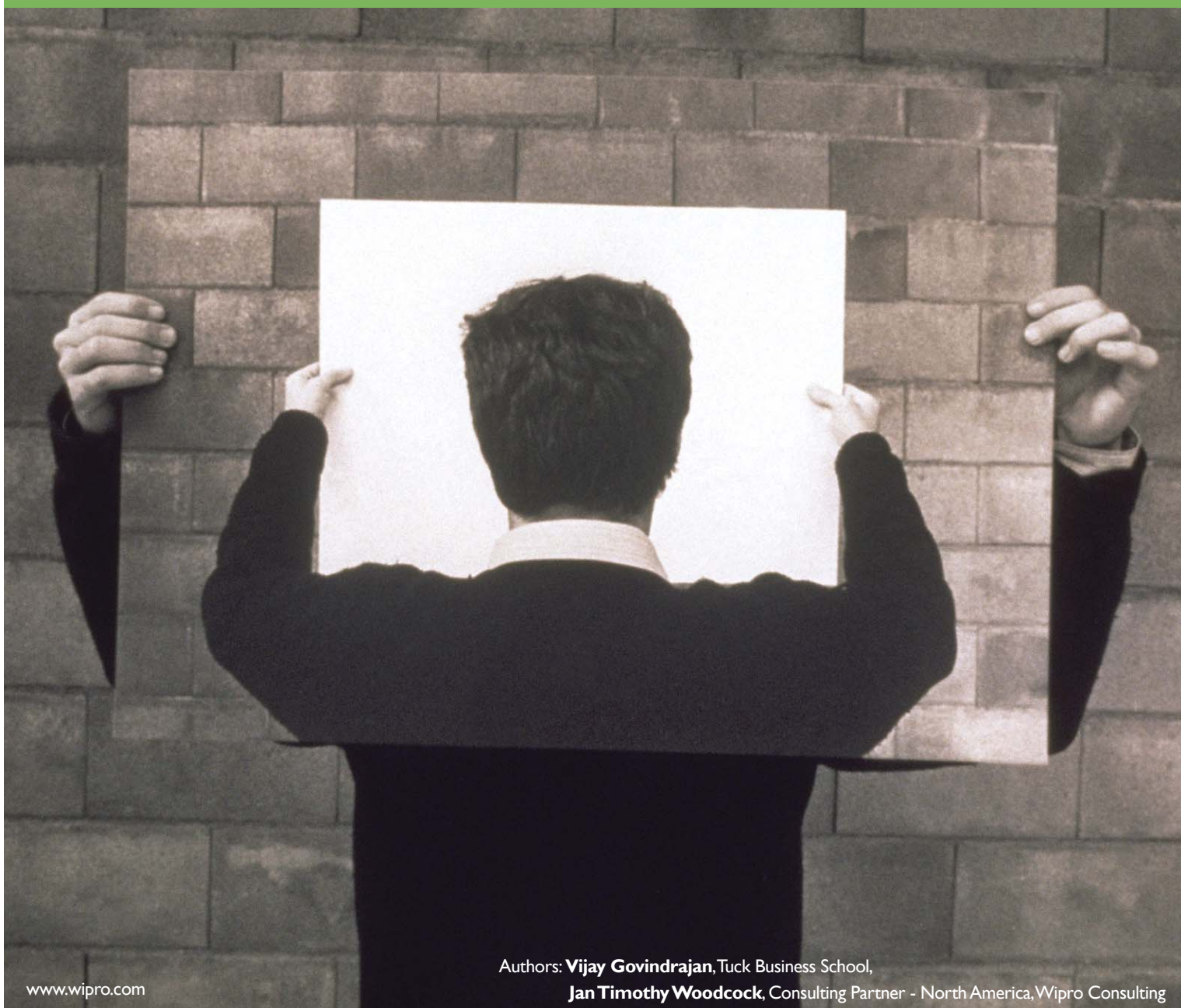
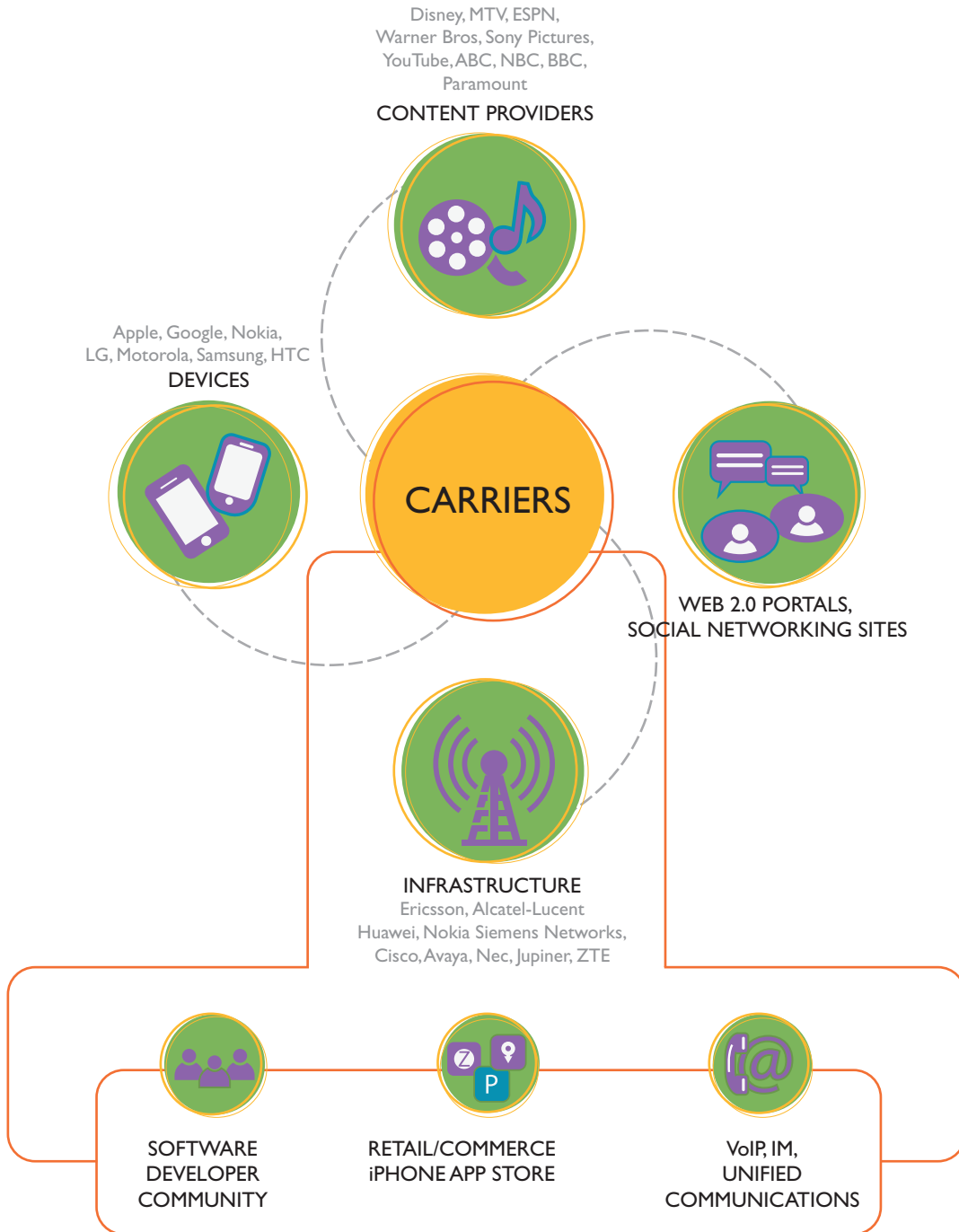


MOVING FORWARD IN REVERSE: WHY U.S. TELECOM COMPANIES SHOULD FORGET THE PAST



Navigating Social Media

We do not envy U.S. telecom CEOs. At a time of rapid change, potent forces chip away at their traditional business model. Surrounded by device makers, content providers, social networks, and an array of disruptive technologies, the carriers face a daunting challenge. They must find a way to transition from owning and operating so-called “dumb pipes” to creating new portfolios of smart network services.



Source: Gartner march 2010

From Dumb Pipes To Smart Services

Owning an infrastructure of dumb pipes used to be a very good thing. The pipes were the heart of the business, a source of healthy rents and tolls from all the voice traffic that flowed through them, and telecom carriers were at the center of almost all real-time communication. They now risk becoming marginal. To give one simple but stark example, the Apple iPhone runs on the AT&T network. It's likely, however, that most iPhone users feel more like Apple's customers than AT&T's. For everything they like about the iPhone's versatility, interface, and apps, customers credit Apple; for the dropped calls and dead zones, they blame AT&T. It's a win-win for Apple. Not so much for AT&T.

It is hard to overstate the difficulty any business faces in abandoning the way it has traditionally defined itself. Nonetheless, in order to turn things around, U.S. carriers will have to leave behind their traditional devotion to infrastructure ownership, and instead embrace a new business model.

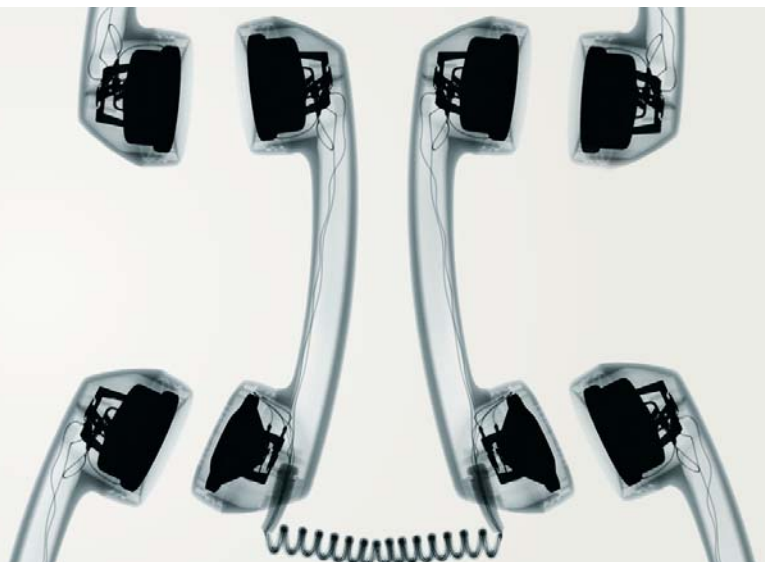
We would like to propose a solution. In a rapidly changing industry ecosystem, heavy investments in hard infrastructure can burden balance sheets and limit flexibility. We believe that U.S. telecoms should re-architect their operations along the lean, agile lines of a virtual organization – one built for 21st century opportunities. Though such a transformation isn't easy, telecom CEOs can draw useful lessons from an example of what's known as “reverse innovation” – breakthrough thinking that originates in emerging markets, and yet is powerful enough to be applied in the developed world. Case in point? The growth of India's telecom market.

To say that the Indian market grew fast would be an understatement. Between 1994 and today, the percentage of the population with telecom services grew from less than one percent to nearly 53 percent. Over the past decade, subscribership grew from six million to nearly 690 million telephones (land lines plus mobiles), a 35 percent compound annual growth rate. That would be astonishing even without factoring in the market constraints of an underdeveloped and unreliable electric power supply; and a vast, poor, and dominantly rural nation outside of the major urban centers.

Indian telecoms staggered under the cost burden of building out the network and keeping up with an overheated demand for service, as the government liberalized regulatory policies to stimulate market growth. Moreover, because competition for new customers was so cutthroat, the telecoms priced calling plans at rates that didn't cover their costs.

Something had to give. Bharti Airtel, an entrepreneurial upstart whose competitive strengths lay in marketing and customer acquisition, was first to recognize that the burden of building infrastructure was diluting its core advantage. Therefore, in 2004, it developed a strategy to outsource network installation, maintenance and service to Ericsson, Nokia, and Siemens; and to have IBM take over its internal IT systems and services. These moves got Airtel out from under the enormous – and continuous – upfront investments the rampant market growth was driving. The tradeoff enabled them to focus on what they were best at. Another Indian provider, Aircel, has adopted a similar model working with Wipro and Alcatel-Lucent.

“Reverse Innovation” – breakthrough thinking that originates in emerging markets, and yet is powerful enough to be applied in the developed world.



Outsourcing is a well-established hedge. With increasing speed, yesterday's core becomes today's commodity. But even mature technologies serve the needs of important customer segments. Once firms identify non-core activities and assets that can safely be managed by capable third parties, they accomplish these valuable economies:

- Offload the burdens of non-core network ownership (maintenance, repair, and replacement of infrastructure);
- Pay only for the services they and their customers consume;
- Reserve more enterprise capital for investment in core activities;
- Liberate management bandwidth to focus on highest-value strategy;
- Structure contracts (like Airtel's deal with IBM) that eschew fixed fees or "time-and-materials" models and instead include profit-share incentives making service providers, in effect, "partners" in the client's success.

Once Bharti Airtel made its move, other Indian telecom companies soon followed suit with deals of their own. Freed from the management drain of network and other infrastructure issues, the carriers innovated a variety of service offerings tailored to Indian customer preferences.

Certainly, the Indian market differs in important ways from markets in the United States and other developed nations. And Bharti Airtel, with its entrepreneurial roots and little previous experience in telecom was ideologically unconnected to past industry practice and identity. Nonetheless, we firmly believe that some of the same sorts of benefits Airtel and its competitors achieved from network outsourcing are available to U.S. telecoms – if only they can let go of the past and find inspiration in reverse innovation!

In fact, one U.S. telecom has already made such a move. Sprint Nextel recently inked a seven-year deal to outsource operation of its networks to Ericsson, a contract said to be worth \$5 billion. European wireless carriers are negotiating deals in growing numbers. In the regions where such deals occur, there is a snowball effect that typically produces greater economies of scale for both clients and providers.

But we believe that the main – and most strategic – benefit U.S. carriers will realize is the flexibility to control their own destiny in an increasingly complex ecosystem. Times of uncertainty and complexity are often the enemies of courage. On the other hand, they are also the times when courage is most generously rewarded.

Though not easy, telecom CEOs can draw lessons from “reverse innovation” or breakthrough ideas that originate in emerging markets and are powerful enough to conquer the developed world.

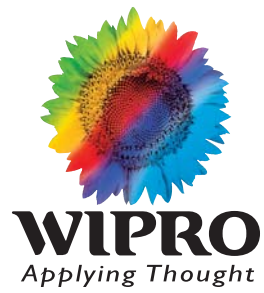
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