STRATEGY
In fast-changing industries like communications, having the right strategy is critical to success. Didier Bonnet and George Yip explain why business models and strategic planning must converge into strategic formulation.

Business academics and consultants have been writing about formulating strategies in fast-moving technology-based industries for many years. Yet there is still great confusion today as to how strategy formulation really happens in industries experiencing high business and technological change.

The Internet era introduced a new term, business model, which, according to one author, provided not just a strategy but a “Web-based business model that promised wild profits in some distant future”. Today, with renewed hype around Web 2.0, both strategy and business model are again used indiscriminately, and this is not helpful for executives attempting to chart a course for their organization in increasingly complex environments. We believe the two terms are separate but complementary business concepts that can go a long way to putting some order in the process of strategy formulation. Our view is that strategy can be formulated both within an existing business model and when a company has to make a shift from one business model to another.

The communication industries – broadly defined as encompassing telecoms, media, entertainment and devices – present a very fertile ground to help clarify the relationship between strategy and business model. In recent years, these industries have experienced radical shifts in their structures leading to the introduction of new and disruptive business models. The nature of competition and the pace of technological innovation in the communication industries (together with the irreversible process of industry convergence, which is fast blurring historical boundaries and market definitions) offer one of the most complex environments for strategy formulation.

Strategy vs. business model
Today, strategy and business model are widely used terms, but there are still no single compelling definitions. Strategy is a long-term plan of actions aimed at achieving a particular objective or set of objectives. In his Harvard Business Review article “What is strategy?” (November-December, 1996), Michael Porter defined strategic positioning as having six elements: the right goal, a value proposition, a distinctive value chain, trade-offs, fit among strategy elements and continuity of direction.

Business model has been widely used to explain how an Internet company operates and which business logic it uses to generate revenue and make money. A business model can be broadly defined as comprising the following key elements:

Value proposition The type of offering or bundle of products and services that create value for customers
The first source of disruption is linked to the flow of technological innovation. More than in any other industrial sector, the rate of technology innovation in the communication industries has had a profound effect on the nature of competition. Witness the continuing level of technology introductions such as WiFi and advanced personal video recorders (PVR). Some key technological developments such as voice over Internet protocol (VoIP) have also allowed for a multitude of new entrants to penetrate what was originally considered a capital-intensive, and thus high, barrier to market entry. This is precisely how cable television companies have started to invade the turf of telephone companies.

The introduction of new technologies in the communication industries is unfortunately very often over-hyped in terms of timing and market impact, so it is important to understand the pattern of customer adoption. Contrary to common belief, disruptions resulting from the introduction of a new technology or from a new business model do not come about as an all-out attack on an established business. Rather, disruptions actually develop in three distinct phases (as Gilbert Clark, in the Summer 2003 issue of Sloan Management Review, has shown). At the outset, the innovation creates a new, non-competitive market somewhat independent of the established business. In a second phase, the new market/technology expands and slows the growth of the established business. In a third phase, the disruptive innovation, having refined its model or improved its performance over time, significantly reduces the size of the old market. One can see such patterns in the competition between traditional voice telephony versus Internet-based voice calls – or between classified ads in a newspaper versus the new forms of such communications online.
Convergence is the second source of potential disruption. Convergence, as a phenomenon, has been an overused and over-hyped term for at least the last 10 years. But, for anyone operating in communication industries today, there is a strong sense that the blurring of the traditional industry boundaries has started to generate irreversible shifts in the nature of competition. The key strategic impact of convergence is that it is driving companies with traditionally distinct and stable business models into the same territory. Companies with radically different logic for generating their revenues and profits are starting to compete for the attention of similar customer groups by offering similar types of services. Think of the competitive landscape in broadcast television today with traditional broadcasters having to fend off new, well-financed entrants from the telecom and Internet industries. Similarly, consider the potential clash between telecom companies and Internet portals around services such as voice calls, email, instant messaging and so on. Telecom companies have built their business model around a regional focus, a capital-intensive infrastructure and a subscription-based revenue stream whereas Internet portals are competing primarily through their global reach, software and an advertising-based revenue model.

There is a possibility that convergence, in the end, may be close to a zero-sum game, whereby for every winner there will be a loser as the value is redistributed across the communication value chain. Understanding the strategic dynamics of convergence is a prerequisite to strategy formulation in industries with the same dynamics as communications.

Strategic agility – the ability to constantly sense, assess and react to market conditions – has become far more relevant than the notion of sustainability.

Strategic anticipation
What we find in many organizations is that the process of strategic anticipation of the impact of both technology and convergence is often ad hoc, not supported by fact-based analyses and/or cemented into a rigid strategic planning process, and thus is out of sync with the pace of market and technology development. In the communication industries, what is needed in order to build a sound basis for strategy formulation is a constant and dynamic assessment of both the timing and impact of technological change on established business models together with an ongoing evaluation of the likely implications of convergence at both industry and product/service levels. This is what we term dynamic strategic screening. Such screening is needed to be able to better grasp:

- Changes in the nature of competition (for example, new entrants or radical shifts in cost structures)
- Disintermediation of established value chains
- Creation of new sources of revenues
- Changes in how customers buy or use products and services
- Radical changes in channels and distribution methods
- Shifts in the skills and competences required to compete

For managers, this implies establishing a structured process within their organizations aimed at providing a continuous assessment of potential technology and market disruptions both from a technical and from a managerial perspective. From our experience, a dynamic strategic screening process should, at least, include a methodology for continuous monitoring of emerging market, technology and business disruptions; a thorough, fact-based screening approach to selecting disruptions that present either a true risk or a true opportunity for the company; a reporting and governance structure that supports and accelerates senior executive decision making; and a roadmap for fast-tracking implementation programmes (often cross-functional and cross-business and generally involving external partners).

Routes for strategy formulation
The outcome of this dynamic screening is that companies will follow one of two distinct types of strategy formulation: (1) incremental strategies to change market position within an existing business model, or (2) radical, or transformational, strategies to change business models completely. Nearly every business seeks to improve its position on an incremental basis. A company with a given market share usually wants to increase that share or to improve its cost position, its quality position or its profitability. In most cases companies seek to do so with incremental strategies that do not change the underlying business model. For example, market share increases can be achieved through...
strategies such as increasing advertising, introducing new products, reducing customer churn rates, increasing customer satisfaction and the like. Such incremental strategies can usually achieve reasonable improvement.

However, if one has more dramatic ambitions – such as doubling or tripling market share or entering a completely new arena in the converged communication landscape – the situation may require a fundamental change in the business model, such as targeting new customer groups or changing the fundamental nature of the company’s value proposition. In such cases, a radical (or transformational) strategy is needed to change the business model in one or more fundamental ways.

Companies use radical strategies rarely and usually only when changes in their environment render their current business models obsolete or when they voluntarily choose to embrace a new business model. The root cause and rarity of radical strategies explains the level of difficulty linked to their implementation. First, having to replace an obsolete business model is inherently risky. Second, the rarity of use means that most companies and executives have little experience of devising and implementing radical strategies. After all, many business models work successfully for decades. For example, IBM’s mainframe computer business model worked from the mid-1960s to the PC revolution of the mid-1980s. Sears Roebuck’s catalogue retailing business model worked for nearly 100 years, from the 1890s to the 1980s.

In a few cases, companies seek to change their business model while still operating from strength (although typically facing incipient environmental changes and threats), as Motorola did in shifting from its consumer electronics business model in the 1970s to its high-technology industrial and mobile telecommunications business model in the 1980s. Similarly, in the 1990s Microsoft extended its business model from personal computer operating systems and software to include the Internet. Although all radical (or transformational) strategies are inherently risky, as they involve moving from an equilibrium position through disequilibria before arriving at a new equilibrium, standing still can be even more risky in industries like communications.

Incremental strategies
Incremental strategies should by no means be underplayed in terms of importance for companies in the communication industries as they are the most common and probably represent the biggest source of value creation in these industries. Unlike their radical counterpart that occurs more often than not as the result of a crisis-induced need for change, continuous incremental strategies are what make companies sustain and enhance their positions. Although complex in nature, they do not require a fundamental shift in the underlying business model. Incremental strategies are about achieving strategic objectives through execution – be it by launching a new service to increase revenue, by using a new channel to distribute products and services to a wider audience or some similar approach.

Consider European retail giants such as Tesco, Sainsbury’s and Carrefour – all foraying into the provision of telecommunication services. These players intend to leverage their strengths in distribution to retail communication services such as mobile telephony and broadband access. This is a clear example of an incremental strategy, since the move into mobile operations has not meant significant investments for these players.

Existing mobile operators have made huge investments in license fees and network infrastructure. In contrast, retailers use an incumbent infrastructure and make no major investments in network infrastructure, expensive license fees or expertise in running telecom networks. The key strength that these retail chains leverage is their distribution reach to access a wide base of customers. This translates into the value proposition of easy availability of products and services for the end-customers and accessibility to an extensive after-sales network due to the deep penetration of the distribution chain. This core proposition remains largely unchanged, regardless of consumers buying a mobile plan or any other product. The revenue model of these retailers also borrows from their existing business of charging wholesale-plus-margin prices.

Transformational strategies
When a company feels the need to employ a radical strategy, there is usually more drama, if for no other reason than the chances for success are less certain. Fixed-line telecommunications companies have been facing an irreversible decline in voice and bandwidth prices that have been eroding their traditional voice and data revenues. Faced with this dilemma, some operators have branched out from...
pure networking companies into the territory of information technology (IT) service providers, acting as a single-stop shop to meet the communication and IT needs of enterprise clients.

While some operators have chosen an incremental strategy route by limiting their offering to managed wide-area network-based IT services, other operators have chosen a more radical route. By entering into areas such as consulting, local area networking or equipment maintenance and security, some telecommunications companies have had to rethink their entire business and delivery model by developing new skills, new value propositions, and often separate organization structures as well as new business development and distribution approaches. More often than not, this radical change of business model has been accelerated through the acquisition of specialist IT service companies to build credibility and establish a position.

The core operating models of communications and IT services differ significantly and, hence, telecom operators that have chosen that route have undergone a significant change in their operations. For instance, their core service definition transforms from delivering a standardized, well-defined service (say, phone service) to one in which the company needs to understand a broad array of customer needs – and have the ability to customize the package of services offered to each customer. The pricing structure, as well, changes from a usage-based model to an asset-based, annual contracts model. In addition, the change in the core service and proposition mandates a transformation of the delivery organization. The account management and delivery teams now need IT specialists with industry knowledge.

Although such radical strategies have proven risky, several operators have taken this course of action. Consider British Telecom (BT), which has pursued this strategy by acquiring several IT companies with an objective of rapidly developing expertise in IT services. BT has invested heavily in acquiring companies such as Infonet, TNS, Radianz and NSB to build expertise in local area networking, IT systems management, consulting and industry-specific solutions expertise. Equally, Belgacom’s acquisition of Telindus is another example of this strategy. BT, for example, made up for the decline in its traditional services revenues from £16.2 billion in 2002 to £14 billion in 2005 by growing its “new wave” services revenues (comprising ICT, mobility and broadband) from £2.2 billion in 2002 to £4.4 billion in 2005.

Strategic choices
Strategy formulation of either kind needs to become a new habit for executives in dynamic industries. The characteristics of a successful strategy have now become either relentless fast-track execution of incremental strategies, or, when required, a well-thought-out defensive or offensive radical set of strategies designed to shift the company from one known business model to an entirely new one.

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