Redefining the Customer: A New Business Model That Defines Success

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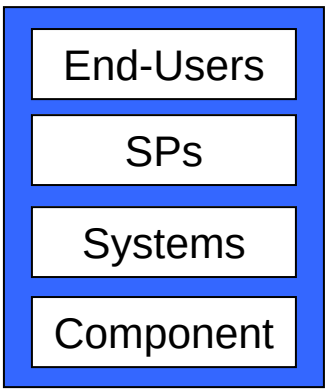
The purpose of this document is to propose an alternative market strategy for telecommunications component manufacturers, system manufacturers and service providers that will allow them to guarantee their place at the revenue table in an increasingly competitive and commoditized market. It requires them to align themselves with a different form of customer and to in many ways modify their relationships with other companies in the industry. The result is an unprecedented level of differentiation and a protected and more lucrative competitive position.

The Problem

Faced with declining marketshare due to increasing competitive pressure, reduced service provider revenues (and therefore CAPEX spending), commoditization of product capabilities, and an increasingly lethargic response from the marketplace to claims of technology superiority as a differentiation scheme, telecommunications equipment manufacturers find themselves in a tenuous place. On the one hand they are unmatched at designing and creating technology-based hardware and software products that address themselves to service provider challenges. It is what they have always done, and they do it exceptionally well. On the other hand they are less accustomed to creating broad-brush solutions that provide a turnkey response to client business issues. Today's customers are asking more and more for a single bundled technology solution that addresses every aspect of their business so that their revenues are increased, their operating expenses (OPEX) and capital expenses (CAPEX) reduced, and their competitive position assured if not enhanced.

Unfortunately, it does not fall within the purview of the telecommunications manufacturer (or any vendor for that matter) to offer such a wide-spectrum solution to its customers. This is not a criticism of the sector; they have never in the past been called upon to be "soup-to-nuts" players and are therefore ill equipped to do so with such short notice. As a result their efforts often fall short of customer expectations. This perceived failure on their part, however, is not really a failure at all. In fact, it is a case of the right capability being delivered to the wrong customer. Realignment on the part of the manufacturing sector can quickly and effectively eliminate this perceived shortcoming.



The Legacy Model

For many years the technology industry has found itself structurally characterized by the stack shown at left. At the bottom-most layer are the component makers, companies that manufacture semiconductors and optoelectronic devices that they in turn sell to the systems manufacturers above them. Component companies include Agere, Intel, AMD, Texas Instruments, and IBM.

Systems manufacturers build switches, routers, multiplexers, and other infrastructure components; they include, among others, Lucent, Nortel, Ericsson, Alcatel, and Fujitsu. They sell their complex devices to service providers. These include local telephone companies (Verizon, SBC, Bellsouth), long distance providers (AT&T, MCI, Verizon, Sprint), ISPs (AOL, Earthlink), Independents (Citizen's Mutual Telephone Company), and corporations large enough to have their own infrastructure (multinational banks, health consortia, universities). Systems manufacturers are technologically visionary, technically adept, and typically have large R&D organizations that push the limits of technology to determine its applicability in customer environments.

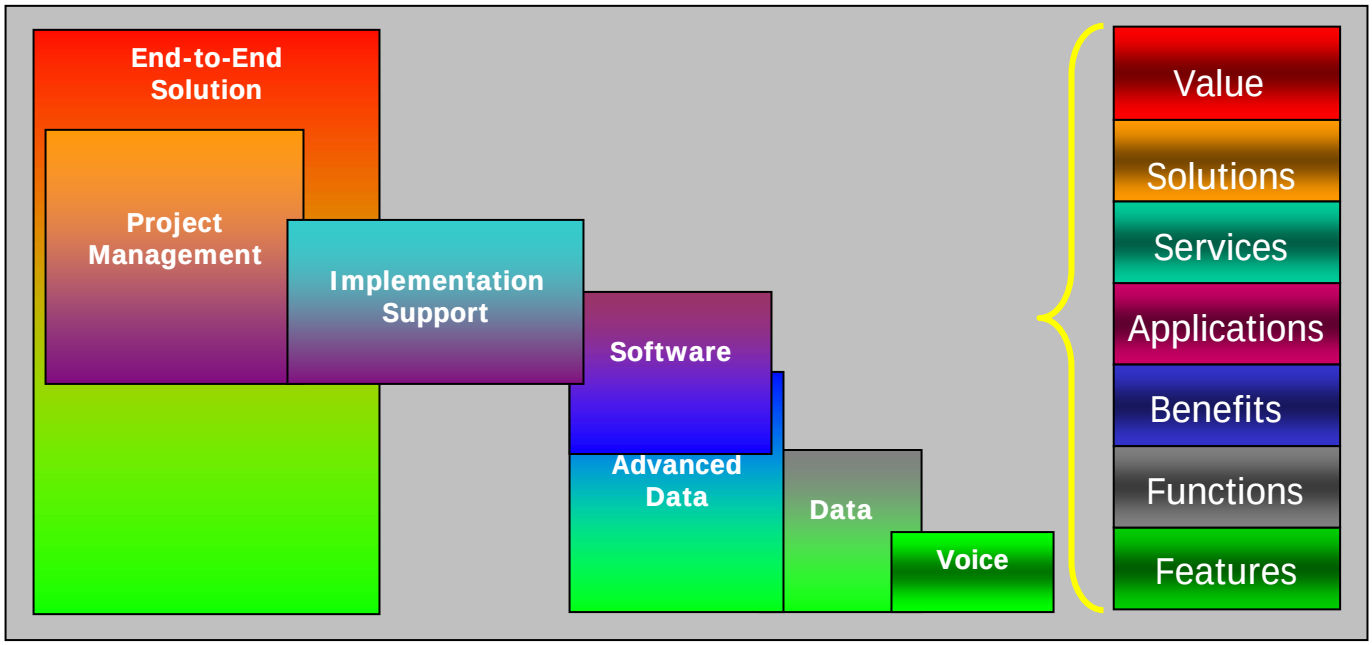
Service providers develop and offer a wide array of access and transport options that include voice and data, wireline and wireless, and additional services such as diverse billing models, converged voice and data solutions, Internet access, and other technology-dependent offerings. Like the manufacturers they are also technically savvy, but tend to have a better understanding of the end-user because they are in direct contact with them.

The end-user is a multifaceted creature. End-users include everything from individual residence customers with simple telecommunications requirements to massive, complex corporations with locations in multiple countries and tens of thousands of employees. The service requirements of these corporations vary greatly based on many factors.

Taking Stock: Where Are You on the Value Chain?

In terms of the value chain continuum, companies want to be as close to the top of the chain as they can possibly get, because that is where the customer (with the money) dwells. Regardless of whether a company manufacturers components, systems, or services, the ability to offer an integrated, innovative solution that exceeds customer requirements is a cornerstone of long-term success. The reality of the situation, however, is that no single company has the ability to do so. Some form of alliance is necessary, and the best way to craft the alliance is by identifying strengths that must be reinforced and weaknesses that must be strengthened. Equally important, but beyond the scope of this paper, is the fact that companies entering into an alliance must enter it with the appropriate motivation: the goal of an alliance partner should *not* be to enter into the relationship as a way to control the partner. That's not an alliance; that's hegemony, and it doesn't work.

Consider the diagram shown below. Voice is a largely undifferentiated service characterized by specific features that certainly have value, but the value is largely commoditized – everyone offers the same features because they are for the most part standardized. Traditional data such as T1, LANs, frame relay and ATM offer both features and functions on the value chain but little else. They too are largely commodities. Advanced data, including switched Gigabit Ethernet, IP services and certain forms of wireless, add a few benefits as they claw their way upward, but they too are dangerously close to the commodity level. Software offers benefits and applications, but software providers do not have the ability to deliver the underlying infrastructure, nor do they offer further differentiation to carry them higher in the value chain.



Implementation support is an example of an offering that provides further differentiation. Project management does as well, but neither offers seriously differentiable value on a standalone basis – nor do they provide infrastructure.

The point of this diagram is that no single technology company offers a complete end-to-end solution. However, if one company finds its "sweet spot" on the continuum shown in the diagram, and if it takes the time to truly understand the customer's requirements, it can identify the company or companies with which it should ally to deliver a complete solution that is crafted on the customer's terms. Such strategic relationships create unique and compelling value that is much greater than any single vendor can offer to their customer, or, stated another way, the whole is greater than the sum of its parts. This is the model of success for the future.

Changing Times

Ten years ago, manufacturers were able to rely on a very different set of differentiators than they do today. The year was 1993, and the Internet was just beginning to appear on the extreme horizon of public consciousness. 'Access' was, for the most part, analog, save for ISDN. There was no DSL, and Ethernet had not yet escaped from the desktop environment to become a valid high-speed access and transport option. Transport was T1 and DS3, although SONET had made its appearance and was beginning to be rolled out by the major long-haul carriers. Switched broadband technologies were limited to ATM and frame relay, and they were used exclusively for the transport of data.

I'm tired of my service provider thinking they provide a service. They provide technology, plain and simple. It's good technology, and sometimes it fits the bill, but I want more than that: I want a service provider to deliver what I need, not what they have.

The telecommunications business environment was different as well. Competition for long distance was mature, having been mandated shortly after the 1984 divestiture of AT&T. Local competition remained spotty at best, a nascent concept that only a few companies – Teleport and MFS, for example – could demonstrate. The Regional Bell Operating Companies (RBOCs), now called Incumbent Local Exchange Carriers (ILECs), were for all intents and purposes local monopolies, a model that would not change for another three years when the Telecommunications Act of 1996 redefined the responsibilities of major industry players.

During this early stage in the development of a close relationship between communications technology and the end user, the key differentiator for both manufacturers and service providers was the technology itself. Because of the lack of competition, it was reasonable for these companies to place a great deal of focus and to invest large amounts of money into technology development, because *that* was their differentiator. They investigated communications technologies, pushed them to the limits of their capabilities, build networking systems around them, and sold them to service providers, which in turn built networks with the devices, from which they derived services for sale to end users. This model worked. It was stable, and every player had a clearly defined role in the hierarchy of technology and services delivery. The final factor that made this model a success was the customer. In 1993 their requirements were much less demanding and typically isolated to a single application or department. IT and telecommunications requirements were largely focused on improving "back office" internal operations.

A Spanner in the Works

As time went on technologies standardized, and the industry matured. Competition became more real as services became more diverse, opening the door for specialization and resulting waves of competition. Customers demanded more from the service provider, and the service provider demanded more from the manufacturer. With full-blown mature competition came a migration of influence from the technologists to the end users, who quickly flexed their muscles and began to redefine the technological rules of engagement. Instead of technology, they wanted applications. Instead of applications, they wanted services. And instead of services, they wanted full-blown, end-to-end solutions that reflected a deep awareness of the end user's business model and competitive challenges.

A great deal has been written in recent years about the need for companies to sell to the "customer's customer," sometimes referred to as the "third tier." For example, systems manufacturers sell their products directly to the service provider sector. In that relationship they compete directly with other manufacturers largely on price. However, if they position their products by selling the advantages that their products bring to the service provider's customer, they will find themselves at a higher position in the food chain. Instead of being one of several potential vendors, they now become a trusted business advisor that enjoys a position within the inner circle because of their ability to affect the service provider's relationship with their own direct customer.

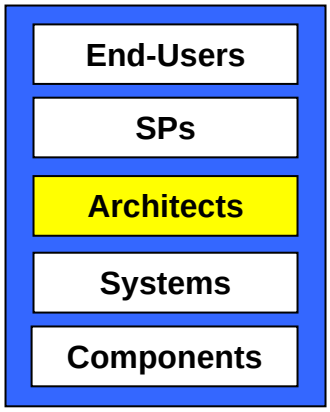
Many things flow downhill, including panic. As competition grew and revenues (ARPU) shrank, service providers began to put pressure on the manufacturers to do something that they had never before been called upon to do: create full-service solutions, in effect an entire network in a single, low-cost box with management and billing built-in. Oh, and one more thing – it had to be targeted at the needs of the end user.

Thus began the great quandary that characterized service provisioning in the waning years of the 20th century and that continues today. Customers became more technologically adept and demanding because they *knew* what the new technologies were capable of. Service providers faced a changing regulatory environment, a legacy network that was built

at a time when economic design efficiencies were not as critical as they are today, a broad spectrum of predatory competitors, falling ARPU, and application demands that changed faster than they could track or build networks to support. As the process cycled through to its inevitable conclusion, several things became clear. First, demands from the customer were not going to slow down, nor could they be ignored or denied – because with competition those customer had a choice and believed they could go elsewhere for what they wanted. Second, service providers faced the realization that the "service" in "service provider" had become a very different thing than it had been in the past, and they were ill equipped to deliver it. Third, manufacturers, driven by service provider demands, tried to become solution providers, but without a clear understanding of the issues facing the industry verticals served by their own service provider customers, they really didn't have what it took to be effective.

The first response on the part of the manufacturers (which in many cases continues to be the only response) seemed to make sense. They formed alliances with other manufacturers. Lucent, for example, formed alliances with Cisco and Juniper. In the final analysis, this type of relationship adds footprint, but in the eyes of customers does not add differentiation – or value. In fact, it reinforces the image of commodity status. Consider the wheat or soybean business. *Because* their products are commodities, farmers grow as much as they possibly can by forming enormous farming cooperatives. Commodity selling is a price game, and the way to have the lowest price is to have the most product. Their differentiator isn't better wheat; it's more of it. In the technology sector, the key to differentiation is added value, not added capacity.

The Answer



Manufacturers sell technology. It's what they have always done, and they are extremely good at it. They have massive R&D infrastructures, employ thousands of design engineers, and have an intimate understanding of the inner workings of the service provider world *from the perspective of technology*. Unfortunately, manufacturers are allowing themselves to be dragged into a role that they are not designed to play. They do not understand their customer's customer (the vertical enterprise space) because for the most part they don't sell to them.

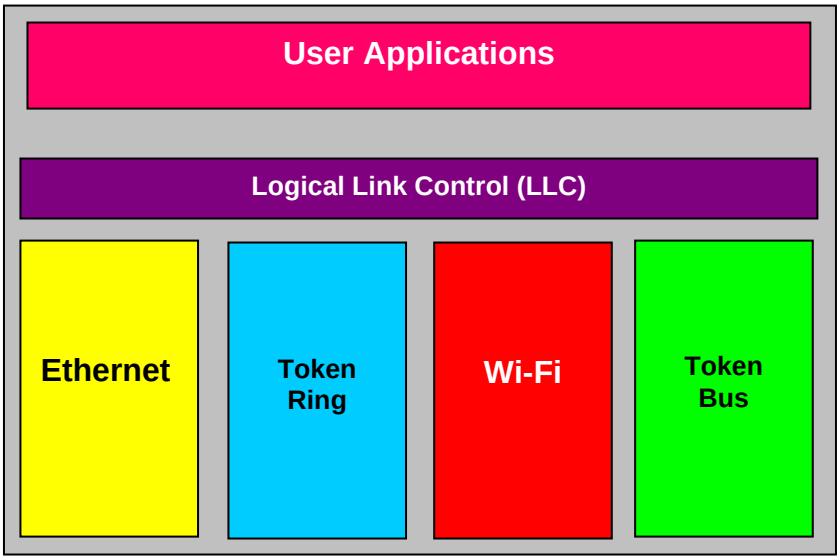
Manufacturers need to recognize that a fundamental change is needed in their value chain if they are to remain robust, viable, and provide value in the technology food chain. The change, shown at right, involves the introduction of a new layer in the value chain called the *architects*. Under this new model, the architect becomes the manufacturer's primary customer instead of the service provider.

Manufacturers will be quick to react negatively to this concept because it implies that they are being disintermediated. Under this model they no longer sell directly to the service provider; instead, they have been "demoted," selling to an intermediate company. In their minds, they lose the customer.

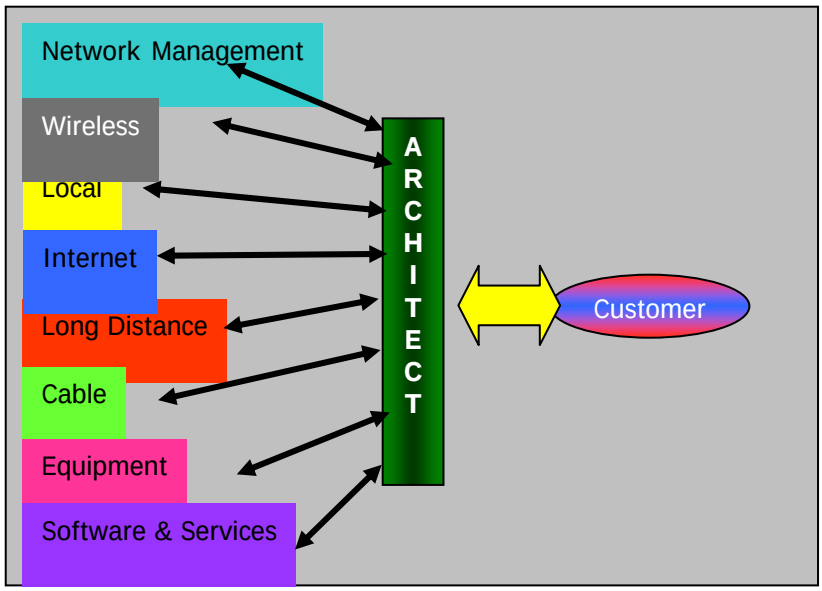
This, however, is not the case. As the hardware and software that manufacturers sell move closer to commodity status – an inexorable outcome – it is critical that manufacturers move up the food chain, providing services that add unique value to the enormously valuable commodities they sell. One way to move up the chain is to redefine the customer. By selling to an architect, the manufacturer's role as a technology innovator is assured. This role is fundamental to the overall process of selecting a valid technology combination, designing a solution, and selling the solution to a service provider. The architect, often called a professional services firm, is strong on the business side of the equation. They do not have technology prowess – but the manufacturer does. The combination of a firm that understands the end user and a firm that offers superior technology is powerful. Furthermore, by adding the architect into the value chain, the manufacturer suddenly becomes the trusted advisor to the architect about the technology issues that face the service provider. Nobody knows the service provider like the manufacturer. Suddenly, the third tier (the customer's customer) for the manufacturer is the service provider, not the end user. The manufacturer's value to the architect is enhanced by the fact that they understand not only the technology-based products they deliver, but also the strategic intelligence they can now share with their architect partner.

Under this model, the manufacturer is not "demoted" to a position of less importance. Instead, they realign themselves with a more strategic customer. Think about it: network systems are rapidly becoming commodities on the open market – indeed, many already have. Furthermore, the services offered by telecommunications service providers are already commodities, as evidenced by the fact that they are price-arbitraged every minute of every day. This model of a

commodity being sold to a commodity provider is a long-term recipe for true disintermediation of both the buyer and the seller. Under the new model, however, the architect sits in a position to aggregate diverse capabilities and offer specific business-oriented solutions to enterprise customers.



A manufacturer's multiservice box may be a solution, but in the final analysis it is a solution to a technology problem, not a business challenge. Under the terms of the *new* business model, however, the architect aggregates the functional components required to offer a solution to a legitimate business challenge, one component of which is the multiservice box described moments ago. The manufacturer takes on a linchpin role as technical advisor to the architect, providing the network substrate over which the final solution is delivered. Each layer of the value chain, then, does what it does best. The component manufacturer sells components to the system manufacturer, which in turn works closely with the professional services firm to craft a technology solution that is based specifically on the business challenge identified by the professional services firm in its discussions with the service provider. The manufacturer also provides advice and counsel to the architect in its role as an expert on the issues facing the third tier. The professional services firm researches and understands the business issues facing the end user, and serves as the key interface between the end user and the technology that runs the end user's applications.



In local area networks, there is a standards-based concept known as *Logical Link Control (LLC)*. LLC allows disparate access techniques (Ethernet, token ring, wireless, etc.) to reach higher layer applications as shown in the diagram, above. In effect, it serves as a universal translator between the user's applications and the network, making the complex underlying technology invisible to the end user. The business model suggested in this paper is identical to the LLC concept: By isolating the customer from the technology and offering them a business-oriented solution that is *based* on technology, the customer's requirements are better served.

This model can be applied to other companies in the technology industry as well. For example, there is no reason why the architect couldn't aggregate products and services from a wider array of providers, as shown in the diagram above. The architect could assemble solution components from systems manufacturers, software developers, network management system developers, billing and invoicing service providers, local and long distance providers, cable, Internet service providers, and wireless providers. These services would then be combined into a targeted solution to customer business challenges. What is understood is that like the Roman God Janus, shown at right, the architect has two "faces:" One faces toward the technologies on the left, the other toward the customer on the right. The left facing half of the company has great technological expertise: it understands what each technology does, what its strengths are, how it works, and how each interacts (if appropriate) with the others. The right-facing side of the firm understands the customer's business challenges. Consider the following example. A strategic customer engages the services architect, the customer in this case a large bank. In the last decade deposits have fled the banking industry in favor of mutual fund investments, most of which are transacted either through a financial services broker or over the Internet. As a result the

banking industry has fewer deposits, and by definition less revenue, forcing them to raise rates to maintain operating revenue. This causes more customers to flee, resulting in a vicious downward spiral.

The customer-facing side of the architect understands this phenomenon from a business perspective. Working closely with the left-facing side of the business, the architect crafts a technology solution that addresses the banking death spiral: perhaps a greater Web presence, perhaps financial consulting services, perhaps converged investment instruments that better position the bank within its marketplace. This results in several outcomes. First, it delivers to the customer a solution that uniquely and immediately addresses the bank's business issues. Second, it shields the bank from the need to have expertise in technologies that lie outside the banking industry. Under the terms of this model the companies that provide technical services to the architect also serve as consulting resources, allowing them to jointly deliver on-target technology-based solutions. The customer is left to focus on banking issues, freed from the need to support an overly robust technical services organization of its own.

This approach is in many ways radically different from the designs of prior customer relationship modalities and requires a significant realignment of thought relative to the evolving roles and responsibilities of the players in the alliance. However, the model has a direct and quantifiable impact on service level agreements and revenue models, and directly speaks to the four things that customers – *all* customers – want today: CAEX and OPEX reduction, increased revenues, protection and advancement of the firm's competitive position, and mitigated marketplace risk. The intermediate architect model complements all four of these drivers.

Steven Shepard is the president and founder of the Shepard Communications Group, a Vermont-based firm that provides industry analysis, technical education, management consulting, and media development to technology companies throughout the world. He can be reached at +1-802-878-0486, or via e-mail at Steve@ShepardComm.com.

Joe Candido is the founder of Fifth Element Associates, a provider of strategic sales and sales support services. His customers comprise a broad spectrum of companies ranging from technology providers to health care delivery firms. He can be reached at +1-802-878-9380, or via e-mail at Joe@FifthElementAssociates.com.