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Meditations on Management in the Digital Age #3

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New Directions for Organizing Carriers

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In 1993, Sam Ginn, CEO of Pacific Telesis, proposed splitting the company into two entities to increase shareholder value. He surprised the industry when he asserted that the more regulated traditional phone business was holding back the newer wireless business; but he shocked everyone when he announced his decision to leave the old entity and lead the new entity—renamed AirTouch, which in succession merged with Vodafone and then with Verizon to be come Verizon Wireless. The lessons are that times change, old businesses can slow the growth of new ones, and to grow investors' wealth, you have to organize and prepare for it.

The Current Situation

The wireless business worldwide has matured, but there still is huge growth potential in value-added services. The old-line communications business is in decline. And the new cloud computing business is poised to boom, bringing windfall profits for carriers, but also for over-the-top providers. Put starkly, by mid-2011, Google managed more than three times as much data traffic as did AT&T.

In parallel, the ongoing consolidation of cellular businesses globally increases profits and draws regulatory attention (including anti-trust and consumer protection regulation) to cellular companies. It is difficult and expensive for firms to fight encroaching regulation. Indeed, the greatest expense may arise because top managers spend so much time defending the company, both from current competitors and regulators, that their attention to growing the company value for shareholders decreases.

Reading the Tea Leaves Carefully

Today, most U.S. wireless companies bundle their services to beat other wireless carriers and the cable carriers. Triple- and quad-play strategies pioneered by the cable companies are the main way that services are marketed. In parallel, cable companies are consolidating content channels and cable to reduce costs and increase free cash flow—as was the case in the Comcast/NBC merger—but simultaneous efforts to generate new revenue or growth becomes more difficult. New services provided by Hulu, Netflix, and others are competing for the value that cable operators provide. Their access to homes is strong and they are expanding into business, but they will capture less and less of the consumer's wallet.

Traditional U.S. communications companies are playing catch-up. Their immediate reaction is to focus more on quad plays and reorganize communications companies by sector, home, business, and so forth. This is unlikely to succeed because it does not bring opportunities for new growth directly in value-added services.

For example, Deutsche Telekom reorganized by country and by customer segment in Germany and grew versus its German competitors. The move meant that Deutsche Telekom's attention was diverted from its overseas cellular markets, which had provided most of its growth. Other incumbent carriers around the world are acting similarly. This is challenging because the wireless, landline, and new cloud businesses are moving in different directions, and in recent years, share less commercially.

Learning from the New Entrants

The experiences of three disruptive entrants illustrate both the new opportunities and the continuing threats to the market position of major carriers, which will drive how, they organize going forward.

eMobile, a division of eAccess, the number-four Japanese mobile carrier, challenged the incumbents by building an ultra low-cost mobile broadband strategy. eMobile did so well that it began selling capacity to NTT DoCoMo, its most powerful rival. By contrast, **LightSquared** only sold wholesale; although its collapse reflected problems in its core spectrum play, its failure also highlighted how incumbent carrier cost structures were not aligned with dropping prices. A third path was taken by Japan's **SoftBank**, which combined telecommunications (ADSL) and services with its part ownership of Yahoo! Japan, with enough effect to buy and transform a mobile network. It is easy to take issue with any one of these approaches, but they all show the potential for disruption to incumbents.

Enabling Value-Added Services

Carriers recognize that competition from new over-the-top competitors is causing them to lose huge swaths of consumer control and value. Apple, Google, and others are capturing the growth in value with customers. The carriers tried walled gardens, but they collapsed, and now they have no garden walls to capture value-added services. Carriers might pursue deep partnerships with these players, but the terms may not be favorable because these players have such strong direct consumer presence. One Spanish regulator lamented to one of the authors that nobody still believed that AT&T, Telefónica, or any other carrier would dominate the future. Europe is in an especially weak position, he noted, because none of the likely over-the-top winners is based there.

New Model of Organization in Korea

To simultaneously consolidate old businesses and grow new services requires rethinking how carriers are organized. In Korea, SK Telecom, not the landline incumbent Korea Telecom, is the market leader with a 50% share, and SK Telecom is an innovator and has set strong performance goals throughout its growth. It now has split into two entities: one to focus on the regulated transport of bits and bytes and the other, a new value-added services company, SK Planet, is meant to vie with Google and others to transform the current remnants of its previous walled garden into a competitive service provider. Aspects of the Korean market are not easily transferable to the United States: local providers dominate social networking, there is a strong Korean content market, international majors are weaker there, and so forth. But SK Telecom believes it can export its model overseas directly and through international partnerships.

The U.S. Case

What if AT&T, Verizon, or Sprint split their advanced services off and freely offered them on different devices and carriers, while experiencing less regulation and less drag from the worries of a regulated business?

Three opportunities come to mind:

1. Major carrier investment in value-added services (a transformed Yahoo! for mobile?) would allow them to invest some of the huge cash resources that they return in dividends because they do not have growth investments for that cash.

2. Faster moving, value-added services divisions could buy innovative start-ups that are rapidly creating new services with a better culture match and greater chances for success.

3. Carriers know a great deal about their users, but suffer significant restriction on how to use that information. What if they could escape the strictures of the regulated business?

Carriers still think of (and bill) handsets as a cost, not a sale, and most of them have lost billions in potential access to consumer wallets by not aggressively pursing ODM strategies under their own brands. AT&T's current success in its machine-to-machine (M2M) division is encouraging. Run somewhat independently, it has a direct focus, enables quick and easy partnerships, and has enabled AT&T to quickly become a leader.

Carrier stock prices are up in the search for value in the presence of persistent near zero interest rate returns on many financial assets, but almost all see this determined by outside forces, not by the transformation of carriers into growth investments. The opportunities discussed above are not as secure as the government-designated wireless licenses in the 1990s. Nonetheless, the lesson is to enter new markets firms may need to unleash the organization.

What would Sam Ginn do?