

Convergence revisited.

Ensuring convergence delivers value in TMT



This speech was delivered by Jolyon Barker at a dinner for senior executives in London, October 2004. The event was the first in a series organised by Deloitte.

Our theme: **Convergence is dead: Long live convergence** has raised some eyebrows, and with reason. After all didn't convergence expire along with the bursting of the dot com bubble at the start of this decade?

We would agree that one facet of convergence did die five years back – ill-considered, value destroying application of convergence at all levels.

However, from the ashes of those debacles we have seen the emergence of a far more rational, business-case based and ultimately **long-term** approach to convergence. In this first speech of our dinner series we consider the boundaries to convergence and the key principles to ensure it delivers value.

Convergence defined

The verb – 'to converge' – originally came into the English language towards the end of the 17th century. Its original meaning was "the tendency of two or more lines to approach one another, as tributaries of a river flowing together." In the 21st century, the forces of digitisation and economic growth are steadily forcing three industry lines together: those of Technology, Media and Telecommunications, and convergence is becoming seen as a by-product of the increasing prevalence of digital technology across all three areas.

Within this context, our specific definition of convergence is "... the successful application of multimedia products and integrated services that previously did not exist, or were provided separately, from organisations across Technology, Media and Telecoms sectors."

The term convergence includes several sub-definitions, each of which refers to a different layer of convergence, but all of which are related to the production, distribution, enhancement and consumption of digital material.

The process of digitisation has changed, and will continue to drive, convergence in the TMT sector. Take the music industry. Music used to be an entirely physical product – a vinyl record or a compact cassette – but is now an entirely digital asset, consumed in physical form as CDs and DVDs, and in virtual form as file downloads.

This fundamental change has both upstream and downstream impacts – it affects the producers of content and services; it affects the intermediaries who assimilate and resell; and affects the end customer, and the means of consumption. The music industry will become increasingly based on the convergence of the technology, media and telecommunications industries. Driven by the process of digitisation and, more importantly, a steady shift in customer behaviour and preferences, convergence will continue at a rapid pace.

But it will not just be manifest at the product or service level. It will transcend the value chain and affect corporate structures, distribution mechanisms and devices.

Digital convergence, in essence, is the foundation for three further – more focused – layers of convergence, namely: Organisational convergence; platform and device convergence; product and service convergence.

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Why convergence?

The simple rationale for convergence is that it can, where appropriately applied, add substantial value from the perspective of suppliers and customers alike.

From the perspective of the customer, it can deliver efficiency, convenience, interactivity, enjoyment, entertainment, integration and immediacy.

The examples below show convergence in action – convergence which has bought greater functionality to customers.

- instant messaging on the mobile phone
- video calling on the desktop computer
- music on the internet
- voice over IP (VoIP)
- interactive television
- BBC Online

From the perspective of the supplier, it can deliver greater ticket value per item, increased profitability, longer and deeper customer relationships, streamlined procurement and distribution, and of course, revenue growth and profitability.

The boundaries of convergence

The answer to the question – why convergence – by definition has to be “because the customer wants it; because it is better than the present offering; and/or because it allows the supply chain to deliver better value to the customer” These variables effectively define the boundaries of true convergence.

These boundaries haven’t always been respected. A comment by Steve Jobs, CEO of Apple, sums up the discontinuity between technological convergence and consumer needs, by looking at the alleged convergence of TV and the internet. “TV is where you go to turn your brain off; the computer is where you go to turn it on.”

Television and the internet may appear at first glance to be broadly compatible (they both require the customer to sit in front of a screen), but in fact they are based on quite different needs, satiated by very different types of service.

The trouble also with products that are multifunctional is that they can do lots of things but often none of them very well. “Drives like a boat, floats like a car” was the verdict on the 1961 Amphicar, an automobile/boat. This quote elegantly sums up why convergence has too often failed to deliver value.

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We can also see the boundaries of convergence in the race to be the first to deliver television over a mobile handset. This is a service based on a far smaller screen than a regular television; which costs significantly more than even the most premium of television services; which drains the battery thus depriving the user of the original reason –making voice calls – for having the phone in the first place. Yet despite this, a number of mobile operators are in an arms race to bring this engineer’s folly to market.

Convergence is misguided in the following four ways:

- It is too often misled by an overriding technology push that generated products and services for which there is scant demand; An example of convergence that led to a product and service in which the whole was definitely not greater than the sum of its parts is the video phone. Actually that’s not strictly true – by mass and acreage the whole is very substantially greater than the sum of its parts. This product failed to adhere to one of our key principles – it converged mobile telephony with video telephony in a way that compromised both services, and resulted in a product that was technically extremely advanced and practically almost entirely useless.
- It has tended to include too many conflicting standards: For example how can you converge on mobile platforms, of which there are over a dozen; on television, which exists in multiple formats: broadcast terrestrial television, cable and satellite television, iDTV, cable broadband, ADSL, wireless broadband, DAB, DVB-H, UMTS?

Case study: A success story

Probably the single most impressive example of convergence is iTunes. Through its iTunes service, Apple has created a service which has – with great elegance – redefined the convergence of the internet with the world of digital music. It brings legal, digital music to a mass audience. It uses exceptional internet design to create a highly appealing user interface. It took two previously uncomfortable bedfellows – the internet and digital music – and created a new, converged offering that has positively and permanently impacted an entire industry (before that industry itself even woke up).

Furthermore, Apple's creation of iTunes has also shown, very powerfully, that the convergence of the broadband connection and the internet do not necessarily have to lead to one of the biggest concerns in the industry today – digital piracy. iTunes has managed to persuade consumers to pay for a product which they were previously acquiring for nothing more than a connectivity cost. iTunes means that the Technology, Media and Telecommunications sectors are sharing in the revenues from digital music.

Apple's iTunes has generated tremendous value: by October 2004, Apple had reached the milestone of 150 million downloaded tracks, at 99 cents in the US, 99 pence in the UK, and 99 cents in the rest of Europe. In Q3 of this year, sales of iPods were 2 million, a 500% increase on the previous year; the brand halo created by the iPod was raising demand for Apple's computers; Apple's profits doubled from the previous year to \$106 million. iTunes is a truly convergent service.

- There has often been a mismatch between the capacity to converge, the demand for convergence, and the willingness of organisations to converge;
- The economic case for convergence is highly variable. Companies have too often failed to properly quantify the return on investment, assuming that the convergence brush will have an equivalent impact on everything it touches. How wrong that is, e.g. with i-mode versus WAP.

Principles of convergence – how to add value

The trial and error approach to convergence has, however, made a positive contribution in the sense that it has led to the emergence of some basic principles – principles that will define the difference between success and failure in a converging world:

1. Make it better than its predecessor

Convergence must add value to something that consumers already want, making it measurably better. A good example of this principle in practice is the BlackBerry handheld e-mail device. When this service was launched, e-mail had already been available on mobile phones for some time, but the user-interface, which lacked a proper QWERTY keyboard on normal phones, was abysmal, the set-up process was laborious and technically complex: the overall customer experience was appalling. But there was established demand for e-mail on the move, so RIM built a device based entirely on a mobile phone, but designed it – and the services that it offered – around the customer need to stay in touch with e-mails. At the same time, they took the additional diary and address book functions from the PC and PDA, and folded them into a package that was completely networked and synchronized. The BlackBerry device is the world's best selling PDA, outstripping iPAQs and Palm Pilots. BlackBerry subscribers increased by 19.1% in the third quarter of 2004, to 1.7 million and the devices now represent almost 10% of the global mobile smart-phone market.

2. The whole must be greater than the sum of its parts

This may seem obvious, but common sense is not commonly applied. The benefits of each individual converging strand must amplify the benefits of its counterpart. An outstanding approach to this has been developed on several occasions by Apple Computer – see case study box.

3. Share benefits equitably

For convergence to work on an economic level, the relationship with the customer must be clear to all converging parties, and the capacity of each to yield revenues from that relationship must be clear. A powerful example of this can be seen in the relative success of iMode in Japan versus the failure of WAP in Europe.

iMode was founded on a very clear converged economic model, in which there was an equitable and consistent share of revenues between the network operator and the content or service supplier. All parties knew what to expect, and as consequence, could invest appropriately in the development and promotion of their offering. By August 2004, there were 42 million i-mode subscribers in Japan.

By contrast, WAP was never afforded such clarity. Network operators were loathe to share revenues with content and service providers, and often used their relative power to impose unreasonable terms on smaller suppliers. As a result, the WAP offering was rather confused, poorly structured and very badly promoted. Not surprisingly, these days, European operators are steadily replicating the iMode model, the most significant example of this being Vodafone's Live service.

4. Take your lead from the customer

At its heart, convergence must be led by customer behaviour. There have been far too many examples of convergence that had little or nothing to do with customer needs.

This takes us into the realm of comedy: The internet fridge, the digital watch with integrated MP3 player or the digital camera with integrated MP3 player.

5. Remember divergence

A final principle is to exploit the cycle of TMT products and applications converging then diverging over time: Sony's PlayStation emerged from the PC and consequently trebled revenues for the electronic games market; the MP3 player is the standalone version of digital music that previously existed on the PC alone – the 100 million and rising paid-for downloads would not have happened so fast, were it not for MP3 players. Indeed this is an example of a divergent device boosting a convergent service.

“Put simply, convergence will transform your industry.”

If you would like to discuss any of the points made in this speech, please contact one of the hosts of the convergence dinner series:

Jolyon Barker

Leader of UK TMT practice
+44 (0) 20 7007 1818
jrbarker@deloitte.co.uk

David Tansley

+44 (0) 20 7303 7195
dtansley@deloitte.co.uk

Ed Shedd

+44 (0) 20 7007 3684
eshedd@deloitte.co.uk

Richard Punt

+44 (0) 20 7007 0887
rpunt@deloitte.co.uk

www.deloitte.co.uk/convergence

So when thinking about convergence, it is important to remember that a single, homogeneous, global converged offering is almost always not what the market is asking for. Consumers have differing levels of disposable income, fashions come and go, and competition leads by definition to fragmentation.

It's also important to reinforce that divergence can create enormous value. The booming television market derives in no small portion from the fact that there are many variations on a theme – and each one serves a different part of the market.

Convergence is dead: Long live convergence

For the TMT industry, convergence can, has and will continue to generate value for those companies which adhere to the aforementioned principles for convergence. It will happen at all of the levels alluded to. And it will happen in a manner that has the potential to radically and permanently affect every company in the TMT sector.

So, what does it mean for you? Put simply, convergence will transform your industry.

At the platform level, for consumers, platform convergence will enable a raft of new, more efficient, more productive, applications, with VoIP being just the first of these. For suppliers, platform convergence can lower the cost of operations, particularly around commissioning and delivery, and hence improve profitability.

Product and service-based convergence can generate significant added value for all companies involved, as we have seen with iTunes, iMode, the RIM Blackberry. Even the apparently trivial incorporation of an increasingly large address book on a mobile phone has had a massive impact on value generation for the mobile industry.

Finally organisation-based convergence, be this based on acquisition, alliance or supplier relationships, will provide opportunities for value creation over time. However your company has to be ready and primed to take advantage of each opportunity as it arises. Sony Ericsson's market share has grown from 5.4% in Q2 2003, to a current share of over 7%. Their third quarter sales figures have seen a 51% annual increase to over 10 million units. It did, however, take two full years to get the convergence of organisations productive, i.e. the combination of Sony's understanding of product design and Ericsson's engineering expertise.

Convergence is real, powerful and an increasingly important factor in the TMT sector. To make the most of it, rather than it make the most of us, all of us have to understand and harness its potential to transform every aspect of our business, our platforms, our services, our organisational structures, our value chains and our customer relationships. The extent to which convergence adds or destroys value is a direct function of the extent to which we anticipate, plan for and lead convergence.

Three further research notes will discuss convergence at the platform and device, product and service and organisational levels.

Service line contacts

Panos Kakoullis

Audit
+44 (0) 20 7007 3337
pkakoullis@deloitte.co.uk

Ian Hook

Tax
+44 (0) 20 7007 3653
ihook@deloitte.co.uk

Jolyon Barker

Consulting
+44 (0) 20 7007 1818
jrbarker@deloitte.co.uk

Chris Williams

Corporate Finance
+44 (0) 20 7007 2813
christopherwilliams@deloitte.co.uk

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