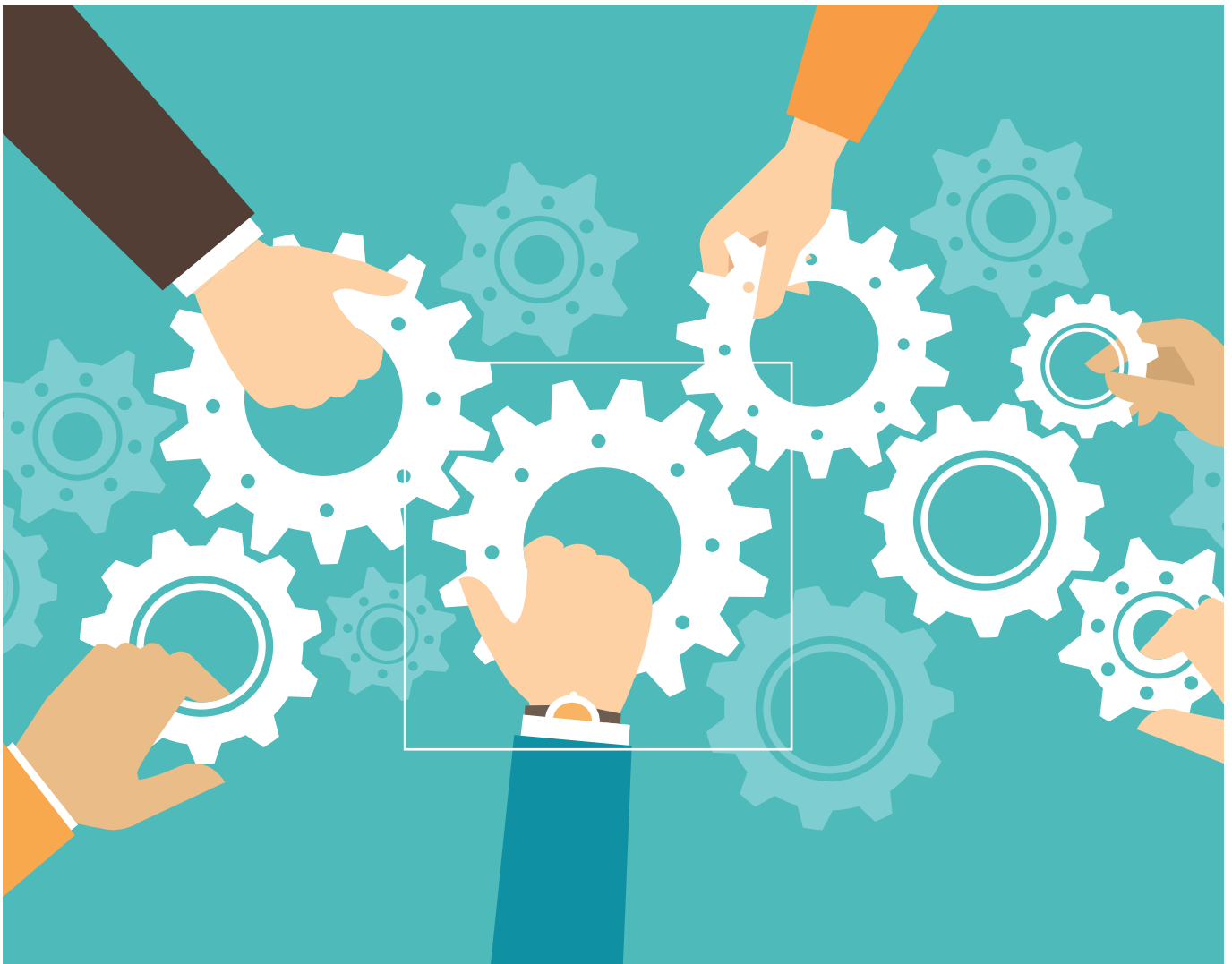


Telecom operators: Open Innovation with start-ups

Venture forth as partners of choice



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Introduction

The latest start-up activity cycle represents not only an accelerated disruption to existing business models but also serves as a renewed opportunity for telecom operators to tap into growth and innovation. At the same time, operators are currently far from being the partners of choice for start-ups, but are rather seen as slow-moving, inefficient, non-decision making and ultimately non-value creating partners.

To truly benefit from start-up collaboration, operators need to fundamentally change their mindset, operations and governance. Specifically this requires (a) a shift from a procurement mindset to actively pitching for innovation partners and (b) commit to enabling governance that incentivizes innovation or at the very least, provides independence to those who are tasked to drive this within the organization. This would help operators change *from* simple facilitators of access to customer, billing and technology platforms *to* partners that actively seek out collaboration and commit to co-creating value by driving *internal change*.

The Motivation

Open Innovation, where corporates collaborate with external parties as a locus for innovation and value creation is a growing trend, even for highly process / technology-intensive, closed-door firms.

Among the many partnering options available, start-ups present a potent mix of disruptive power and execution speed.

Never before has the power and speed of start-ups been this imminent. Companies younger than 20 years on the S&P 500 have become the norm¹. Venture capital investments in 2014 reached their highest levels since 2001² while the proportionate participation of corporate venture capital in VC deals is almost one-fifth of all deals³, nearer to the peak in 2008. Telecom operators had to painfully experience the disruptive power of start-ups threatening their very core over the last decade. Just consider the impact of WhatsApp and Instagram, which have reimagined text and picture messaging in a way on top of the very same platforms that traditional providers have failed to execute on in an interoperable manner.

1 Arthur D. Little scan in 2013 using data from Innosight/Richard N. Foster/Standard & Poor's; Additional Analysis based on Fortune 500, 1955-2012

2 CBInsights Year in Review 2014 - <https://www.cbinsights.com/venture-capital-2014> (US only)

3 Sourced from National Venture Capital Association Q1 2015 data – <http://nvca.org> (US only)

1. Energizing collaboration with start-ups

Most telecom operators (be it the ones with global reach or local champions) struggle to be the first-choice partners to work with either for capital or for collaboration⁴. On the other hand, a recent HBR study quoted that the revenue growth of start-ups that had corporate venture capital backing showed 27% higher revenue growth than traditional venture capital companies⁵. The key to working with start-ups is to realize that their needs are quite different.

Key shifts have to happen all the way from scouting for and onboarding start-ups to making the collaboration succeed as a long-run partnership.

Figure 1: Energizing the operator start-up collaboration



Source: Arthur D. Little

- **Seek** startups or start-up like firms with the operator’s value proposition, instead of procurement-style sourcing or limited sponsorships as PR / marketing
- Provide **Scale** through enabling governance instead of as-is internal processes
- **Sustain** the ongoing partnership well beyond the post-startup phase based on results, avoiding the “not-invented here” trap

Why consider start-ups as part of the corporate innovation options?

- Obtain access to an organization with full freedom and dedication to innovate and breakthrough mindset
- Allow full flexibility to adapt the innovative ideas during the development process without respecting any complex organizational guidelines
- Gain access to seed ideas in completely new product areas / markets (“Breakthrough”) or ideas that re-invent the way things are done (“Radical”)
- Reduce conflict of interest from existing stakeholders in executing opportunity areas
- Gain access to the preferred destination for talent
- Bring in new culture and new means of thinking into the sponsor organization, *above and beyond* traditional investments in internal R&D or strategic partnerships with more mature organizations.

⁴ Based on interviews / discussions in Q2 / Q3 2015 with leading European operators

⁵ Corporate Venturing, Harvard Business Review (Oct 2013) - <https://hbr.org/2013/10/corporate-venturing>

2. Seek, not source, start-ups with a clear value proposition

Operators, over the past decade, have become proficient at sourcing and scouting programs – reflected in their participation rates across many of their incubators, renewed push into accelerators (as in the case of SK Telecom Americas, Wayra’s push into China, Deutsche Telekom’s hub:raum), sponsored business challenges etc.. Establishing a healthy pipeline of potential partners to work in chosen innovation areas requires a prioritization of chosen modes for scouting – this pipeline serves to fill a healthy portfolio of start-ups that minimizes risk to the operator. Leading operators that we scanned⁶ have started to articulate their innovation needs and priorities in a more public fashion than before.

However, looking from the start-up’s view, putting together “what we need” or “what we are innovating on” is not enough. Operators are yet to consistently reinforce what their own **value proposition** towards start-ups is. This also has to be backed by a willingness to **pitch** to the start-up community rather than just a selection process, thus instituting a two-way discussion process. Without this serious effort by operators, we believe most attempts remain as a sourcing exercise on the lines of “connect with us (*conditions apply)” without creating real traction amongst start-ups wanting to work with the operator.

Efforts like the Telecom Council Carrier Connections event in the Silicon Valley (<http://goo.gl/Mm4qi>) are a step in this direction where operators “pitch” to start-ups. Platforms in other geographies such as the Pioneers Festival (<http://pioneers.io>), TechInAsia conferences are emerging to ensure more opportunities for engagement. To ease discovery and successful integration for start-ups and operators alike, bespoke initiatives have taken off, as in the case of Match-Maker Ventures (<http://goo.gl/iHtoSo>) that is connecting leading-edge start-ups to corporates serving 500+ million customers in Europe.

The importance of operator ecosystems in emerging markets

In the context of emerging markets, operators continue to play a far more important ecosystem role typically due to their residual gatekeeper roles in legacy value added services, innovative distribution channels that they have managed to build and also by remaining an important source for capital and technology access. To successfully nurture this ecosystem, operators have additionally invested in capability-building within their local ecosystems⁷ though it is arguable if they have changed from the role from traditional gate-keepers to being the locus of aggregating innovation. In Africa, examples include the efforts by MTN, Millicom through the Rocket Internet Fund and Tigo’s Think Incubator. Similarly in a bid to provide reach and scale, SingTel, Orange, Deutsche Telekom and Telefonica are in the process of detailing their shared startup support network that would provide selected start-up access to the resources of all four operators across their respective footprints spanning Europe, Asia, Middle East and Africa⁸.

⁶ Scan based on publicly available information covering Vodafone Germany, Teliasonera (including Purple+), Orange group, SingTel Group (including Innov8), Deutsche Telekom Group, Telefonica Group

⁷ GSMA – Financing Innovation (July 2014) - <https://gsmaintelligence.com/research/2014/07/financing-innovation/436/5>

⁸ Reuters – Major telecom groups to combine their start-up incubators (9 Sep 2015) - <http://www.reuters.com/article/2015/09/09/telecoms-startups-idUSL5N11F1KS20150909>

3. Provide Scale to the engagement, going beyond sponsorship

In our view, getting to a pilot stage or initiating preliminary discussions are the easier parts for an operator-start-up collaboration.

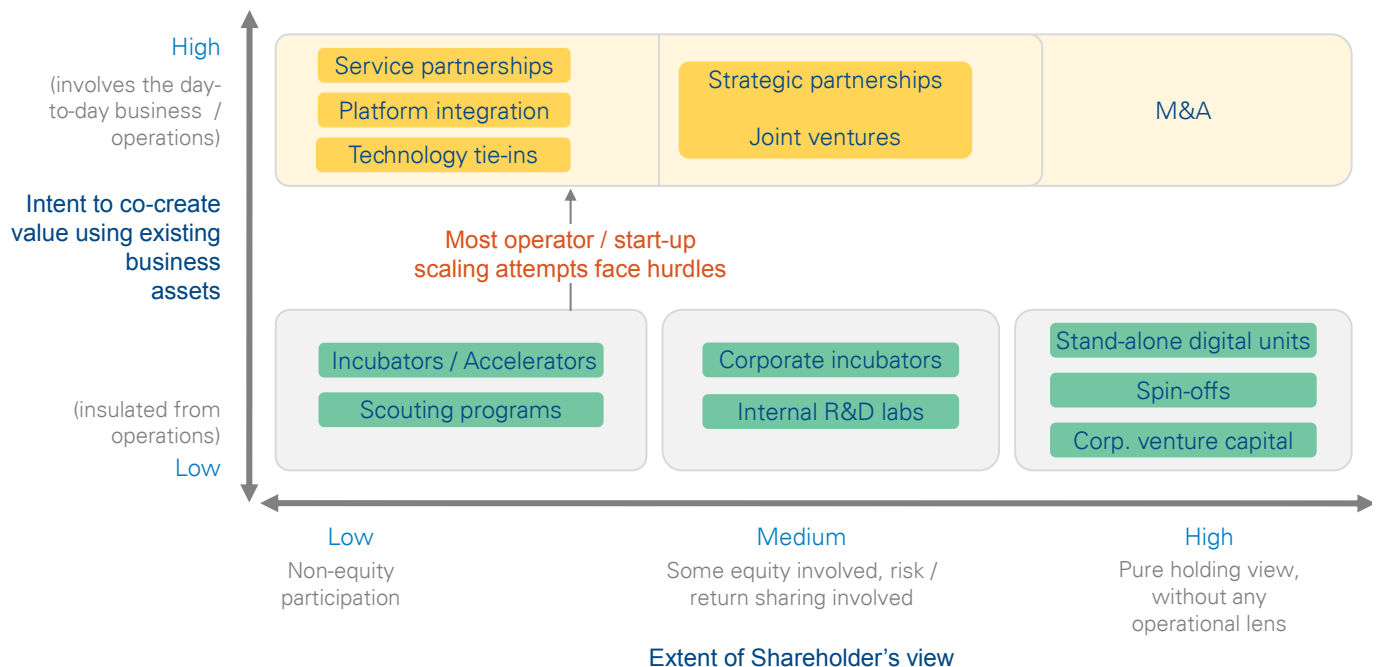
From a start-up’s viewpoint, not being able to gain scale in a short timespan defeats the very purpose of working with the operator in chosen areas. No start-up wishes to or can remain a start-up forever. The timelines on which a start-up works to achieve scale in the market or to reach product maturity is radically different from what is offered in typical operator environments.

As depicted in the figure below, we see the pain points arise when operators go beyond sponsorship of resources to actual integration and deployment for market-facing launches or for production-use (in case of technologies).

Key challenges exist inside operator environments:

- Lack of clarity on decision-making and slow decision-making: Too many departments are typically involved – trying to schedule follow-up meetings can take weeks, or rather months because of availability issues
- Risk-averse: Tendency for teams for tried and tested solutions, tipping the scale towards working with established vendors
- Incentive structure: From a people perspective, working with start-ups is indeed taking a risk and a deviation from the rigid performance targets set up for running the core business smoothly.
- Ignorance / Lack of awareness on how to deal with start-ups

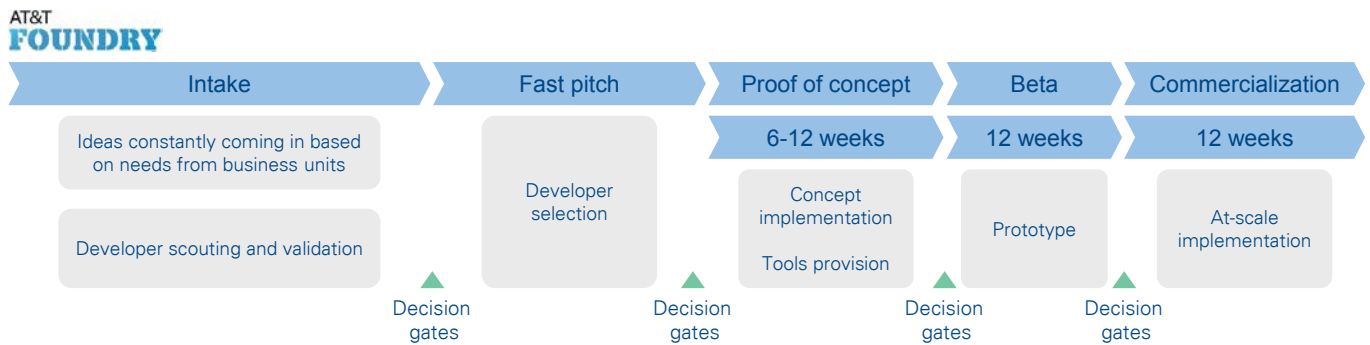
Figure 2: Challenge: Scaling operator / start-up value co-creation



Source: Arthur D. Little, Adapted from Making sense of Corporate Venture Capital / Harvard Business Review (2002)

As a case-in-point for operator side initiatives that try to tackle some of the challenges, the steps taken by AT&T foundry ensure that both internal and external ideas get onto a fast-track, gated process towards at-scale implementation and go-to-market launches (see figure below).

Figure 3: Facilitating internal access in a predictable manner



Source: AT&T, Arthur D. Little

Ensuring the internal sell:

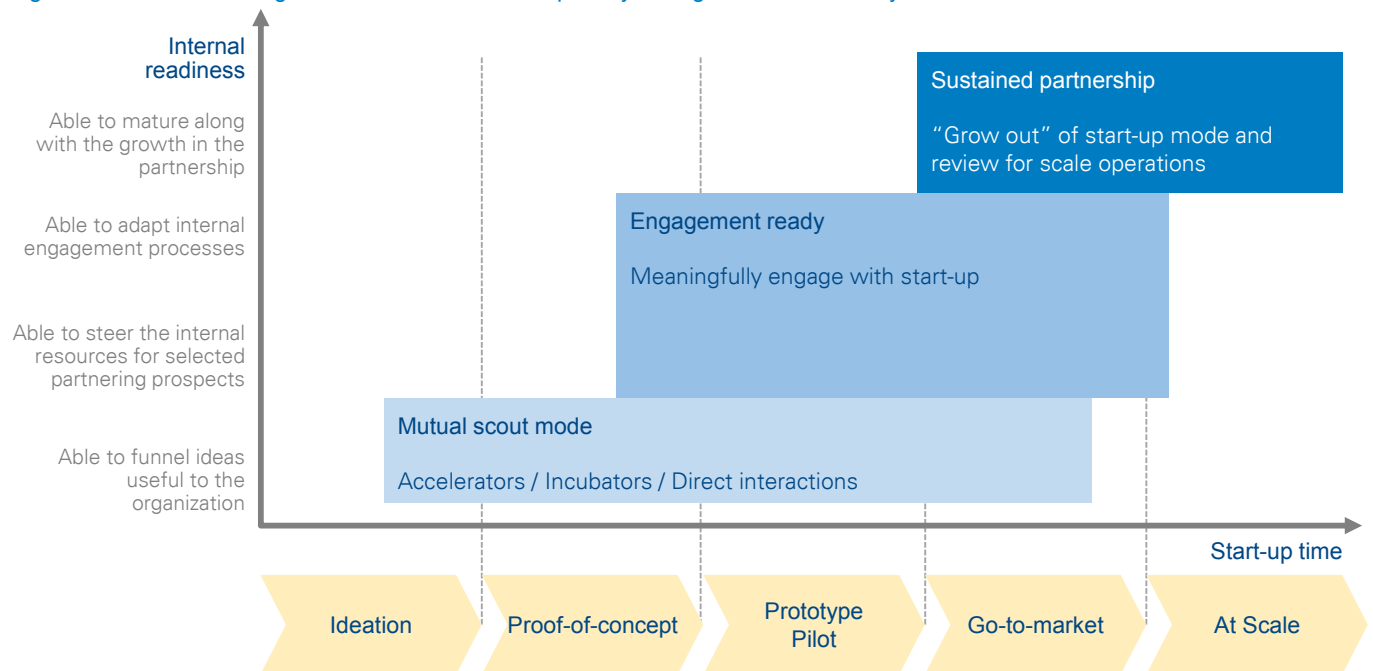
Corporations constantly need success stories to provide intrinsic momentum. At any point in time, the internal question on “why to collaborate with startups” would be prevalent amongst a sizeable percentage of internal employees. The only way to resolve this conundrum is to prove this with tangible outcomes and communicating successes early and often.

4. Sustaining the partnership starts by ensuring fit

To maximize the chances of success, choosing which start-ups to work with and at what maturity stage is an important factor. It is essential to also recognize that the approach on **how** to deal with start-ups depends on the organization's readiness and the maturity of the start-up's offering. It would be a drain on the organization's resources in terms of effort, time and money to work when it is not in the best interest of both parties. For example, operators can simply choose not to listen to pitches when start-ups are still in idea stage. Conversely, start-ups can choose to walk away when their aims are not in line with the operator's focus areas.

This requires a mutual clarity in vision and openness in discussions between operators and start-ups, which needs to ideally be articulated in the value proposition.

Figure 4: Fit for co-creating value: Ensure both start-up and your organization are ready



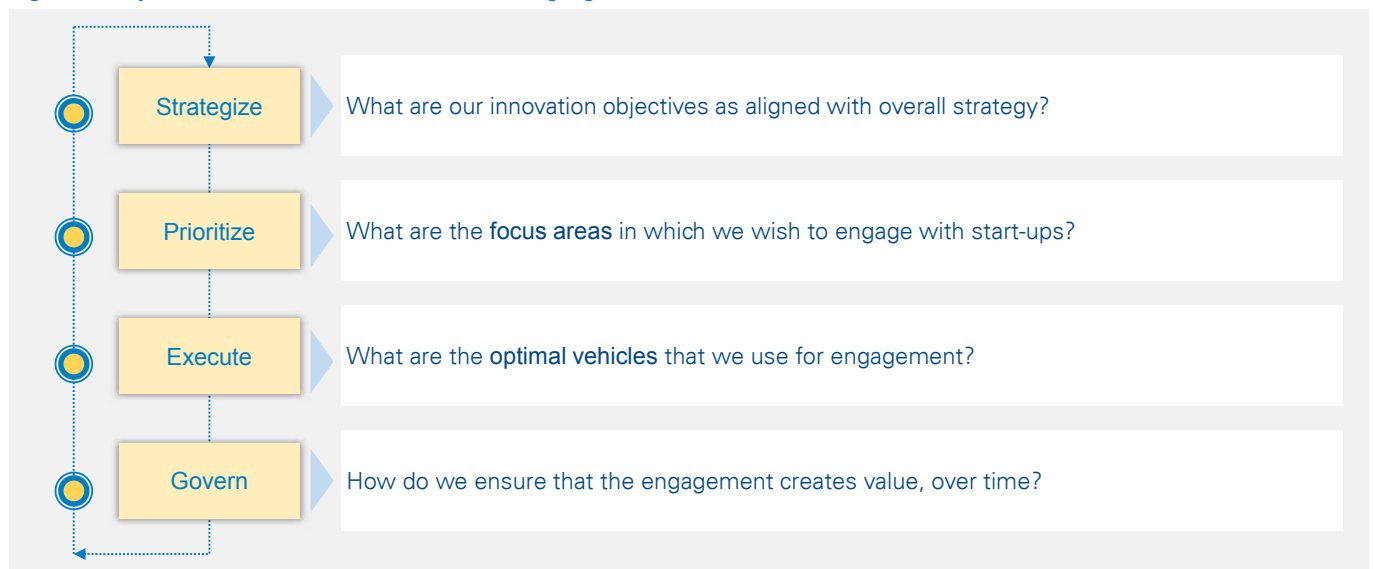
Source: Arthur D. Little, Discussions with practitioners

5. Big Picture: Winning with start-ups needs to be grounded in Corporate Objectives

Business leaders across industries clearly articulate business strategies but rarely do the same when it comes to defining how innovation serves the overarching business objective and drive the message through the organization. It is equally if not more important to recognize the organization's and shareholders' resources are finite. For example, a shareholder may prefer the immediacy and value of sustained fiber investments versus an uncertain bet on a working capital funding to help a disruptive start-up. Without ensuring this clarity and direction, subsequent executive commitment cannot be guaranteed.

In addition, there needs to be alignment amongst various innovation initiatives. Failure to align creates a multitude of *well-meaning* but disparate islands of innovation attempts across the organization spanning In-house R&D, Ideation factories, Intrapreneurship, Spin-ins, Spin-offs, Corporate venturing, Corporate Accelerator or Incubation Programs, Strategic Partnerships, Licensing, M&A efforts. Once again, trade-offs have to be factored in for choosing which set of which "access-to-innovation" vehicles work best for achieving strategy objectives.

Figure 5: Beyond the buzz: Do ensure fit with strategic goals



Source: Arthur D. Little

6. Ensure value co-creation and appropriation through the right governance

Getting the governance equation correct is intrinsic to the success of the operator-start-up collaboration.

Operators have tried models ranging from a highly centralized, “bolt-on” innovation units that compete for resources to “Constellation” approaches with appropriate steering where the collaboration mandate is provided to individual operating units.

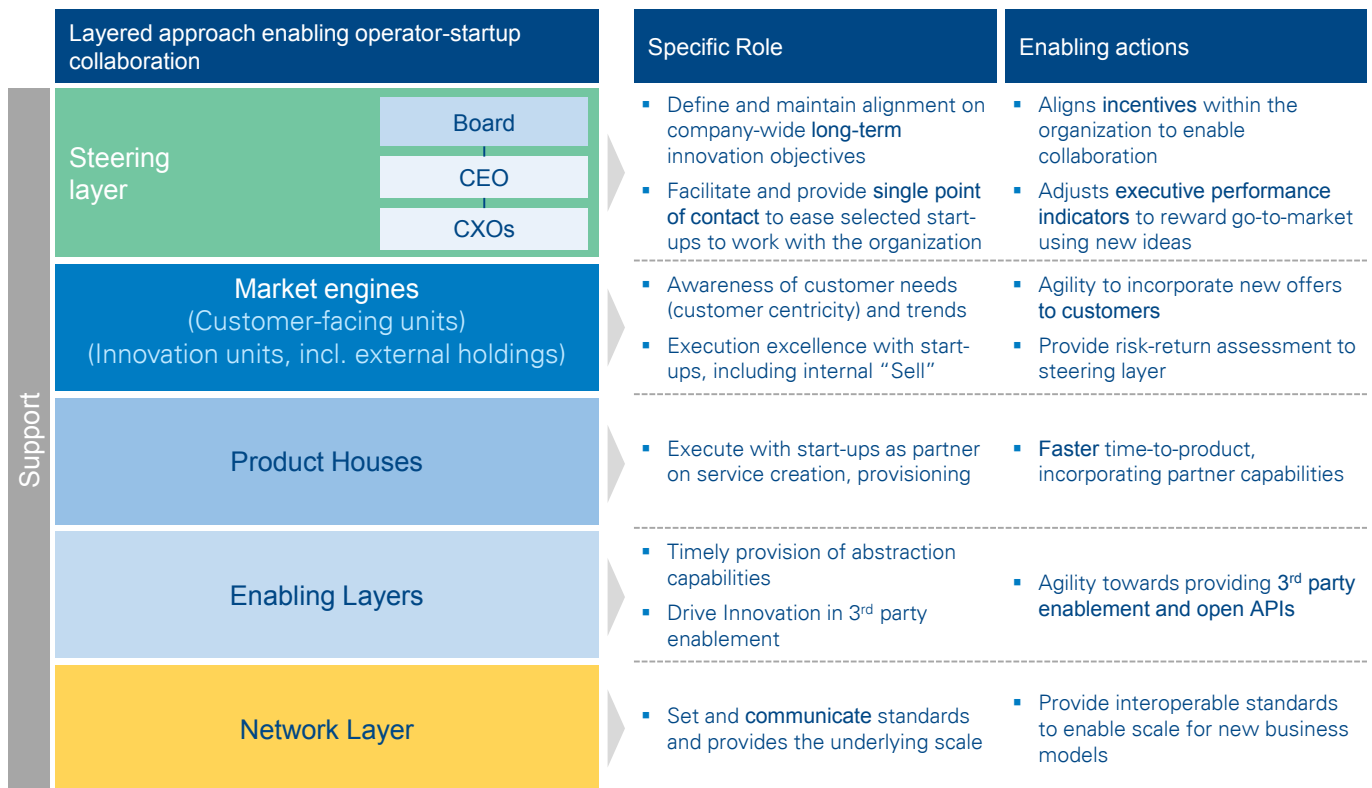
We believe there is no silver bullet approach – however, we focus our key observations and recommendations using a layered approach. The layered approach is an alternative to the traditional operator models (that were more silo'd) – within this approach, orchestration of internal decision and execution processes become more streamlined and amenable for new business models. The approach also breaks down the notion of

a vertically integrated operator by introducing a service-oriented approach amongst the different layers.

In the layered model⁹, the steering functions are responsible for orchestrating and guiding the operational layers with respect to Key Performance Indicators and Service Level Agreements. The Steering layer also infuses new strategic ideas, such as long-term innovation, into the organization. All other layers including customer-facing units, product houses, enabling layers and network layers provide the necessary elements to meet strategic objectives.

In the context of operator-startup collaboration, the layered approach provides a more conducive path to ensure that start-ups are sought and provided the platform to co-create value.

Figure 6: Creating the appropriate internal governance



Source: Arthur D. Little

⁹ See Arthur D. Little viewpoint From Silos to Layers (Feb 2014), Ansgar Schlautmann, Karim Taga et al. - <http://www.adl.com/FromSilosToLayers>

7. Ensure a strong steering function to drive operator-start-up collaboration

We argue for a Centralized Innovation Single point of contact that **facilitates** the various innovation activities inside the organization. This unit needs to be backed by an explicit mandate and enablement from the top executives in the steering layer. However, this alone is not sufficient. For the steering function to work effectively, the following key factors must be considered:

- **Ensure right incentives to the management:** The board and the CEO need to enable incentives within the organizational layers that encourage measured risk-taking. Successful operators have even relaxed performance targets of tightly-managed market engines to enable CXOs so as to bring innovations to end-customers.
- **Ensure appropriate time horizon:** Recognize that the timescales for engagement with startups and value creation are different from quarterly results. Strategically, this requires a lot of staying power and top level backing.
- **Ensure active management of the long-term vision:** Be prepared to disrupt your own business by installing governance principles to facilitate investments in conflicting ideas, through internal or external vehicles
- **Be willing to fail and manage the fall-out:** The hardest aspect is to have a shared understanding across the board and management that the operator-startup collaboration is not without its risks; and that not every operator-start-up project has to be brought back or integrated into the operator's commercial or technology portfolio or processes
- **Avoid excessive "support":** Once in cooperation mode, many companies benevolently overwhelm the start-ups with offers to support or try to integrate the start-ups too early in the enterprise. Autonomy is the drive motor of a start-up's success and must not be subverted.

Alternately, when it comes to pure investment models where an operator chooses to "invest" through Digital Units / active or passive Corporate Venture Capital etc., such activities have to move away from the core operating logic of the stable business. This is due to:

- **Differing governance logic** to decide on resource allocations, to avoid mismatches in shareholder expectations and managerial incentives
- **Differing risk profile** of the core business units with any kind of ventures / bets in related and unrelated domains

A related example that reinforces the challenges was highlighted in the latest move by Google (Aug 2015) to split into a holding structure ("Alphabet") and an operating entity (the new "Google")¹⁰. This has lent more clarity to shareholders and executive teams on its core / near-core businesses. The holding arm will oversee the Google Venture and Google Capital efforts whereas the operating entity retains the ability to source innovation for its own assets.

¹⁰ Sourced from <https://abc.xyz> and <http://time.com/3991798/google-alphabet-companies> (Retrieved 30 Aug 2015)

Takeaways for executives

The motive and the current momentum for collaborating with start-ups or start-up like companies are well-established. As counter-intuitive as this may sound, the key challenge for operators is make themselves the partners of choice in this engagement and choose a model that works for them from strategy to implementation. We urge operators to:

- Embed the innovation goals into the overall strategy
- Proactively **seek** collaboration with a well-defined value proposition, instead of being a gate-keeper
- Provide **scale** by facilitating access to your organizational resources, while ensuring internal empowerment
- **Sustain** the partnership by treating the collaboration as a business over the appropriate time horizon

Also of interest

- Systematizing Breakthrough Innovation (April 2015) - www.adl.com/Breakthrough
- From Silos to Layers – How operators need to change their business models (Feb 2014) - www.adl.com/FromSilosToLayers

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