

The choice is theirs.

Why product and service convergence should be customer-driven



This speech was delivered to an audience of senior executives by Ed Shedd in January 2005. The dinner was the third in a series organised by Deloitte.

Tonight is the third Convergence-themed dinner in a series of four – the final dinner to be held in February, hosted by Richard Punt. So far in this series, we've heard from Jolyon Barker – who introduced the theme of convergence in the Technology, Media and Telecommunications (TMT) market. Dave Tansley then spoke about platform convergence, highlighting IP's key role as the foundation for, and a major power behind, the broader process of convergence.

Today I want to talk about product and service convergence. I want to explain to you why it's so important; how it can both add, and destroy value; and I want to present some guiding principles that I hope will illustrate how to most effectively approach convergence.

First, a quick recap of our definition of convergence. It is – **“the successful application of products and integrated services that previously didn't exist, or were provided separately, from organisations across Technology, Media and Telecoms sectors.”**

Let me illustrate this with a couple of examples. The PC is now a converged product. It's easy to forget that just 10 years ago it was just a glorified typewriter. Today, not only does it comprise a personal computer, but also a DVD player, a CD player and a set of speakers. Several previously discrete products have been combined into a single device. Similarly the BBC Radio service has converged with broadband connectivity as BBC Radio Online – previously discrete digital content and broadband connectivity are combining to create a significantly improved, more powerful service.

Both of these examples show product and service convergence in action – bringing previously separate elements together to create something new. And delivering the potential to create greater value to customers, and greater revenues for suppliers.

The importance of being convergent

There can be no doubt that product and service convergence is a very hot topic for those suppliers. The Consumer Electronics Show in Las Vegas last week saw convergence as one of its primary themes – not only as a talking point but also as a central element of many of the products and services on show. Indeed, for Microsoft convergence was top of its list – and the company painted a picture of the future in which the Windows operating system is manifest on everything from the television set to the mobile phone. Similarly, Hewlett Packard used the event as a platform to show off its new Digital Media Hub – a networked high definition television, cable decoder, digital video recorder and DVD burner – all in one device. The Financial Times commented that the show represents a turning point for convergence – for the first time **“hardware manufacturers, software makers and service providers are starting to look more closely at ways to simplify their products and make them work smoothly with other devices”**. In short, product and service convergence is becoming a commercial reality and a major strategic driver”.

“We’re increasingly witnessing a blurring of the line between products and services. The product and the service combine to create value. The two are essentially becoming increasingly inseparable, interdependent and ultimately, converged.”

But why are we talking about both product and service convergence in the same speech? Well, we now live in an age in which devices are becoming more powerful, more intelligent, and most importantly, more connected. The personal computer, the mobile phone and the PDA are now commonly connected to serviced networks. The television and radio are connected to networks – networks that increasingly require paid-for service provision. You can even now buy digital watches (e.g. the Microsoft SpotWatch) and hi-fi systems that connect to networks. And so we are not only seeing the convergence of products with other products, and services with other services, but also, we’re increasingly witnessing a blurring of the line between products and services. The product and the service combine to create value. The two are essentially becoming increasingly inseparable, interdependent and ultimately, converged.

Let me illustrate this point with an example. Apple’s iTunes service is a uniquely successful converged service offering – using broadband connectivity to deliver digital music to the consumer – as of last Friday it had sold over 200 million music tracks – and analysts are predicting that it will sell half a billion tracks this year.

But the bulk of the value generated by the converged service has been manifest in an entirely divergent device – the iPod. A divergent product that was born of a convergent service, the iPod has generated revenues in excess of a quarter of a billion dollars for Apple¹. But the iPod on its own would never had had such a colossal impact had it not been inextricably linked to the converged iTunes service. Success for both has been their coexistence, interdependence and convergence.

But of course convergence doesn’t always lead to value creation. Nokia’s N-Gage gaming mobile phone clearly demonstrated that just because it’s possible to bring together two products in a single device does not mean that the new device will succeed.

Similarly, a whole host of experiments with broadband television delivered to the home computer have so far gained very little traction.

Why? Largely because these attempts at convergence have resulted in ‘lowest common denominator’ offerings – which do lots of things – but none of them very well. And this is an important point. It tells us that convergence is not a panacea. It tells us that convergence is not always relevant. It tells us that convergence can destroy value, as well as creating it.

So today I want to offer you three guiding principles for product and service convergence – principles that I hope will help to highlight what constitutes successful convergence.

Sell value – never sell convergence

And the first derives from the fact that customers never, ever buy convergence. Convergence is a term the industry uses – not customers. And this is a critically important point. The word ‘convergence’ may well get us all very excited, but nobody – nobody – ever walked into a shop and asked for a converged product or service. Probably nobody ever will. But many millions of people will happily buy converged products and services – if they meet their needs.

So, our first principle for successful product or service convergence is to sell value, not converge. And that means understanding customers – not in terms of convergence – but in terms of their actual present and future needs. Because for any company in the TMT arena, convergence should always be subordinate to customer need. Regrettably, that hasn’t always been the case.

A consumer electronics manufacturer who will remain nameless recently launched a product that combined a personal computer with a television receiver, an AM/FM stereo radio, a CD player and a DVD player. What more could customers want, they asked?

¹ Sales of iPods (including Minis) are approaching 10 million. The company sells about 1 million iPods per month.

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How about ease of use, reliability, light weight, lower power consumption, new and useful functionality, protection against early obsolescence, and low cost, for example?!

Before we get carried away by the excitement of technology, and the myriad apparent convergent opportunities it presents, we must be very wary of the fact that customers will only ever buy converged products and services when they represent value. And that value is manifest in:

- (i) Performance – the converged offering has to perform the various functions that it has absorbed better than the separate products or services used previously.
- (ii) Simplicity – it has to be significantly easier to use, more convenient and more practical than its predecessors.
- (iii) Price – the converged offering has to make genuine economic sense for customers.

Let's look at an example to illustrate the point. The mobile phone. It has an address book, an alarm clock, an answering machine – none of which are required in order to make it a functional device – but all of which make it a more useful, practical, and of course, converged product. This convergence is relevant – it's simple, functional and obvious. So obvious in fact that it's easy to overlook the fact that it is, indeed, convergence at play. And that's the point – people buy converged mobile phones because they represent value. But resolutely not because they happen to be converged.

Convergence promotes diversity

The next principle is that convergence is not about reductionism – it's not about trying to cram as much functionality as is technically possible into a single product or service.

If it were, then product and service convergence would ultimately lead to the creation of a single device, serviced by a single provider, which together satisfied every possible customer need. Clearly that's not the case today. It never has been, and it never will be.

In fact, quite to the contrary, product and service convergence has historically proven to be inherently creationist, not reductionist – particularly in the digital era.

To date, converged products and services have tended to promote diversity – leading to the creation of a greater total number of products and services, more consumer choice – and more to the point, a great deal of divergence.

Consider the digital camera and the camera phone. It's easy to imagine that the appearance of digital cameras on mobile phones – a clear example of product convergence – would essentially destroy the market for stand-alone digital cameras. But exactly the opposite has happened, because for many users, the converged camera phone has offered an introduction to digital photography that has actively encouraged consumers to go out and buy a proper digital camera.

In 2004 the market for camera phones grew at 200%. At the same time, digital camera sales grew equally rapidly – with 53 million units being sold in 2004². And every day new devices are appearing in both markets – adding diversity and choice for consumers. In fact the latest interesting twist in this market is the Kodak Easyshare 1 – a fully featured, dedicated digital camera with integrated (converged) WiFi connectivity. Turning the tables on the camera phone formula, this converged product offers enormous potential – giving consumers the opportunity to take exceptionally high-resolution photographs, and share them efficiently and quickly. This product – and many others – will stimulate further growth in the digital photography market as a whole – a market that already generates over 94 billion photos every year!

What this tells us then is that converged products and services supplement their forebears rather than making them obsolete.

Mobile e-mail – a converged service consumed on a converged device – has captured a healthy niche – but it hasn't and will never destroy the fixed e-mail market.

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² Infotrends Research, 2004.

Internet radio – which represents the convergence of an existing medium with broadband connectivity – has created a sizeable market, but it hasn't in any way affected the broader radio market. Instead, both of these examples – and many others – have created new markets serving specific groups of consumers.

It's all too easy to take a 'black or white' perspective on convergence – the new converged offering appears on the market and makes its unconverged predecessors obsolete. But the principle is clear. In reality convergence drives diversity. It grows the total number of products and services – offering consumers more choices, and offering manufacturers and service providers additional revenue streams.

Convergence is cyclical

In a similar vein, we have to remember that convergence is not constantly relevant or applicable. And what makes a successful converged product or service today may not do so tomorrow.

Look at the electronic games market. For a period in the early 1990s convergence was unequivocally driven by the PC – with a powerful processor and a colour screen, the PC was the ideal converged device for electronic games to thrive on. But it wasn't until the functionality required to deliver electronic games was taken out of the PC and put into a £300 device called the PlayStation that the electronic games market really took off. Delivering greater gaming functionality for less than a third of the price of a PC, the console market has exploded and over 300 million units have been sold worldwide.

So for the electronic games industry, the converged PC nurtured the sector in its early days, but it didn't truly take off until it was afforded its own – diverged, device.

We're seeing this cycle repeated in other sectors too.

The online music market was spawned from the converged PC – but only now, with a stand-alone device, is it generating hundreds of millions in revenues.

The same may well happen with video. Video on demand is currently most popular on the PC, but it won't be until it has a stand-alone device attached to the television that it really takes off. Rumours abound that Apple will produce exactly that – a set top box – using Apple's famously user-friendly operating system, and drawing on its experience from iTunes and the iPod – that acts as a home entertainment server – the gateway to the home for all things digital.

Rumours aside, our third principle is that product and service convergence is cyclical and constantly changing. And companies must respect this fact, and be constantly in touch with the dynamics and drivers that underpin convergence.

The drivers of product and service convergence

1. The move towards digitisation, and the increasing acceptance of IP – and the Internet – as the foundation for all things digital;
2. The growth in processing power (Moore's Law), which is allowing more appliances and systems to become automated and/or intelligent;
3. The increasing prevalence of networks – fixed and mobile – that allow for the transmission and reception of digital information and content.

The more digital a market becomes – the greater its capacity to converge. And just about everything that every company in the TMT arena does these days is digital.

The convergence battle begins

Not surprisingly, therefore, we're about to witness a major collision between three massive industries as product and service convergence marches forwards.

In one corner stands the trillion dollar computer and software industry. In another is the \$200 billion consumer electronics sector. The third is the \$2 trillion communications industry. All three will have a hand in building the next generation of converged products and services.



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But none of these industries, much less a single company, can put all the pieces together. They all need help. Convergence is about alliance – about sharing risk and reward. And working together to create genuinely meaningful offerings for customers. Richard Punt will pick up this point at the next Convergence dinner in February.

Summary

Product and service convergence has the potential to create huge value – it already has – and it will continue to do so. But to maximise the impact – and relevance of convergence – companies must bear our guiding principles in mind.

Making sure that convergence is always subordinate to customer value is critical. All too often we get obsessed with convergence – the need for it, the speed of it, the potential for disruption and so on – but our customers are barely aware of it – and should remain so.

Convergence must not be allowed to distract companies from focusing on serving customer needs – from creating value – and from innovating in the true sense of the word.

And counter-intuitive though it may be, convergence should always be used to grow the total number of products and services available to the market. Any company that builds its product and service strategy around the assumption that new converged offerings will make unconverted ones obsolete, is heading for trouble. Historically convergence has served to add new products and services – to expand the total size of markets – to create new categories, and even new markets. So it represents a huge opportunity for value growth if planned for on the basis of sensible assumptions.

And finally, convergence – like any other variable or business issue – is anything but static. The cycle of convergence is complex and ever-changing – and in order to derive real value from convergence, companies must constantly monitor, revise and refine their strategies in order to develop products and services that are relevant.

What does product and service convergence mean for you – for your company?

So long as product and service convergence is dealt with carefully, it can be translated into a very substantial opportunity. For media and entertainment companies, convergence brings new routes to market, new devices on which content can be consumed, new vehicles for monetising the back-catalogue and even new ways to extend the ‘shelf-life’ of content.

For technology companies, convergence represents not only the opportunity to create more devices and more diversity, satisfying a broader set of consumer needs; it also represents the possibility to reduce costs by eliminating duplication and overlap – all of which can lead to products that have great real and perceived value.

And finally, for telecoms companies, convergence has the potential to bring the next wave of traffic growth – with massive files being downloaded, stored and shared.

Of course success isn’t guaranteed – and I want to leave you with a quote that sums up what everybody should think about when working on converged products and services. “Quality in a product or service is not what the supplier puts in. It is what the customer gets out and is willing to pay for. A product is not quality because it is hard to make and costs a lot of money, as manufacturers typically believe. This is incompetence. Customers pay only for what is of use to them and gives them value. Nothing else constitutes quality.” [Peter Drucker. Quality & value drive convergence].

Convergence – like every other driver or variable in the world of business – must be considered in its proper context – and that context is driving customer value. Convergence should be considered as just one of many possibilities for creating high quality products and services.

Our final research note in this series will discuss convergence at the organisational level.

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Designed and produced by The Creative Studio at Deloitte, London.

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