

From product to service

How service orientation can generate long-term growth in the telco industry

A brief comparison of best practice

Mai 2010



Executive Summary (1/3)

- > Telecommunication services are undifferentiated and commoditized, competition is fierce, pressure on margins high, growth in established markets negative
- > Incumbent operators are desperately trying to differentiate through better service, challengers through price; the impact of new products and services on the top line is not visible
- > With the ever evolving technology and new and more complex products, incumbent operators have potentially a powerful asset they can leverage: their technical field service organization and capabilities
- > Companies in similar circumstances, e.g. computer or telecoms HW (like IBM, HP, Dell, Ericsson etc.) or printing (Xerox etc.) have demonstrated, that service can be an attractive "second leg" to stand on providing growth and better margins
- > In order to establish a service revenue stream in its own right, i.e. not as an addendum to a product, it is important to provide the right platform from which to grow

Executive Summary (2/3)

- > This means a dedicated unit, focusing on developing the service business, having full control over its entire value chain, freedom and leeway to develop its business, full management attention and support in doing so
- > The following pages describe some of these examples and draw conclusions and lessons learnt for the telecoms industry
- > **IBM**
 - In anticipation of a shift from hardware and software spending to technical services by their corporate customers, IBM announced an aggressive move away from its traditional hardware business and into services in the mid-1990s
 - Selling its loss making PC unit to Lenovo in mid-2005 marked a major step in this direction as did the 2002 acquisition of the consulting business of PwC

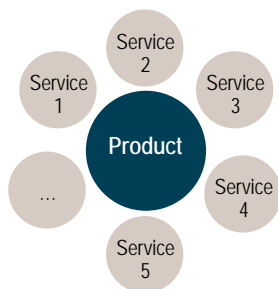
Executive Summary (3/3)

- > **HP** and **Dell** followed along a similar path with their acquisitions of EDS and Perot Systems in 2008, respectively
- > **Ericsson's** Global Services Business Unit, the market leader, accounts for approx. 38% of total revenues for the Group
- > **Nokia Siemens Networks** and **Alcatel Lucent** are pursuing a similar strategy as are **ZTE** and **Huawei** from China
- > In becoming service providers, telecom-equipment makers are taking a page out of the handbook of technology companies such as IBM and HP
- > "The way the telecom-equipment business is changing is very similar to the way the information-technology sector changed," says Andy Williams, who heads Alcatel-Lucent's service business after spending many years at IBM. "We're just about five to eight years behind" the information tech industry.

Delivering good services as part of a core product offering does not suffice as a stand alone differentiator in highly competitive markets

The notion of excellent service

Product-based services: services as part of core offering



"Enhancing customer experience by superior service support of product usage"

Key features of service excellence

- > Customer **segment-based optimization** of service levels vs. costs
- > Maximization of **service level flexibility**
 - Internalization of service level hygiene factors
 - Delivery of standard cost-effective services to low-value customers
 - Ability to offer maximum service to top-value segments and/or to price it to broader customer groups

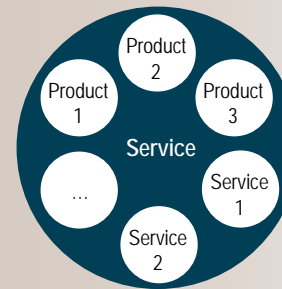


Core product/product-service offering markets increasingly become **commoditized** – excellent service as supplement not enough to grow and retain profit



Focus of this discussion paper

Services defining business models: a new growth paradigm



"Building sustainable and sizeable business around customer service offerings with products as their elements"

- > Understanding of customer base and company-related customer activities as the **key asset**
- > Services define new **business opportunities** and are a key dimension of strategic growth on corporate level
- > Ability to **acknowledge and monetize** company-related **customer activities**
- > Ability to develop a **sizeable new services business** diversifying from saturated and commoditized product markets



Business development based on new services is the definitive measure of service excellence

There has been a clear course of how companies moved to the service-oriented paradigm driven by declining core revenues and margins

The shift towards growth through services: market prerequisites and development path towards success stories

The market environment: what sectors have developed transformation cases?



- > Being a high-risk strategic move, growth through services has been **more focused in sectors where companies suffered particularly high commoditization losses** – with very clear business case vs. status quo
 - Engineered products and high-tech – former hardware producers, OEMs, etc.

The company: what had to be done to become a success?

Find opportunities

- > Explore **product-related and adjacent customer activity chains**
- > Find **value gaps and develop offerings**, closing them and/or redistributing value contribution between company and customer
- > Evaluate options and **formulate overarching "growth through services" strategy**

Internalize new strategy

- > Inventory customer-related assets and capabilities and **reorganize towards new service strategy**
- > Develop **new skillset** (above all, service innovation and delivery, people and reward management)
- > Ensure shift from product-centric to **service culture**
- > Acquire and develop partner ecosystems to ensure **fast scaling**

- > As with any bold strategic move, success required **innovation and execution** – particular challenges due to significantly **different cultural and competence imperatives** of a services-centric company

Telcos need to learn from other industry best practices to gain a competitive edge in and expand beyond their core markets

Growth through service success stories, situation in telecoms and key questions

Strategic growth through service: success stories

- > An increasing number of companies have redefined themselves and significantly outperformed the markets by growth through services



Relevance to telecoms: the current situation

- > Not yet feeling as heavy a press on margins, telecoms are only starting to develop service-oriented business models beyond their traditional offering



- > To date, the definitive sizeable service-centric model pursued by telecoms best practices is IT solutions and services for large corporates (e.g., BT, T-Systems, Orange/Equant, AT&T)
- > Growth through service in other segments is in the experimental 'piloting' stage – telecoms are much slower-paced than their Internet/IT/IS rivals

1 How have these companies who really achieved exceptional growth through service reorientation empowered and reorganized themselves towards this goal?

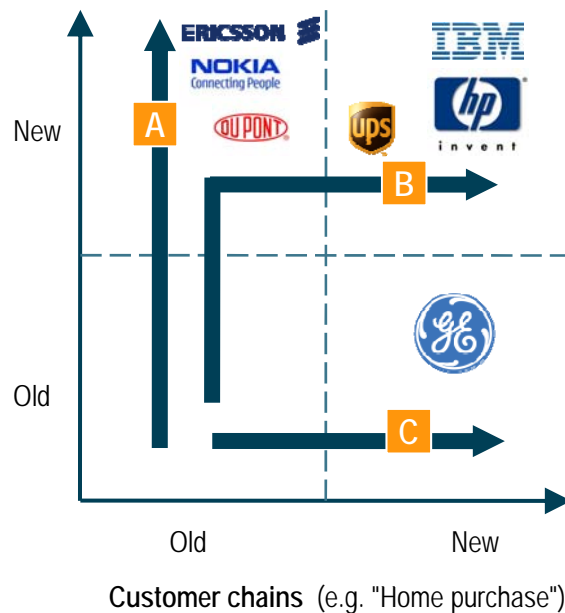
2 How can telcos better differentiate themselves via services using the cross-industry best-practice experience?

Previously product-focused companies have used different strategies to succeed in a service-driven environment

Overview expansion into new customer activity chains (schematic)

Selective successful service transformation cases

Customer activities (e.g. "The purchase decision")



Service transformation: overall description

A Capturing new customer activity/creating new customer activity within core activity chain by services

I ERICSSON > Took over network design, deployment and maintenance activities from clients by offering these services as well as network consulting

II NOKIA
Connecting People

III DUPONT > Developed into facility management services provider from its painting product expertise

B Moving on from core product-based solutions towards extended portfolio of professional services

IV IBM

> First developed a comprehensive technical services and IT integration portfolio, then moving on to BPO services ("On Demand Enterprise", "Agile Business")

V HP
invent

VI UPS

> Moved from traditional parcel services to total supply chain solutions

C Rolling out successful service transformation experience to new business units/customer groups

VII GE

> I.a. transferred successful medical services business model to other industries (e.g. aviation, power systems)

Three key learnings can be derived from successful cases of transformation towards growth through services

Organizing towards growth through services: overview of key learnings

A Building up from solid competences and assets

- > Successful new services did not begin with entering completely new turf
- > Companies started developing service-centric business models by extending relationship with existing customer base leveraging
 - Superior customer knowledge as key asset
 - Customer proximity and delivery competence



IBM GS initially developed from hardware after-sales service units



UPS developed from several product-based service units via subsequent acquisitions in various regions

B Setting up organization: services as separate units

- > New services have been developed in separate organizations for a number of reasons
 - Developing distinctive growth-and service-oriented culture
 - Creating possibility for product neutrality
- > Services set-up either as front-line or as innovation and delivery-focused organizations
- > Often separate 'talent pools', e.g. professional services, units created within service organizations

➔ Overall setup identical in most cases, setup within service organizations can have specifics



C Ramp up: developing necessary skills and scale

- > New service-specific processes required, above all, service innovations process to ensure fast scalability of process and time-to-market
- > Extensive partnering and M&A activity to rapidly achieve scale and make services a sizeable business – with inevitable integration problems and risks



Service innovation process for scaling service offering to a broad array of customers



Numerous acquisitions with varying degree of success

Successful new services did not begin with entering completely new turf, but depend on owning their own services value chain completely

Building up from solid competences and assets: selected examples

Evolution to Global Services

- > Accumulated service expertise within product units via operating large government IT systems
- > Transformation from a business division into Integrated Systems Solution Corporation
- > IBM Global Services: rapid expansion in the IT integration and consulting services
- > Development over existing customer base into new markets: the on-demand strategy, focusing on business process optimization and consulting
- > Further service focus by organizing into Global Technology Services and Global Business Services



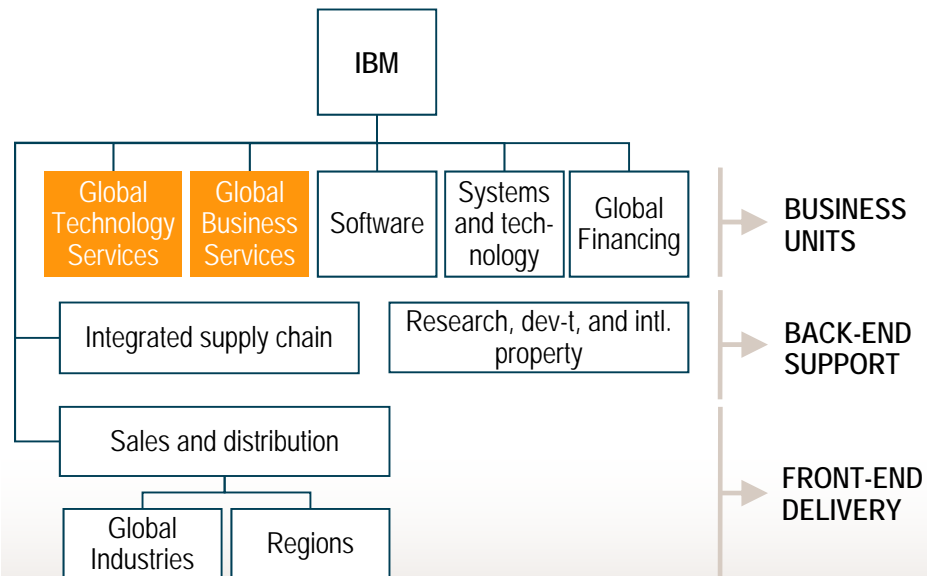
Evolution to Total Supply Chain Solutions

- > Standalone development of small service operations within the organization :
 - World Wide Logistics unit
 - Service Parts Logistics
 - World Wide Dedicated Services
 - UPS Truck Leasing
 - UPS Consulting
- > Expansion of product portfolio and consolidation of existing service resources into UPS Supply Chain Solutions
- > Reorganization and major M&A effort (16 key acquisitions to develop scale and growth)

IBM organizes services as stand-alone business units; segmented front-end organization focused on sales and customer relationships

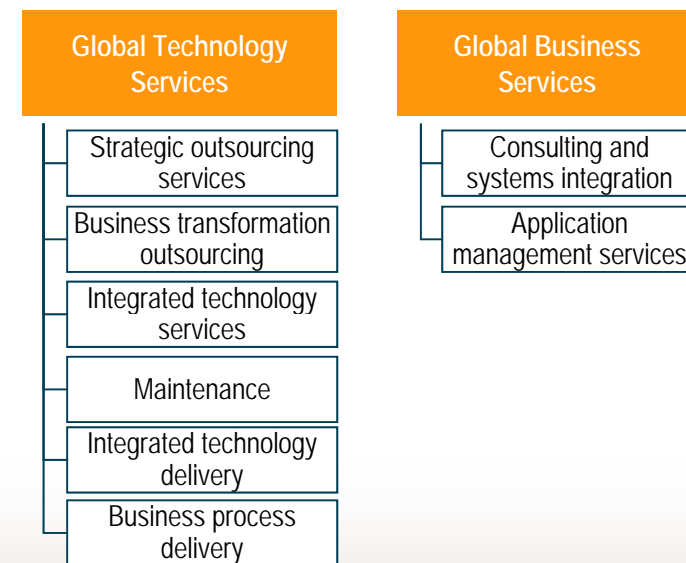
Setting up service organization: overview **IBM GLOBAL SERVICES**

Overall organizational setup



- > IBM organized into 5 business units and a global delivery unit structured by segment-region principle
- > Dedicated fully accountable service companies: Technology Service and Business Service
- > Service organization organized by solution type, further on breaking down by industrial segments

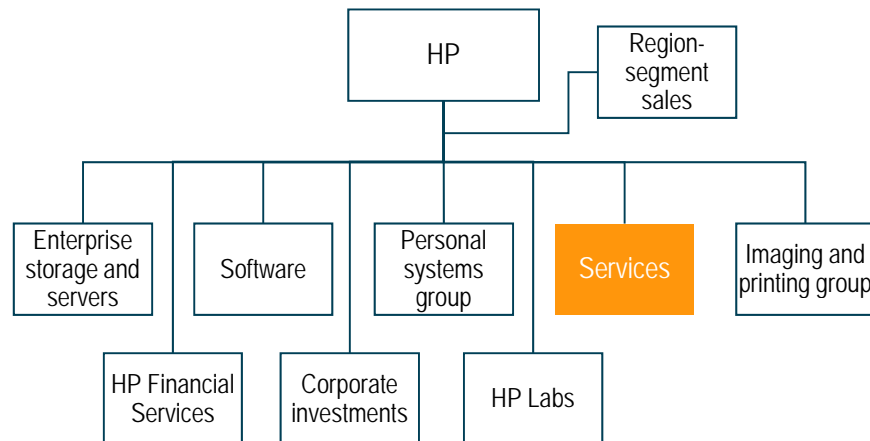
Service organizational structure



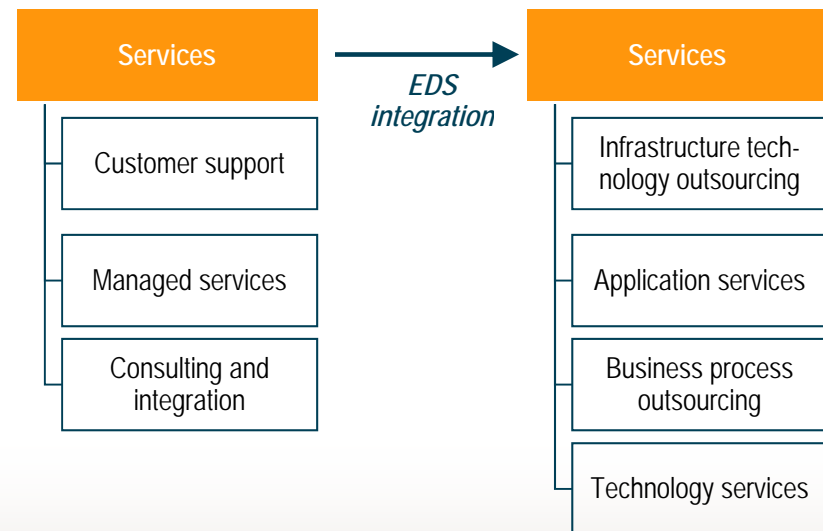
HP organized and grouped services into one dedicated company

Setting up service organization: overview HP

Overall organizational setup



Service organizational structure

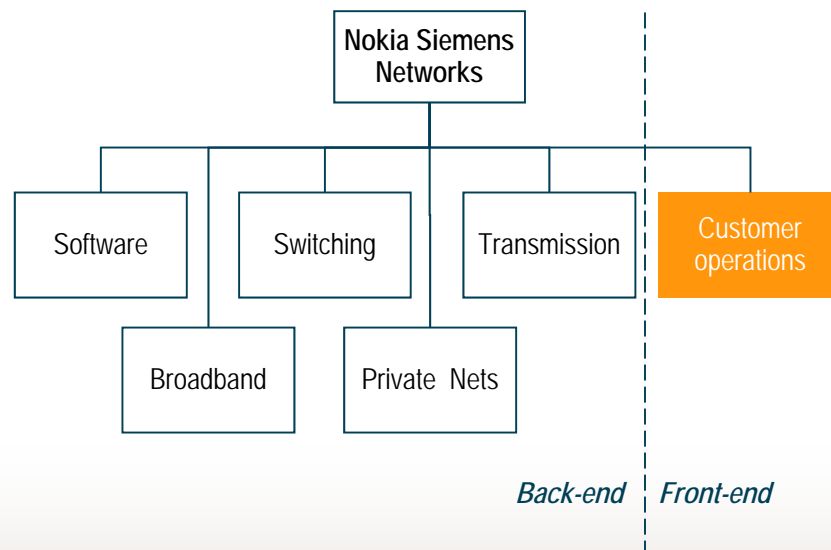


- > 7 business units and a regional organizational matrix
- > Services centralized into 1 business unit; major reorganization after integration of EDS
- > Service organization organized by solution type, further on breaking down by industrial segments

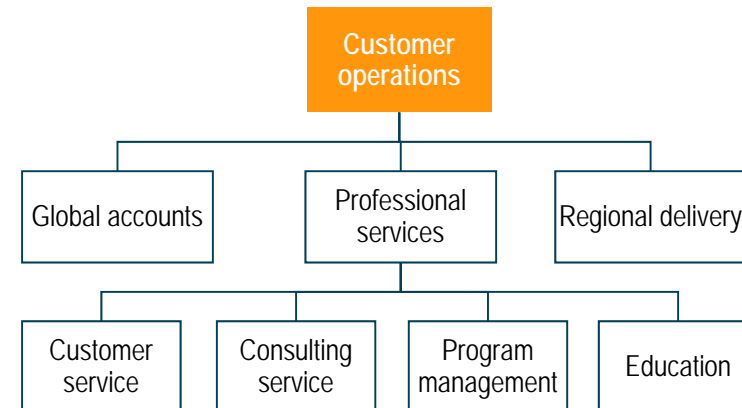
Nokia develops its services business in the front-end customer operations unit, having consolidated it with delivery units

Setting up service organization: overview **NOKIA SIEMENS NETWORKS**

Overall organizational setup



Service organizational structure

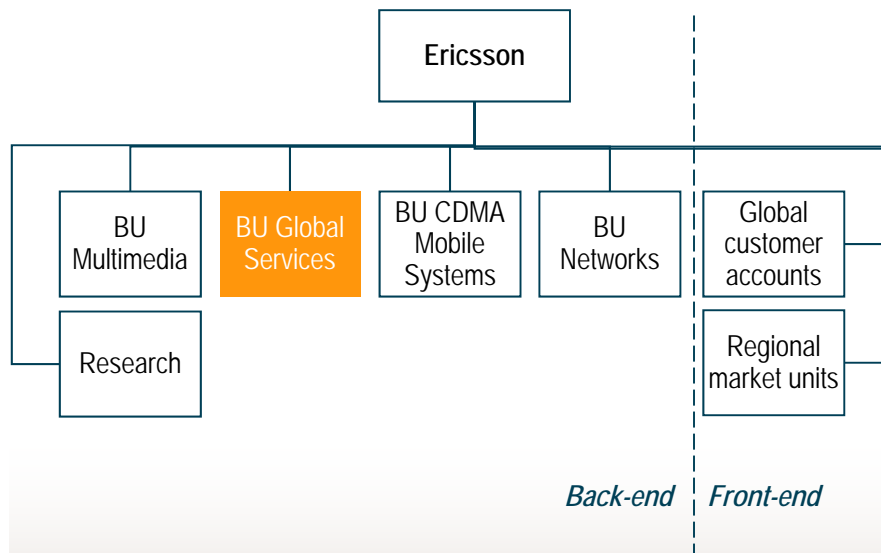


- > 1 customer-based front-end service unit with all the services consolidated – from maintenance to consulting
- > Within the customer operations unit delivery is organized by customer groups (global accounts and regional customers), dedicated Professional services organization

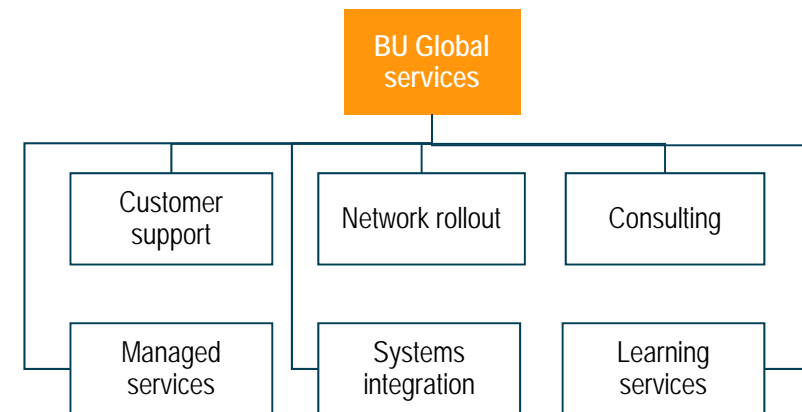
Ericsson organized its services in a dedicated business unit performing customer relationships via separate entities

Setting up service organization: overview ERICSSON

Overall organizational setup



Service organizational structure

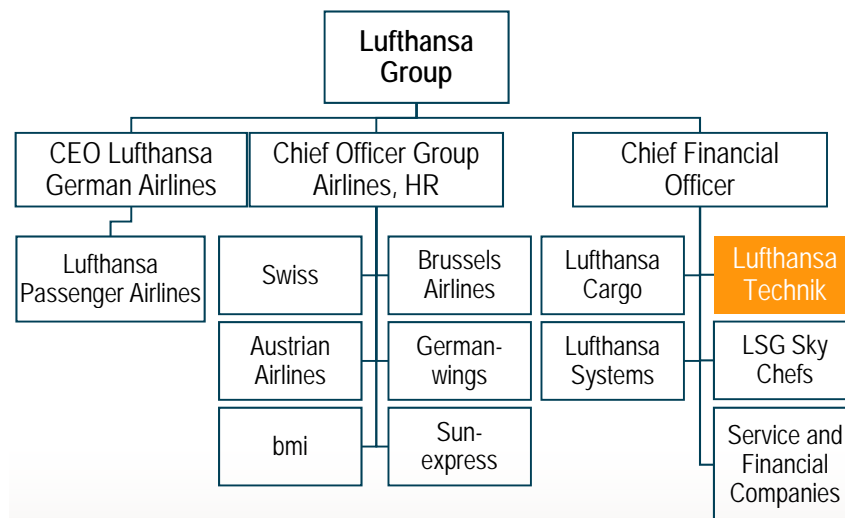


- > Consolidated back-end service business unit structured by service types
- > Clear front-end definition for sales and customer relationships based on key accounts and regions

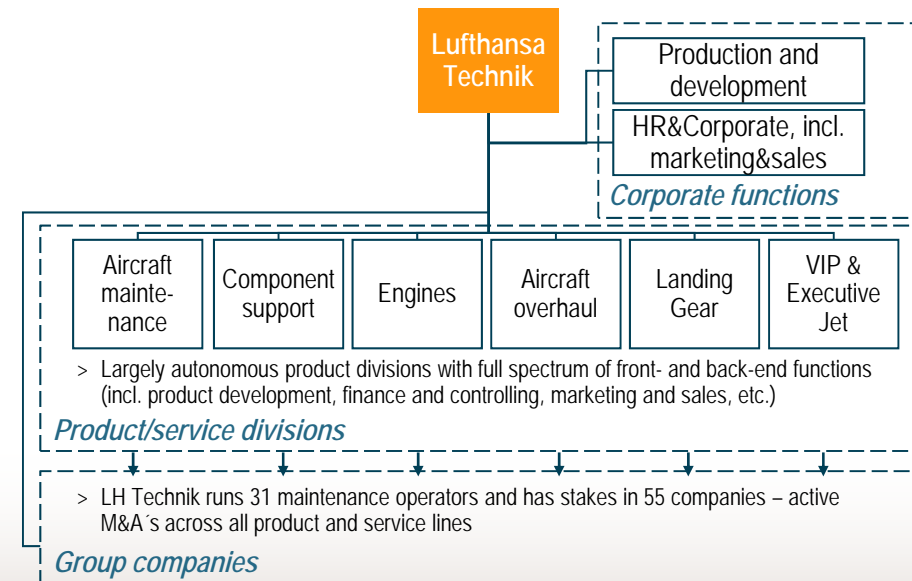
LH Technik run in a decentralized way, with most sales and delivery capabilities down on the level of divisions/division business units

Setting up service organization: overview LUFTHANSA

Overall organizational setup



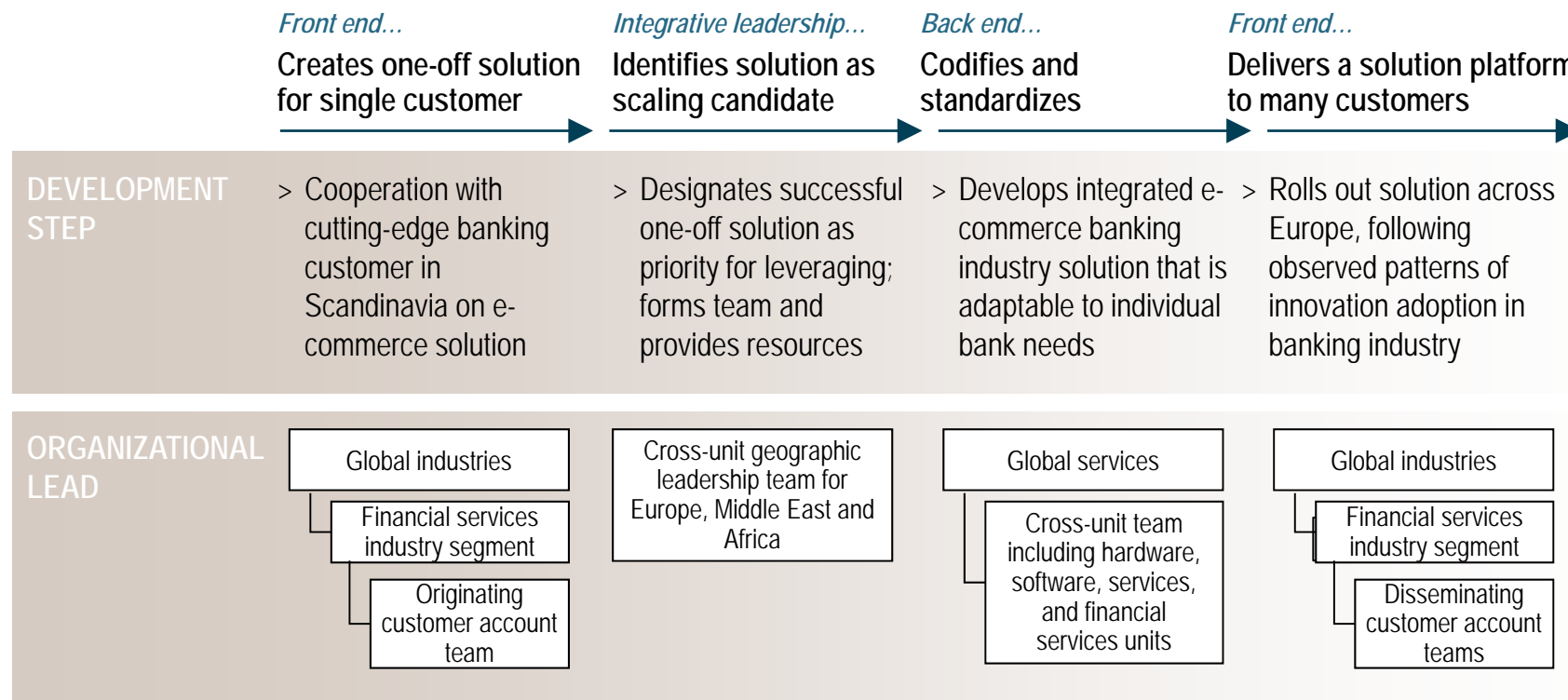
Service organizational structure



- > Dedicated technical service group of companies established in 1994 to further diversify Group's business in the competitive markets
- > Service organization marked by rapid growth of business and constant M&A activity – organizational consolidation perceived as a staged effort, with many divisions/daughter companies still functioning in an autonomous way

Successful growth through service requires a robust service innovations process for quick scaling and control of the value delivery chain

Service innovations process: example IBM

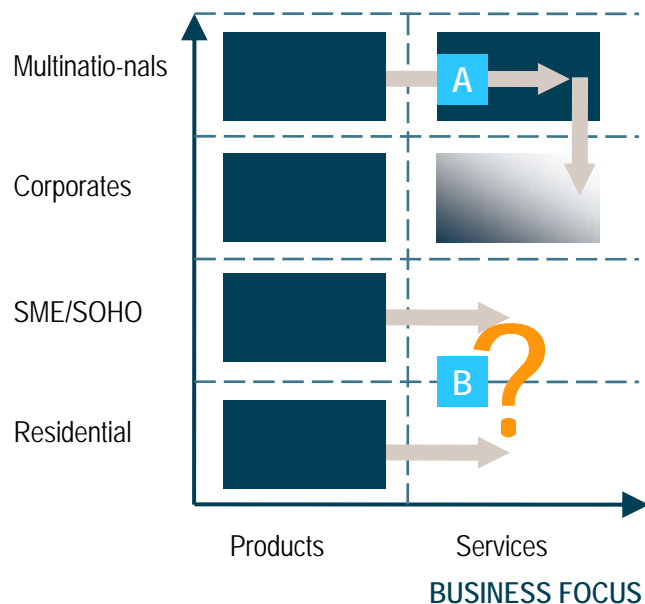


Telcos pursue growth through services only in the large corporates segment – service differentiation in mass segments the next step?

Organizing growth for new services by telcos: overview

Product vs. service orientation in key telcos' business segments

CUSTOMER SEGMENTS



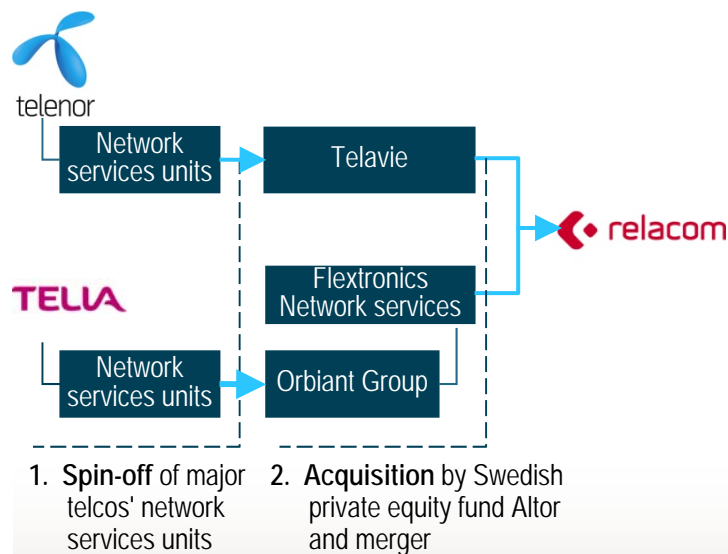
Service transformation: overall description

- A** Development of separate communications and IT solutions and outsourcing businesses for the global market of large corporate clients
 - > Best-in-class telcos have reorganized towards dedicated solutions businesses for large corporates – BT Global Services, T-Systems, Orange Business Services, Verizon Business, AT&T widely cited as most successful cases
 - > Development of service business for large corporates even in case of telcos proves the case – dedicated services organizations necessary, on top of existing corporate clients business units – as hubs of service culture, innovation and integrated delivery
- B** Growing through services in mass (residential and business) markets
 - > Telco's are only starting to explore the potential in the mass segments - on the one hand there is more complexity of scaling/rolling out services to mass markets; however, many enabling technologies are already in place
 - > Two major areas pursued as of today:
 - Experiments with new service business models via M&A's or separate incubation (strategic/equity participation with limited integration into core business) - e.g. acquisition of Terra Networks by Telefonica, partial separation of service areas into new companies and acquisitions by Swisscom (Alphapay, Calex, acquisitions of CoComment, Evita, etc.)
 - Development of partner ecosystems to get more presence in communication based services (content, e-commerce, IP communications etc.)
- ➔** Local efforts may be not enough to make a meaningful business out of services for mass markets – rethinking overall strategy and organization necessary?

Although still rare, successful cases of growing through services in telecom mass segments are starting to appear

Successful service-centric business models in telecoms: case Relacom

Background



Business model overview

➔ Independent provider of network services to operators, corporate and residential clients

relacom@networks

- > **Clients:** Fixed and mobile operators, network equipment producers
- > **Services:**
 - Construction: project management, site management, design and technical planning of networks
 - Installation: network construction, hardware installation, start of operation
 - Maintenance: administration, repairs, optimization

relacom@office

- > **Clients:** Business clients from telecoms and other industries (e.g. Volvo)
- > **Services:**
 - Telephony: Operating fixed and mobile applications of clients
 - IT, networks and security: operating of network infrastructure, administration and optimization

relacom@home

- > **Clients:** Private clients
- > **Services:**
 - Installation: field installation of broadband and telephony
 - Maintenance: customer care in case of network problems

- > Although currently primarily concentrated on working with telecoms operators, Relacom was one of the first to apply the service-oriented business model to mass segments
- > An extremely high-growth company to date: since its foundation in 1998, Relacom's revenues grew from EUR 5 m to > EUR 1 bn in 2008

Telcos, therefore, should consider growing through services via a focused effort on corporate level

Organizing growth for new services by telcos: overview

- > In order to leverage further strategic growth opportunities, telcos should consider an option of developing a dedicated service organization (company), which has control of its entire value chain, primarily focusing on multiproduct communications services for mass segments
- > Successful service companies do not start this from scratch – these service organizations should be built up on the basis of existing units/companies and businesses with the best-suited set of service assets and capabilities
 - Customer knowledge
 - Service development, standardization and roll-out capabilities
 - Complete service delivery
- > The primary focus of new service organizations should be service innovation excellence and ability to scale customer solutions, rapid growth orientation and PMI capability, excellence in service delivery
- > Customer front-end responsibility (marketing and sales) should be placed into new service organization