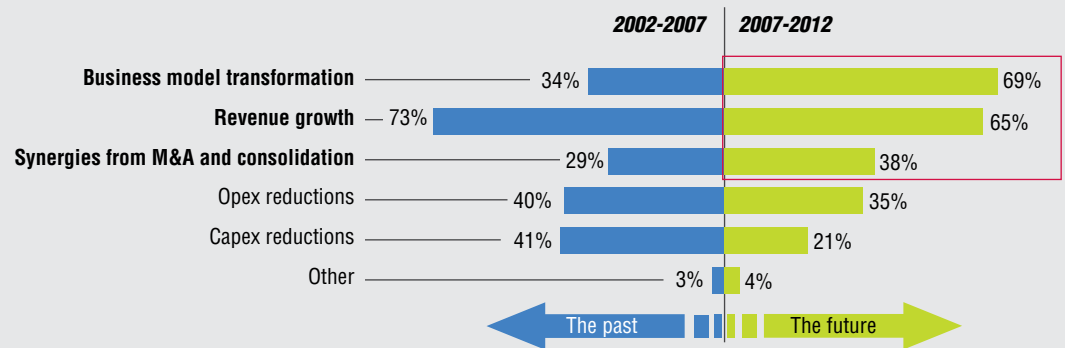
There seems, however, to be little expectation of further consolidation in the North American telecom market following the recent spate of mergers and acquisition: Verizon and MCI; SBC and AT&T, Bell South and Cingular; Sprint and Nextel. Synergy from consolidation is not among the top three sources of value in North America, or in Middle East and Africa.

Around the globe, however, fewer companies see managing operating expenditure as a means of creating substantial additional value.

Anticipated business model changes

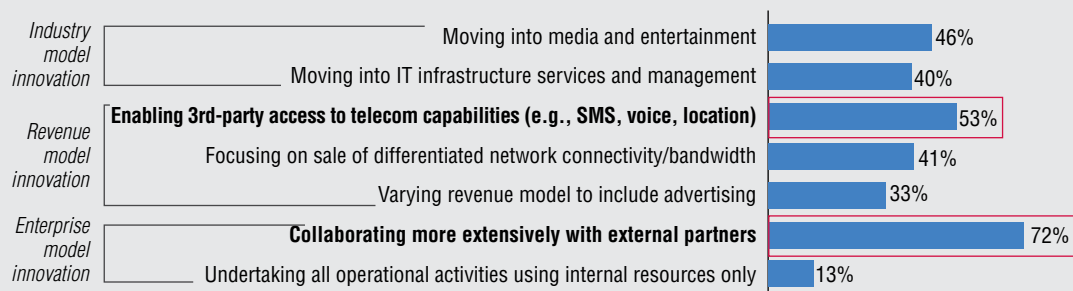
An overwhelming majority of telecom executives (72 percent) that selected business model transformation as a future source of value suggest extensive *collaboration with external partners* as one of the critical initiatives they have underway, or anticipate, as they transform their business models (see Figure 2).

FIGURE 1.
Sources of value in global telecommunications, 2002-2012.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=252).

FIGURE 2.
Anticipated business model changes in telecommunications global: 2007-2012.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=173).

Just over half of the telecom executives expect to earn revenues by making underlying telecom services components, such as messaging, location, presence, the ability to initiate and terminate calls and conference calls from anything other than a handset (for example, software applications) – pervasive to enable third-party service providers to embed these in a variety of applications – not just the standard telephone handset.

Globally, fewer than half of telecom providers have plans to move into IT services management or media and entertainment. However, a majority of fixed (60 percent) and integrated telecom providers (57 percent) anticipate moves into IT services / management and media/ entertainment respectively.

With digital convergence blurring industry boundaries, telecom providers now believe they can expand their addressable market to include areas of media and advertising that were once beyond their reach. Many telecom operators are investing in digital content with the expectation of offsetting declines in voice revenues.

The most promising areas of advanced content services are television and video. However, delivering all but the most basic digital content services over networks that were originally designed for voice communications and Web browsing is challenging, and telecom operators are having to upgrade their networks to compete. The returns on these network upgrade investments remain uncertain and are likely to be positive only in the long term.

Beyond upgrading the physical infrastructure, telecom providers will also need to acquire new sets of capabilities (for example, systems integration, managing a multitude of small third-party application providers, content acquisition and aggregation), to establish a basis of competitive advantage in these adjacent markets (such as media and IT) that have their own strong incumbents and equally formidable new entrants.

Anticipated business model changes will require new distinctive capabilities but telecom operators continue to emphasize traditional strengths.

Distinctive capabilities

In describing their “distinctive capabilities,” telecom executives continue to emphasize traditional strengths such as network coverage, availability and access to a large customer base (especially incumbent fixed providers in uncompetitive markets). Only about one-third of telecom executives identified product and services innovation or brand recognition/reputation as distinctive capabilities even as they contemplate moves into IT, advertising and media.

With consumer trends pointing toward a preference for choice over communications and content, and for flexibility and consumers’ control over their media experience, it is surprising that very few telecom executives recognize device control and access (8 percent), ease of use and simplicity (11 percent) and customer service (16 percent) as distinctive capabilities (see Figure 3).

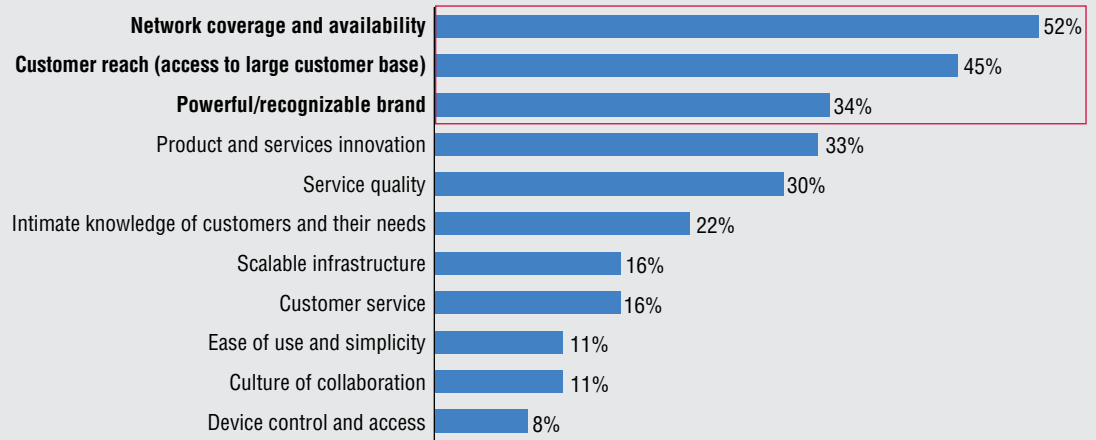
As telecom providers seek to change their business model, the sources of sustainable competitive advantage for new markets and revenue models are unlikely to be the same as those for traditional telephony.

Advertising

As with traditional media, advertising will be a critical component of digital content revenues but telecom providers still haven’t figured out how to attract “ad” share.

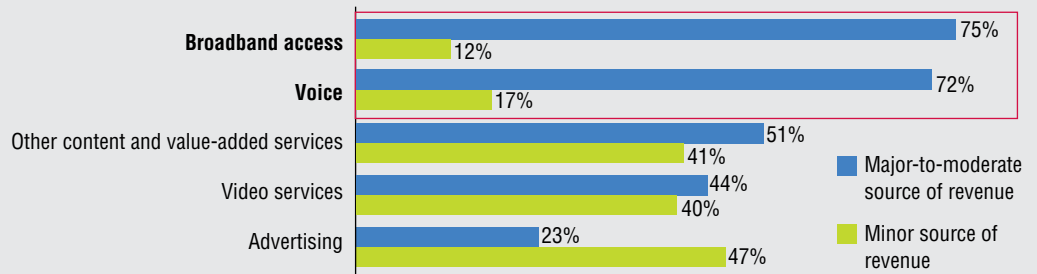
Although 23 percent of global operators expect advertising to make a major-to-moderate contribution to overall revenues, advertising and the ability to best target and deliver advertising messages are underdeveloped in telecoms for the digital/online world (see Figure 4).

FIGURE 3.
Distinctive capabilities of telecom providers, 2007-2012.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=252).

FIGURE 4.
Global Telecom Services Revenue Contribution: 2007- 2012.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=252).

As audiences fragment in response to the proliferation of digital channels, advertisers are increasingly seeking to better target and personalize marketing messages. As a result of the trend away from broadcast toward one-to-one, advertisers are demanding more individual-specific and involvement-based measurements, putting pressure on the traditional mass-market model.

Both of these major trends in advertising are favorable to telecom providers who have the ability to reach customers across a multitude of platforms, and a wealth of customer information and insights that could be used to better target marketing messages. Telecom providers are also well-positioned to deliver individual tracking information to improve overall the effectiveness measures marketers are demanding.

However, there is not yet a clear view on how best to exploit these advantages. The majority of operators indicate they are likely to work with established online advertising aggregators such as Google and Yahoo!, with a smaller number indicating that they expect to build their own advertising capabilities. Customer information and customer insight are perhaps two of the most critical distinctive assets that telecom providers have to exploit in this new market.

Future revenue sources

The majority of telecom executives expect the telecom “revenue mix” to shift substantially over the next five years toward convergent services; however, revenues from broadband access and “voice” will remain critically important,

Of those telecom providers that believe revenue will be a key value driver, the vast majority expect much or most of the growth to come from the sale of convergent services.

Most telecom executives expect revenue sources over the next five years to shift to growth areas such as converged services, bundled packages, mobile voice offerings, broadband access, content services and video services.

Bundled and discounted multi-play packages will continue to be an important source of revenue for fixed telecom operators (68 percent), presumably as they continue to battle it out with cable triple-play offerings, particularly in North America.

For mobile telecom operators, voice will remain the dominant revenue earner. However, 61 percent of mobile telecom executives expect broadband to be a major-to-moderate source of revenue. This suggests expectations of increased sales of wireless broadband in the form of 3G Internet cards or possibly even WiMAX, as it matures.

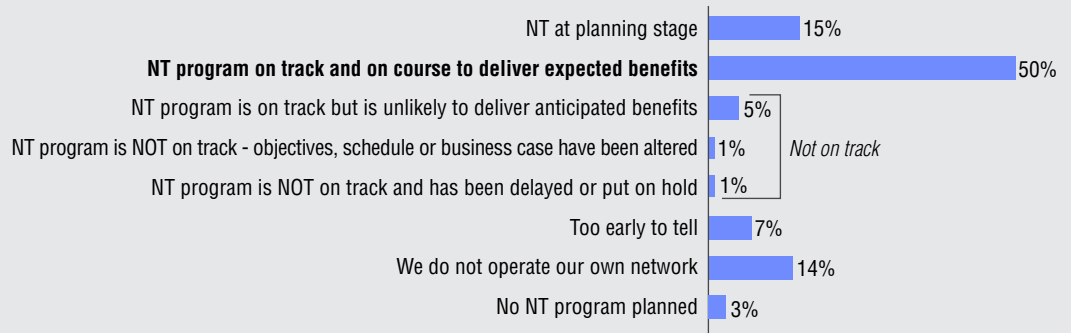
The majority of fixed and integrated operators, on the other hand, expect broadband access to be the major contributor to revenue, with traditional voice revenues becoming progressively less important.

Even so, telecom providers expect content services to contribute a significant portion of overall revenues. Forty-four percent of global telecom executives (50 percent of North American providers) are bullish about securing major-to-moderate revenues from video services. Over half of global telecom executives (68 percent of Asia Pacific and 56 percent of North American) expect non-video content services (ring tones, text voting, music downloads and the like), to make major-to-moderate contributions to revenues over the next five years.

Network transformation

Network transformation and migration to next generation networks – critical to the delivery of convergent services – continues apace with only 7 percent of respondents saying their programs are either not on schedule or unlikely to deliver the desired benefits (see Figure 5). Reported progress here is better

FIGURE 5.
Status of network transformation.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=252).

than expected and a significant improvement on comparable industry migrations in the past, such as the move from analog to digital.

In spite of this promising finding, many operators found the complexity of network transformation to be greater than expected and found next generation network technology to be less mature than anticipated.

Other challenges include the realization by many that they will have to maintain their legacy systems (alongside their new infrastructure) for longer than expected.

Even so, an overwhelming majority of the companies polled are optimistic that their network transformation program will complete within the next five years and deliver the desired results, with the average schedule for completion being three years.

Enhancing customer experience

The majority of telecom executives also expect to drive revenues through improved customer service. The key focus area for improving customer service is providing a consistent, high-quality, customer experience across all channels, and enhancing retail operations to attract new customers while increasing spending levels among existing ones.

Sixty percent of executives for whom revenue growth is the primary source of value believe such growth can be achieved through improved customer service. All operators agree that the most important criterion for

improving the customer experience is to improve service across all channels (that is, to deliver a consistent, high-quality service level).

Among the initiatives operators are working on to improve their interaction with customers are: building or enhancing the online retail experience; transforming the physical retail experience; and enhancing call centers with multimedia and Web-based collaboration tools. There appears to be a renewed focus on physical stores, reflecting the need to allow customers to experience new products and services first hand; this also reflects the broader shift in the consumer electronics market. About a third of telecom executives expect to leverage virtual worlds and social networks in their customer interactions.

The two top initiatives telecom operators are working on to enhance the end-to-end customer experience are: improvements to network quality; and improving time-to-market for products and services. In addition, just over half of integrated operators are working on enabling customers to use services across multiple devices and networks.

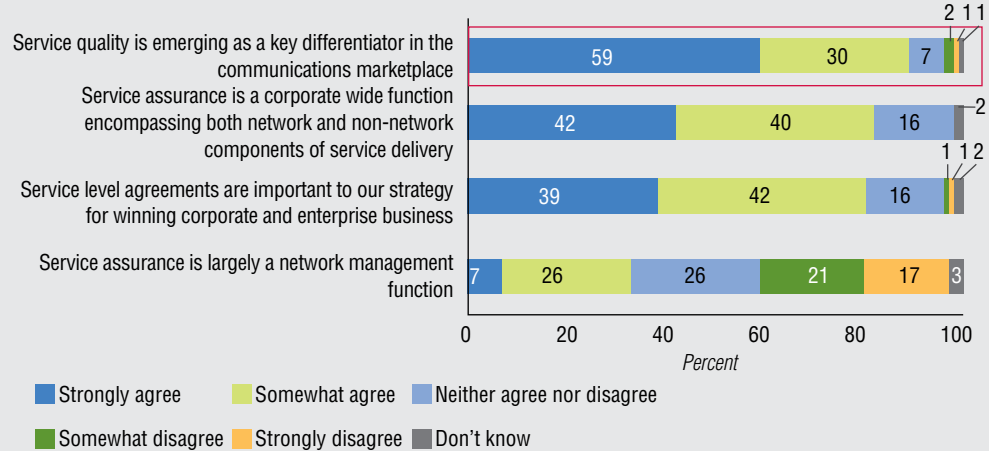
Service quality management

The ability to deliver a high quality end-to-end user experience for telecom and media services is emerging as a key area of differentiation in the communications marketplace.

More importantly, most telecom executives in the survey "strongly agree" that service quality is emerging as a key differentiator in the communications marketplace (see Figure 6).

Even though 89 percent of surveyed telecom providers strongly or somewhat agree that service quality is a key differentiator, just 28 percent cited service assurance as an important area of focus or investment.

FIGURE 6. Importance and scope of service quality and assurance.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=252).

This finding is contradicted, however, by the limited investment telecom providers are putting into service assurance. Only 28 percent of respondents strongly agree that service assurance / management is an area of strong focus or investment. It is no surprise therefore, that nearly half of the executives polled reported their organizations had no end-to-end service assurance capability.

As users demand convenience, flexibility and choice, end-to-end service management across multiple networks and devices will become an important area of differentiation.

Telecom providers continue to outsource to cut costs

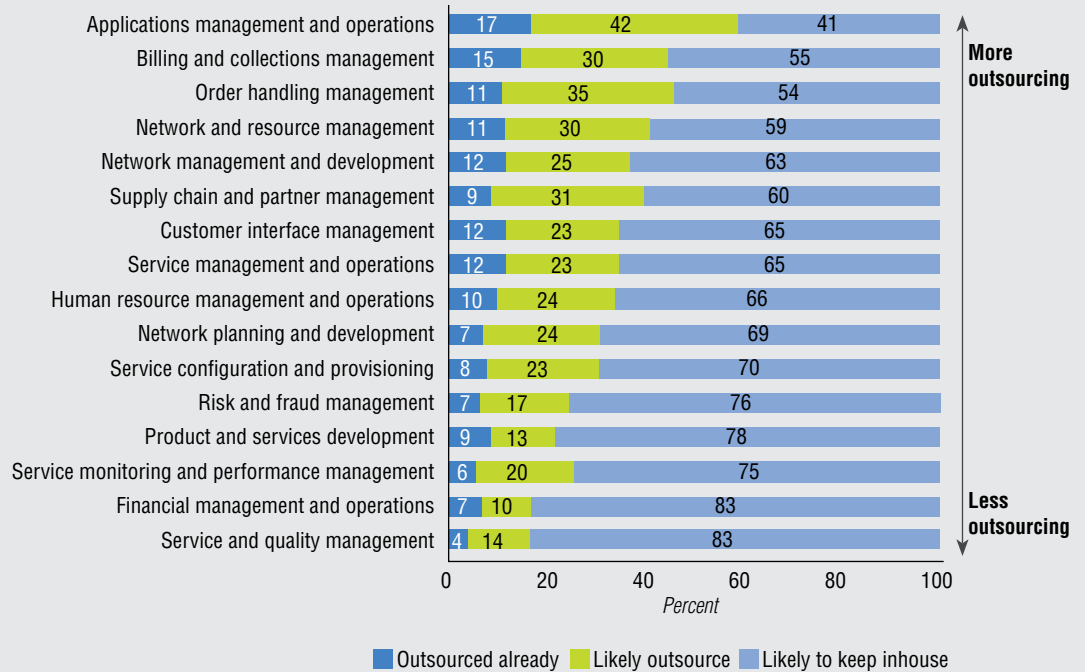
Telecom providers continue to evolve their operational models to improve business flexibility and reduce overall operational costs. The

majority of telecom executives in the survey anticipate an increase in the share of operational expenditure on outsourcing, from 5-10 percent currently to 11-25 percent over the next five years (see Figure 7).

Applications management and operations is the function that most firms are likely to outsource in the next five years. This is followed in sequence by order handling, supply chain and partner management, and billing and collections management.

Asia pacific operators appear keener to outsource a wider array of functions, including human resources, and network and resource management.

FIGURE 7.
Business functions and the potential for outsourcing.



Source: The 2007 IBM Institute for Business Value and Economist Intelligence Telecom Industry Executive Survey (n=252).

Conclusions

Over the next five years, telecom providers will be focusing primarily on the twin challenges of transforming their business models while growing their revenues. As revenues from traditional telecom services decline, the continual erosion of technology barriers to adjacent industries offers the prospect of new markets for telecom providers. Technology changes in themselves however, do not confer competitive advantage on telecom providers in the new converged markets. To be successful, telecom providers need to think about the applicability of their distinctive capabilities to these new markets.

As the share of the household expenditure for traditional communication services peaks, opportunities for growth in competitive telecom markets will, among other things, be achieved by taking market share both from traditional competitors and new entrants; extending the scope of telecom services to other parts of the household budget; and from alternative sources, such as advertising.

Telecom providers, however, need to be realistic about revenue expectations for advertising and content. The skills and capabilities required to compete in these markets are very different from those traditionally nurtured by telecom providers. Where possible, telecom

providers should exploit partnerships and collaboration with leading partners in each of these areas, but they must be clear about the value they bring to the relationship. For example, customer information and insight is critical to the future advertising revenues: Telecom providers need to be careful not to undersell these critical assets.

With the expected shift in the revenues toward convergent services, service quality will become critical. Service management capabilities for traditional voice services are not sufficient for the delivery of high quality converged voice and data services. Current levels of investment in this area, however, do not appear to match its growing importance. As telecom operators increasingly compete with media and other non-telecom providers, end-to-end service quality management across multiple networks, devices and content sources offer opportunities for differentiation.

As telecom providers transform their business models – redefining their role in the emerging convergent value chain (of IT, media and telecom) and exploring alternative ways of earning revenue – they will have to develop a set of complementary distinctive capabilities for sustainable competitive advantage.

To learn more about this IBM Institute for Business Value study, please contact us at ibv@us.ibm.com. For a full catalog of our research, visit:

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