

**Industry Study on Sustainable Development of
Minority, Women, and Disabled Veterans Business Enterprises
in the Telecommunications Industry**

April 2003

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Introduction

In October 2002, the Joint Center for Political and Economic Studies (Joint Center) in partnership with The Telecommunications Industry Group (TIG) of the National Minority Supplier Development Council (NMSDC), commissioned an industry study focused on identifying and addressing the issues of achieving sustainable development of Minority, Women, and Disabled Veterans Business Enterprises (MWDVBEs) that supply goods and services to the telecommunications industry.

The study (to be released at SUPERCOMM 2003) sought to provide insights into the following:

- The industry trends in the supply and value chains that affect supplier diversity initiatives and MWDVBE suppliers
- Establishing a baseline assessment of MWDVBE suppliers within the industry (commodity concentration, tiered structure, size distribution, etc.)
- Addressing the industry-specific issues and challenges regarding the sustainability of minority businesses. Identifying some industry-specific challenges to minority sourcing and observed solutions by industry players
- Identifying any industry, capital, and operational issues that must be addressed in order to achieve MWDVBE suppliers' sustainable growth
- Best ways to evolve the current mindset from one which asks only "what contracts are immediately available for me" to a mindset that says: "Given industry dynamics/changes, what are the solutions that add value to the client corporation?"
- How should a telecommunications corporation leverage its current supplier diversity and diversity marketing efforts to build lasting customer and brand name loyalty with minorities and women?
- How should MWDVBE firms develop growth strategies that are not based strictly on organic growth, but also on portfolio approaches: strategic alliances, acquisitions, mergers, etc.?

The Asaba Group, Inc. (a Boston-based strategy and management consulting firm specializing in supplier diversity business issues) conducted the industry study.

Executive Summary

This industry study was undertaken with the intent of determining how best to achieve sustainable Minority, Women, and Disabled Veteran owned businesses as suppliers to the Telecommunications Industry. In developing the study, industry interviews were conducted with a significant number of individuals representing a broad spectrum of stakeholders involved directly or indirectly with Supplier Diversity initiatives. These individuals represented the senior leadership of MWDVBE suppliers, senior corporate procurement managers, program managers for Supplier Diversity programs, leadership from advocacy organizations, and senior corporate managers in strategy and new product development. Alongside the industry interviews was an extensive secondary research effort on the industry trends, regulations, competitive dynamics, benchmarking, and the supply chain. As the industry study evolved and was taking shape, the emerging hypotheses regarding the issues affecting sustainability of MWDVBE suppliers began to appear as systemic and broad rather than firm specific.

The industry over the last six years has experienced significant structural changes, which affected every participant in its value chain. Examples of the structural changes are the significant number of corporate restructurings, changes in the way business is conducted, increases in the level of competitiveness, uncertainty in the regulatory environment, and reactions in the capital markets. These are all testaments to an industry undergoing change. With this backdrop, Supplier Diversity efforts and their associated outcomes are not immune to these changes. Some of the MWDVBE sustainability issues are actually the unintended consequences of an industry experiencing structural change, but some are reflective of Supplier Diversity processes that have not evolved to reflect the new realities in the industry.

This report is based on an “outside in” perspective. It starts with laying out the issues affecting the industry and how these issues affect the MWDVBEs. It begins to present the case for developing a strong business case and consistent value proposition for engaging in Supplier Diversity. It then presents the current state of MWDVBEs. This is accomplished via a data-driven, fact-based analysis of the issues facing MWDVBEs in the industry. These issues range from commodity concentration, value migration™,

size/scale, scope, competitive positioning, and sensitivity to industry capital expenditures. The report also addresses the effectiveness of Supplier Diversity programs and the challenges associated with aligning (in some cases, evolving) current efforts in dealing with the new industry realities.

Three discussion forums were held with the goal of reviewing the gathered information and emerging hypotheses, and then developing the recommendations. Two of the forums were roundtables hosted by AT&T and Verizon. These roundtables had senior level representation from corporations, advocacy organizations, and MWDVBE suppliers. The third forum was a presentation to the Telecommunications Industry Group. The recommendations reached at the roundtables reflect the need for a change in perspective in the industry's approach to Supplier Diversity. The change in perspective (similar to a shift in paradigm) is from one based on "creating supplier access and getting on the bidders list" to a proactive focus on "supplier development and sustainability." Sustainability is defined by an enterprise's ability to be competitive and create wealth over the long-term. The roundtable participants concluded that past approaches to Supplier Diversity would most likely be inadequate in an industry where the fundamentals in the future will be different from the last six years. The recommendations to key stakeholders involved in Supplier Diversity require them to take on new roles, evolve their processes, and redefine the measures of success. While the MWDVBEs are expected to do their part in creating resilient business models focused on high value opportunities and creating superior value to their customers, the enabling environment must exist to enable these suppliers to thrive in the supply chains. Creating the enabling environment will be dependent on the following:

- How the corporate supplier diversity programs evolve their processes and deployment of resources
- The ability of advocacy organizations to enhance their value proposition to the corporate and MWDVBE community by providing relevant services that enhance sustainability
- The leadership from the Telecommunications Industry Group in driving the implementation of identified initiatives

Industry Realities and Impact on Diverse Suppliers

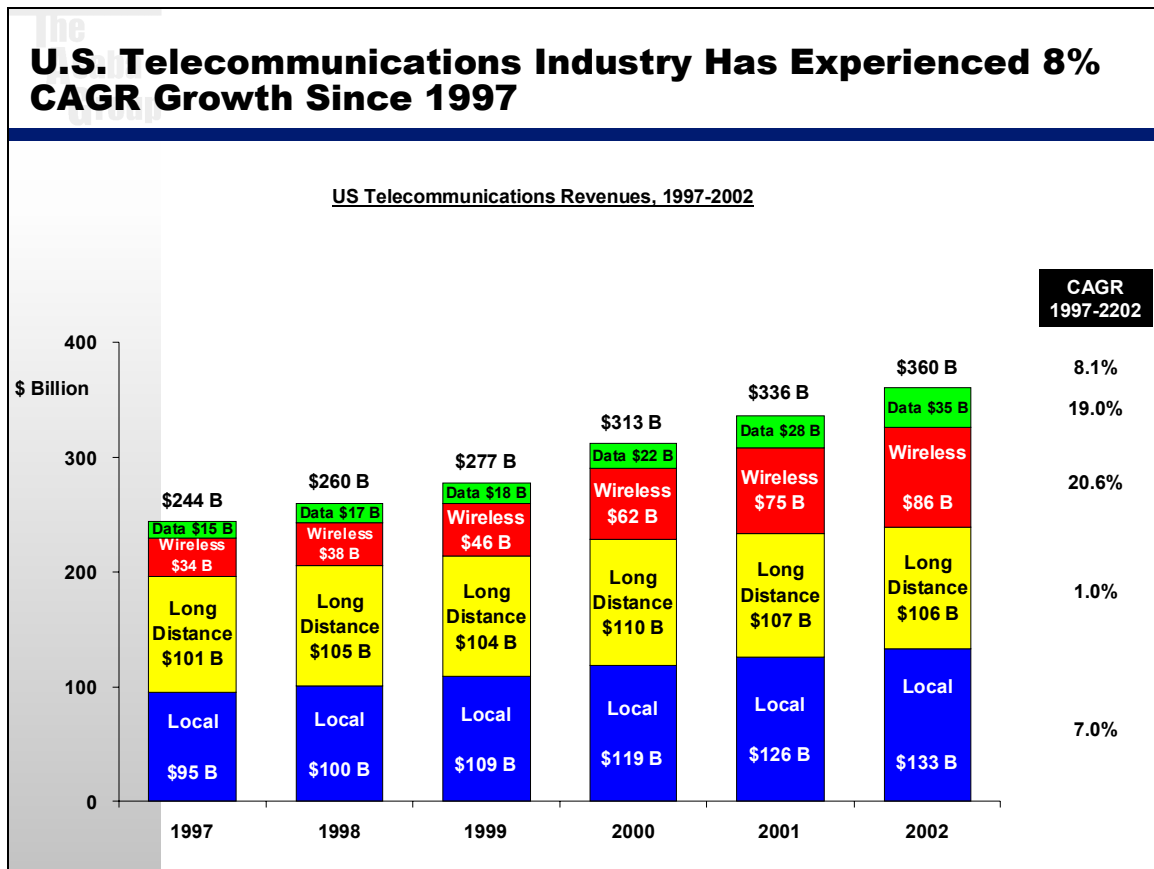
This chapter briefly discusses the current industry realities – key factors and issues that impact all players in the sector. The chapter goes on to discuss specifically the resulting impact and threats to MWDVBE suppliers.

Industry Realities

A) Market and Revenue Trends

The overall U.S. Telecommunications Industry has experienced an 8% Compounded Annual Growth Rate (CAGR) in revenues since 1997 and continues to grow despite the soft economy. While local voice wireline services continue on a slowing trend due to commoditization, and long distance wireline services stay flat, the wireless and data segments remain the main driver of industry growth (Fig. 1).

Fig. 1



Wireless service revenue growth is driven by the increased adoption of cellular phones, telecommuting, and applications such as wireless Internet and computing. Data services

continue to grow with broadband proliferation and the shift from circuit switched to Internet Protocol (IP) switched networks. IP networks are considered more flexible and cost efficient and enable a wide variety of new services for commercial and residential customers. Growth in wireline local and long distance voice services revenues are declining mainly because of increased competition (which drives prices down) and the substitution effect from wireless services and cable telephony.

B) Regulatory Uncertainties

The Telecommunications Reform Act of 1996 (TRA 1996) introduced competition into the local wireline services segment. The Incumbent Local Exchange Carriers (ILECs) were made to provide to competitors an Unbundled Network Elements-Platform (UNE-P) at low wholesale rates. These competitors were either long distance operators (such as AT&T, Sprint, or MCI), cable TV operators, or new entrants called Competitive Local Exchange Carriers (CLECs). The ILECs (primarily the RBOCs, or Regional Bell Operating Companies) have argued that existing rules have held back broadband deployment and created significant regulatory uncertainty that unnerves the financial markets. In response to the RBOCs argument, the Federal Communications Commission (FCC) met to consider proposals to adjust these rules. The most recent regulatory milestone for the telecommunications industry was reached in February of this year, when the FCC kept in place the TRA 1996 ruling on ILECs obligations to make elements of their networks available on an unbundled basis to new entrants. This ruling introduced an increasing amount of vagueness to an industry already plagued by uncertainty. According to the ruling, individual states shall now be responsible for determining the wholesale rates of the local loop voice networks that the ILECs shall lease to competitors. Not only does this introduce high levels of red tape to the regulation process and unpredictability from state to state, but also increases the probability of numerous lawsuits challenging the FCC ruling. This raises the risk levels associated with future Capital Expenditure (CapEx) planning as well. In terms of additional capital investments (i.e., network build out and upgrades) for which the ruling was expected to pave the way, it appears that the RBOCs are still reluctant to increase their spending – and this despite the favorable second part of the ruling, which postulates that in Broadband, RBOCs no

longer have to lease lines at wholesale rates. This may be because the voice business is considered the cash generator for future investments. In summary, the February ruling by the FCC resulted in an increased level of uncertainty in the telecommunications sector, which makes it somewhat unattractive to investors: in traditional wireline services, it appears RBOCs are undecided about increasing network-related expenditures, and in Broadband, data CLECs (DLECs) such as Covad will now have to pay much higher rates to lease Baby Bells' networks.

The February FCC ruling retains the role of state regulators in deciding what elements of the ILECs phone networks should be available and at what wholesale rates. The ability to influence state utility commissioners will be a determining factor in how telecom players compete in the foreseeable future. In Michigan, for example, the state's Public Service Commission is considering a state house bill (House Bill 4044) that would break up the ILECs' wholesale and retail units into separate companies.

C) Industry Upheavals and Restructuring

In the last few years, the struggling telecommunications industry, already afflicted by a number of negative factors, was hurt even further by the burst of the Internet bubble, the economy slowdown, and capital markets unwilling to provide new capital to unprofitable ventures. The result was a significant shake-up of industry players and restructuring of the value chain. Up until recently, the daily news was full of companies announcing layoffs, bankruptcies, or restructurings. Many have outsourced traditionally internal operations (such as call centers for service providers or manufacturing for OEMs) in pursuit of additional possibilities for cost reductions and to re-focus on core competencies. The competitive landscape proved over-saturated to be able to sustain the unjustifiably large number of new participants, one of the outcomes of the TRA 1996. Deregulation that it introduced led to thousands of CLECs rushing into the telecom market space and engaging in vicious price wars. Eroding margins made it impossible to service the high levels of debt necessary to play on the telecom arena, and a wave of bankruptcies started gaining momentum when the overall economy fell into a recession in 2000. Looking into the future, bankruptcies are expected to continue, albeit at a slowing

rate, given the growing competition and lingering price wars on three new fronts: RBOCs entering long distance markets; Interexchange Carriers (IXCs) entering local markets; and CLEC's emerging from bankruptcies with lightened debt burdens, spurring them to cut prices (in order to win customers) to unrealistic levels. The industry shakeout is predicted to last until only a rational number of industry players matching existing (not forecast) market demand remains.

D) Fiber Overcapacity

Excess bandwidth has received perhaps the most blame for the telecommunications industry decline. Even though some highly targeted opportunities in additional network build out do exist, the amount of fiber capacity already installed far exceeds both current demand and what some industry analysts claim as future anticipated demand for high-speed services. Again, the culprit had been the unreasonable demand forecasts driven by the booming Internet economy. Feverish network expansion that was supposed to carry huge amounts of data (predicted to double every two years) has driven many telcos into heavy debt or bankruptcy, but today's capacity utilization is running at roughly 35%, only half of the ideal load level.

In our opinion, one of the underlying reasons why data services growth lags far behind expectations is the current absence of "killer applications" (applications that provide value to mass-market consumers who will in turn drive the utilization of speed and bandwidth). In the last few years the industry has failed to produce "the next big thing" that would require a lot of bandwidth, convince users of its indispensability, subsequently entrap them, and ultimately drive demand for high-speed data networks. Significant focus has been on providing high-speed access and not on mass market utility. Without such new yet proven applications (and being able to take and send pictures using a cell phone is not one of them), financing options have been scarce, with investors continuing to exercise extreme caution within the telecommunications sector.

Impact on MWDVBE Suppliers

A) Capital Expenditures Impact

The implications of discussed key industry trends are quite unfavorable to smaller suppliers, especially those who lack a well-defined value proposition and operations focused on well-defined core competencies. As the U.S. telecommunications industry started witnessing a dramatic drop in CapEx levels beginning in 2002 (Fig. 2), there is not enough business to go around for everyone in the supply chain to survive. The Minority, Women, and Disabled Veterans Owned Business Enterprise (MWDVBE) telecommunications suppliers have been adversely affected by the drop in industry CapEx. A number of MWDVBE bankruptcies (Fig. 3) has occurred as a result. Furthermore, as opportunities for incremental savings from CapEx cuts have diminished over time, reducing the Operating Expenditures (OpEx) became the new focus of the large players' cost containment initiatives. This explains their dedicated efforts of applying strategic sourcing initiatives to purchasing spending.

Fig. 2

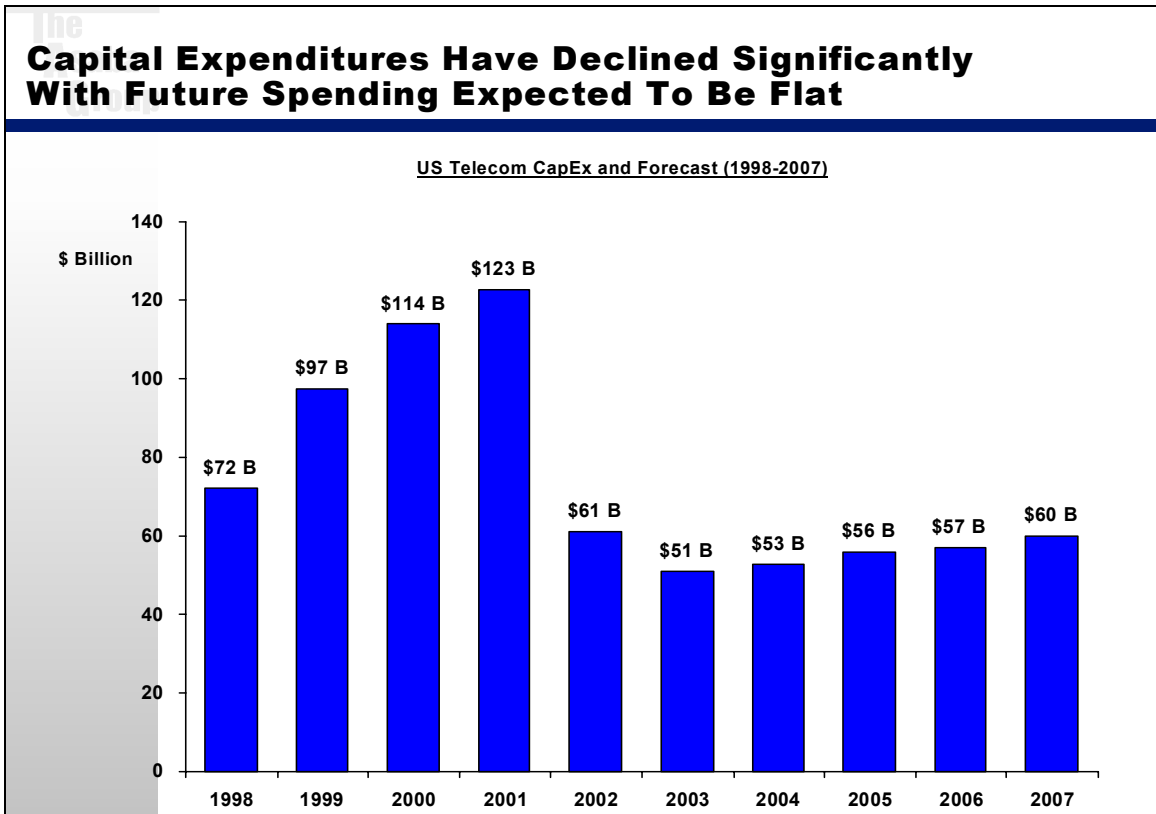
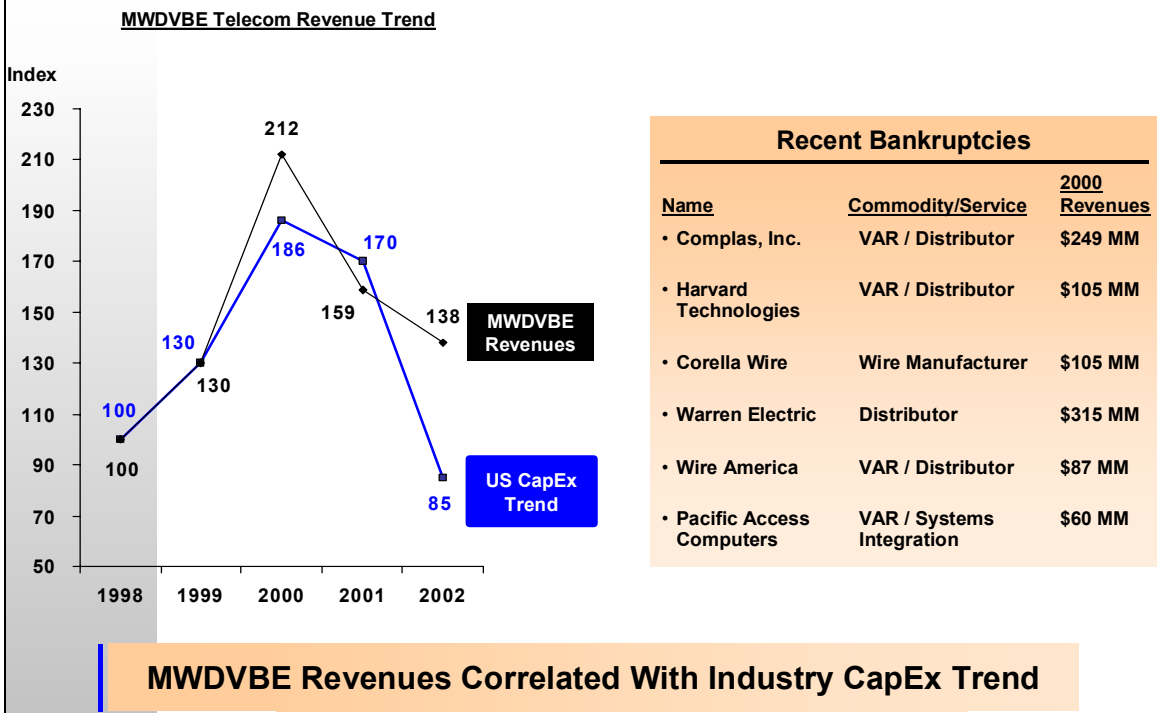


Fig. 3

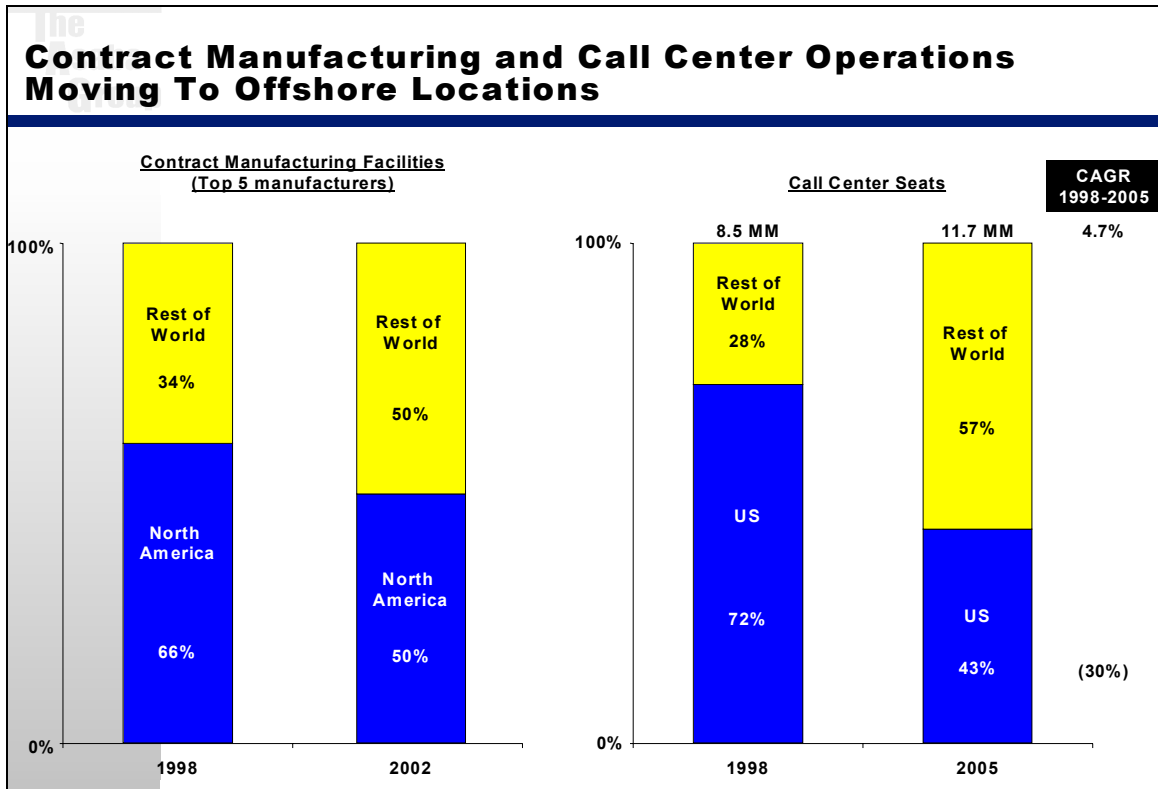
Drop In Capital Expenditures Has Negatively Impacted MWDVBEs
 Some MWDVBEs Are In Bankruptcy – About \$1 Billion In 2000 Revenue



B) Outsourcing, Bundling, and Offshore Migration

Yet another trend negatively affecting smaller U.S. suppliers is the accelerating pace of outsourcing and subsequent migration to sourcing products and services from lower-cost offshore locations such as India, China, the Philippines, etc. This is most evident in contract manufacturing, call center operations (Fig. 4), software development, and Information Technology (IT) operations (Fig. 5). Most MWDVBEs do not have the scale and/or scope to either compete effectively with offshore competitors or take on large outsourced projects. For MWDVBEs, such difficult environment translates into a shift of operational modes: it has become one of survival in an environment where the relevant opportunity space continues to shrink.

Fig. 4



During our industry interviews with purchasing managers, they mentioned the challenges currently facing MWDVBE telecommunications suppliers. Below are some representative quotes:

Outsourcing and Bundling:

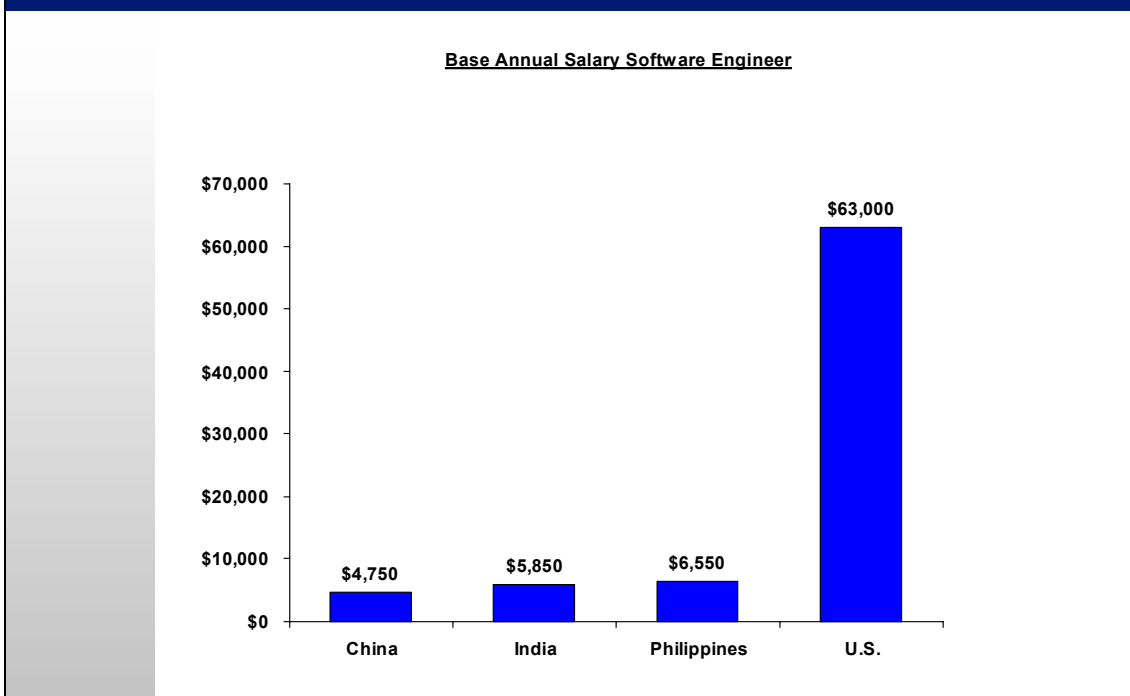
“Overseas outsourcing and bundling are the two biggest trends today adversely affecting MWDVBE’s. This is why I increasingly find myself doing more mentoring than actually looking for opportunities for our diversity firms.”

“OEMs break up contracts into pieces and source those with lower margins to MWDVBE’s: thus diversity suppliers neither get the juiciest pieces nor see the whole picture, which makes them unable to take the business away from OEM one day.”

Fig. 5

Offshore Migration Also Observed In Software Development And IT Operations

Driven By Cost Savings In Asia Compared To U.S.



“Everything is outsourced nowadays. We play more of a managerial role today, which includes negotiating with Contract Manufacturers, selecting suppliers for them, and determining prices at which they should buy from these suppliers. [Given this level of control] we are more likely to use parts from OEM’s than distributors.”

Offshore Migration:

“It is a difficult balance between minority manufacturing with minority employees in under-utilized areas and global competition that necessitates low cost manufacturing [overseas].”

“The OEMs won’t pay a premium for minority sourcing (manufacturing) in the US – can’t meet cost structure competitiveness.”

“Market realities are driving the movement to low cost region – call centers, manufacturing, and software development.”

“Empowerment zone works well for low value added (JIT) work, e.g., distribution or sequencing, but difficult when you require skilled low cost labor and infrastructure for electronic manufacturing.”

In summary, the soft economy and continuing regulatory uncertainty have contributed the most to the telecommunications industry’s pervasive cost cutting mantra to sustain operating profits. However, these cost improvements are leveling off and further cuts are no longer improving margins. With capital expenditures reduced to network maintenance and improving efficiency, the big players have shifted their attention to operating expenditures. In attempts to gain additional efficiency and productivity improvements, they began to focus on their purchasing spending to achieve cost savings. Industry players have engaged in dramatic supplier base rationalization and consolidation of their spending with fewer larger suppliers; they also indulged in the ever-popular outsourcing trend, in essence deconstructing the old supply chain patterns and rerouting the value flow. Component OEM’s no longer maintain a customer base – they simply off-load their products to distributors. Equipment OEMs no longer actually manufacture – Contract Manufacturers have taken on that responsibility; instead, OEM’s increasingly focus on research and development and program management functions. Service Providers have increased their focus on customer acquisition and retention, putting more emphasis on building marketing and branding advantages, lowering cost associated with

customer acquisition, and creating products and services that improve retention. So, where and how does Supplier Diversity fit into this rapidly emerging landscape that is increasingly challenging for small businesses – an environment where every expenditure is viewed in terms of “what value is created from it?”

C) Supplier Diversity Value Proposition

From our survey of industry procurement managers, it is clear that the articulation of Supplier Diversity value proposition is inconsistent, both within companies and across the industry. Below are comments from industry interviews that reflect the direction that Supplier Diversity programs had taken in the currently tough economic environment:

“Why should I change the way we do business? The value proposition must be pretty compelling for me to use a new supplier.”

“With issues of how performance ranks compared to sales and profit... Supplier Diversity is at the bottom of the list.”

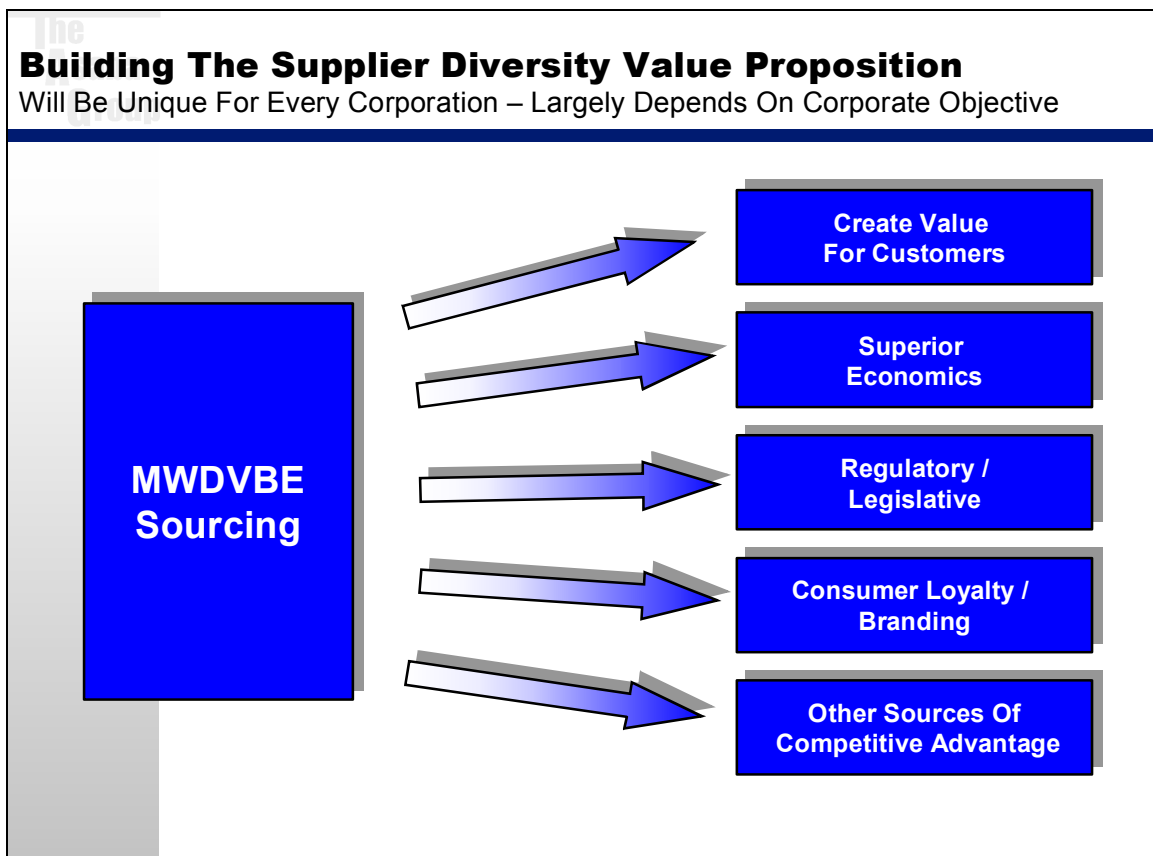
“We support procurements from Minority (MWDVBE) suppliers..., but they must be competitive in every way to earn the business.”

“We are in a survival mode... Only real value added is sustainable as a differentiator.”

“The approach of ‘give everyone a chance to bid’ doesn’t create value for anyone. No one made any money because the business was bought [under-bid].”

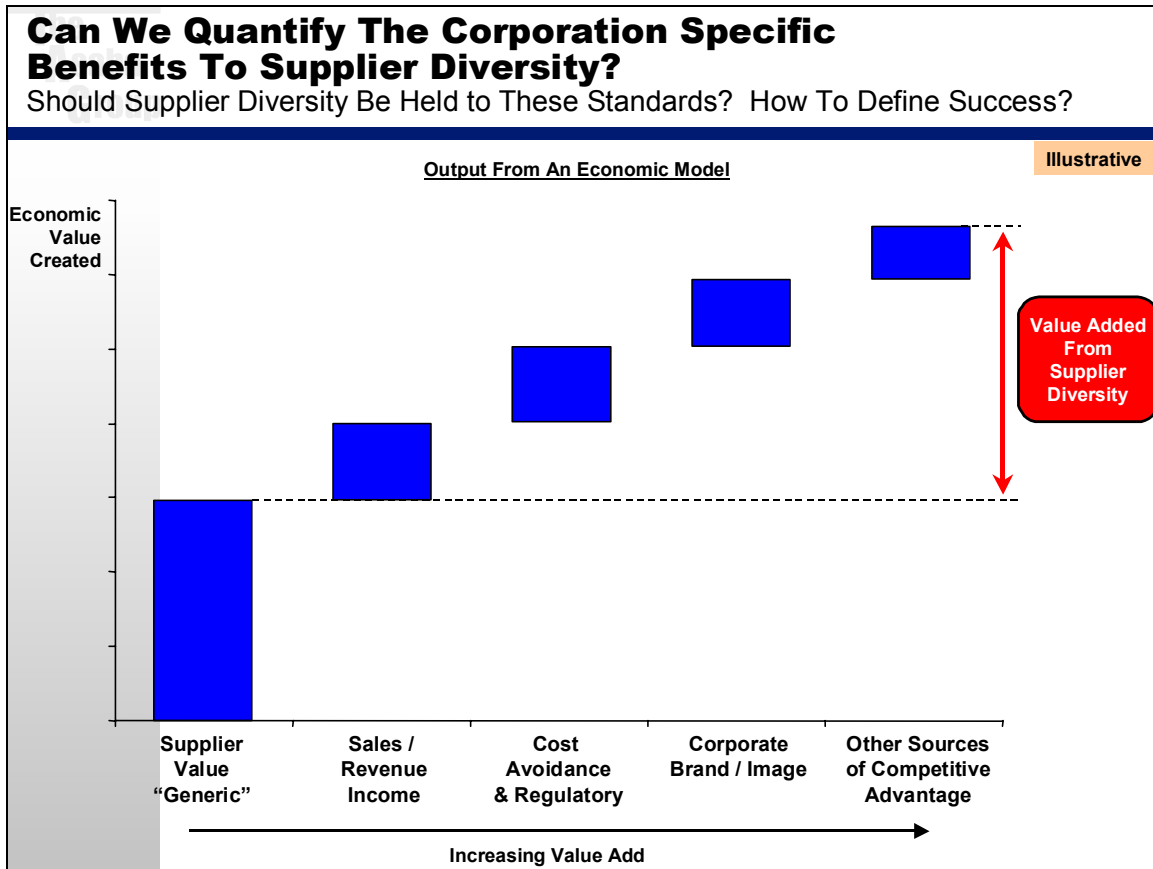
Given the industry realities, Supplier Diversity is not, nor will ever again be, done simply for the sake of creating diversity in the supply chain based on non-economic/non-business reasons. The value proposition has to make sense now, for all stakeholders involved and with the corporation at the top of the beneficiaries list. From commodity buyers to top executives with profit and loss responsibility, every corporate manager today wants to see how an additional dollar spent on Supplier Diversity trickles down to the bottom line, either by adding value (revenue growth) or by eliminating costs (Fig. 6).

Fig. 6



This means that the business case for Supplier Diversity must now be clearly and succinctly articulated and, where possible, quantified in an economic model (or, on a case by case basis, at least those components of the economic model that are key drivers of the corporation's objectives) (Fig. 7).

Fig. 7



How existing Supplier Diversity stakeholders deal with these and other pressing issues is the subject of the next chapter.

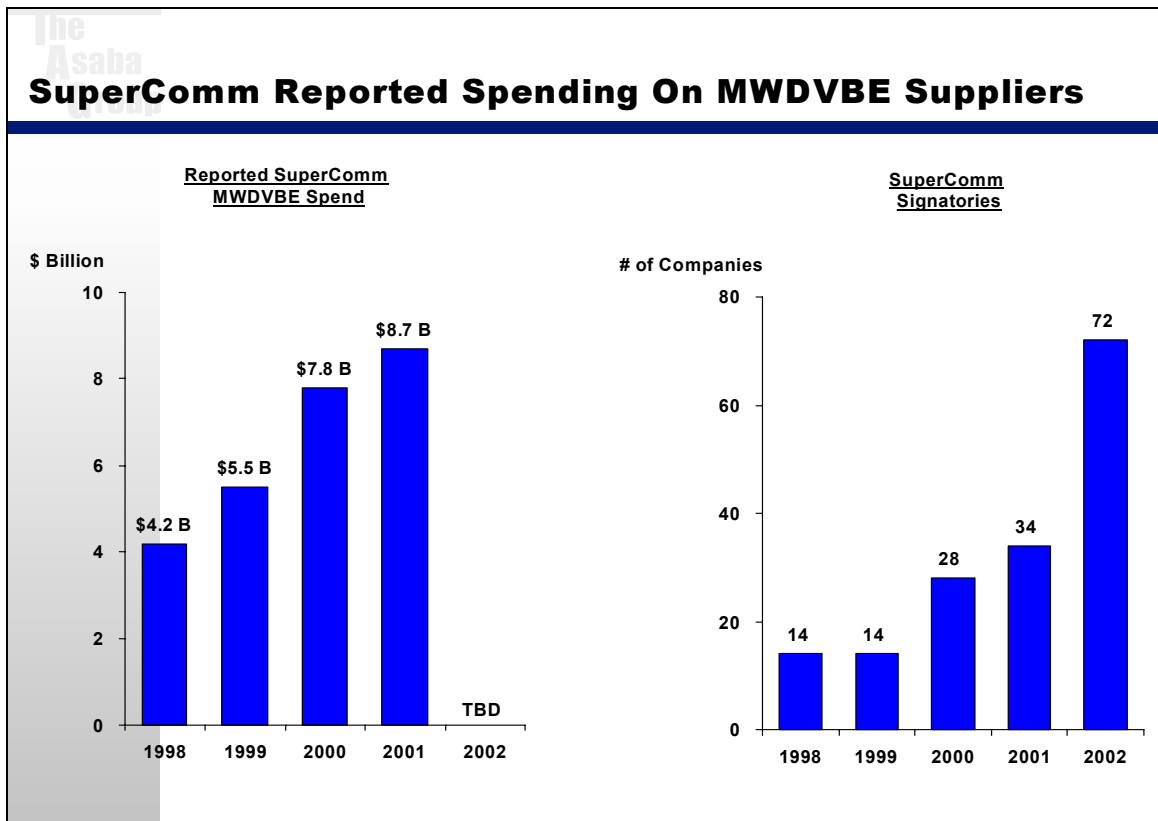
Current State of MWDVBE Suppliers

In developing this industry study, we were provided a considerable amount of information and data about MWDVBE spending by a number of industry participants. In this chapter, we share some key findings and insights garnered from our analysis of provided data. This represents a significant step forward in defining the state of MWDVBE suppliers founded on fact-based, data-driven analysis.

A) MWDVBE Sourcing Trends and Bankruptcies

One of the more widely touted measures of success for Supplier Diversity is the amount of annual industry spending with MWDVBE firms. Together, SUPERCOMM signatories have been reporting a steady rise in MWDVBE sourcing dollars, but as evident from Figure 1, a significant driver of the increase in MWDVBE spending has been expansion of SUPERCOMM membership versus organic growth of the spend by the same companies year over year. The SUPERCOMM MWDVBE challenge result creates an imprecise view of historical trends and the current situation of MWDVBE suppliers.

Fig. 1



To adjust for these inconsistencies, we selected a broad sample of major telecommunications companies that collectively represent a very large share of total industry purchases and more than 50% of reported industry MWDVBE spending (Fig. 2); when we plotted these same companies' reported year over year spending with MWDVBEs, a truer organic trend picture of MWDVBE spending emerges. As a check to this observed trend, we analyzed the annual revenues for top 23 telecommunications MWDVBEs (Fig. 3): their revenue trend mirrors the sample MWDVBE spending on Figure 2. This shows that MWDVBE spending has indeed declined since 2000.

Fig. 2

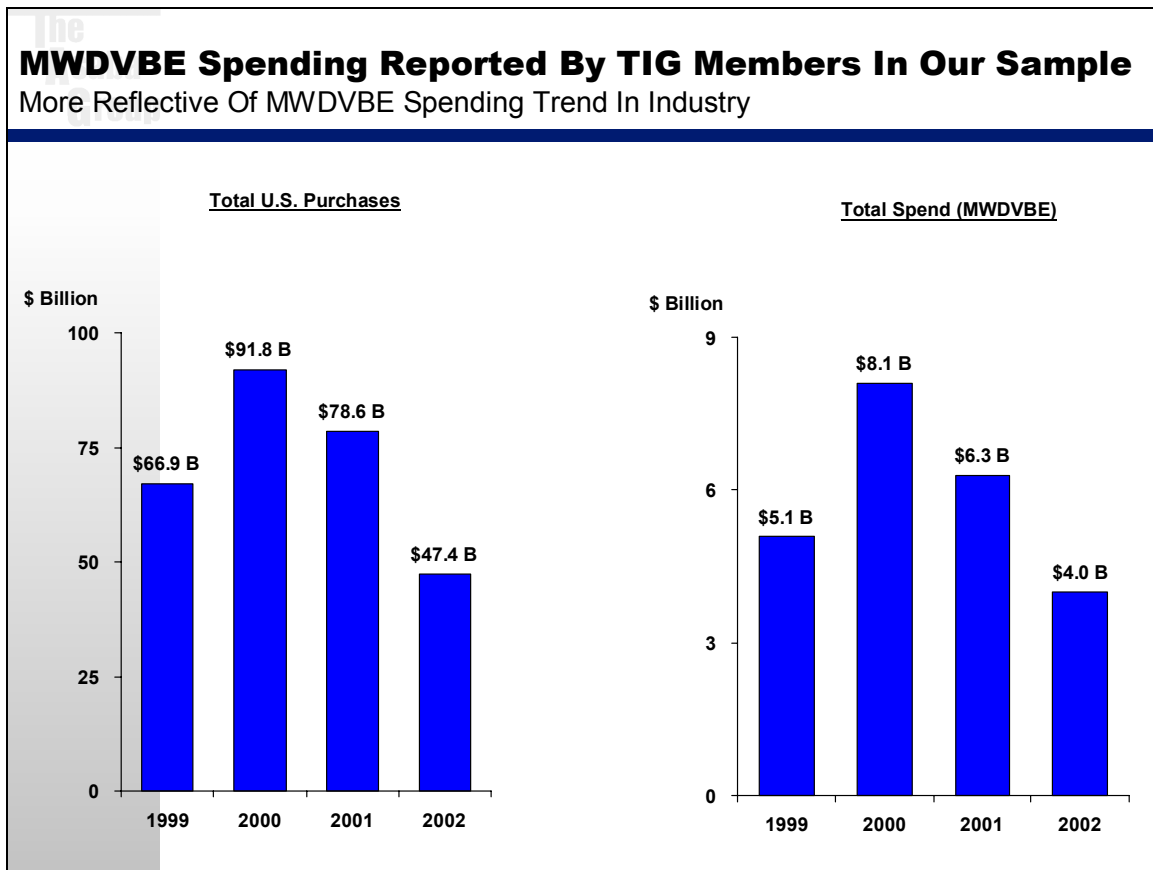
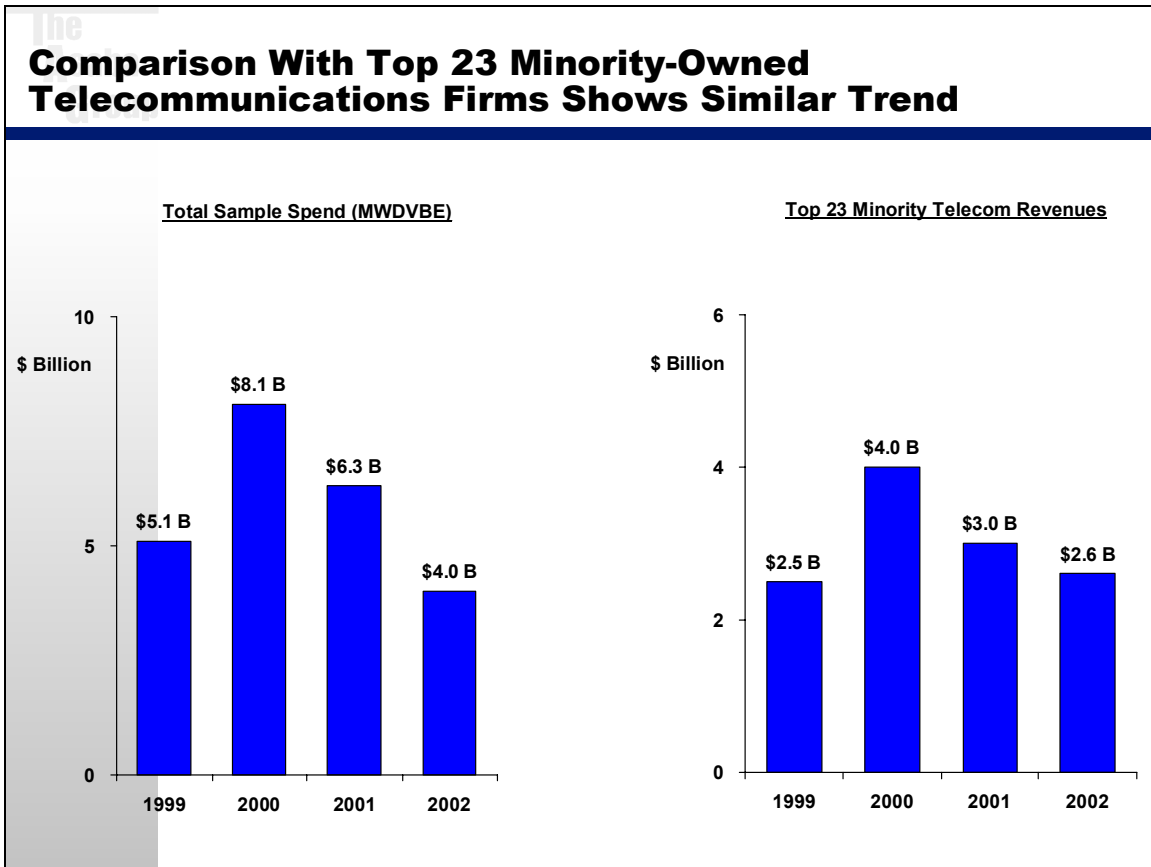


Fig. 3



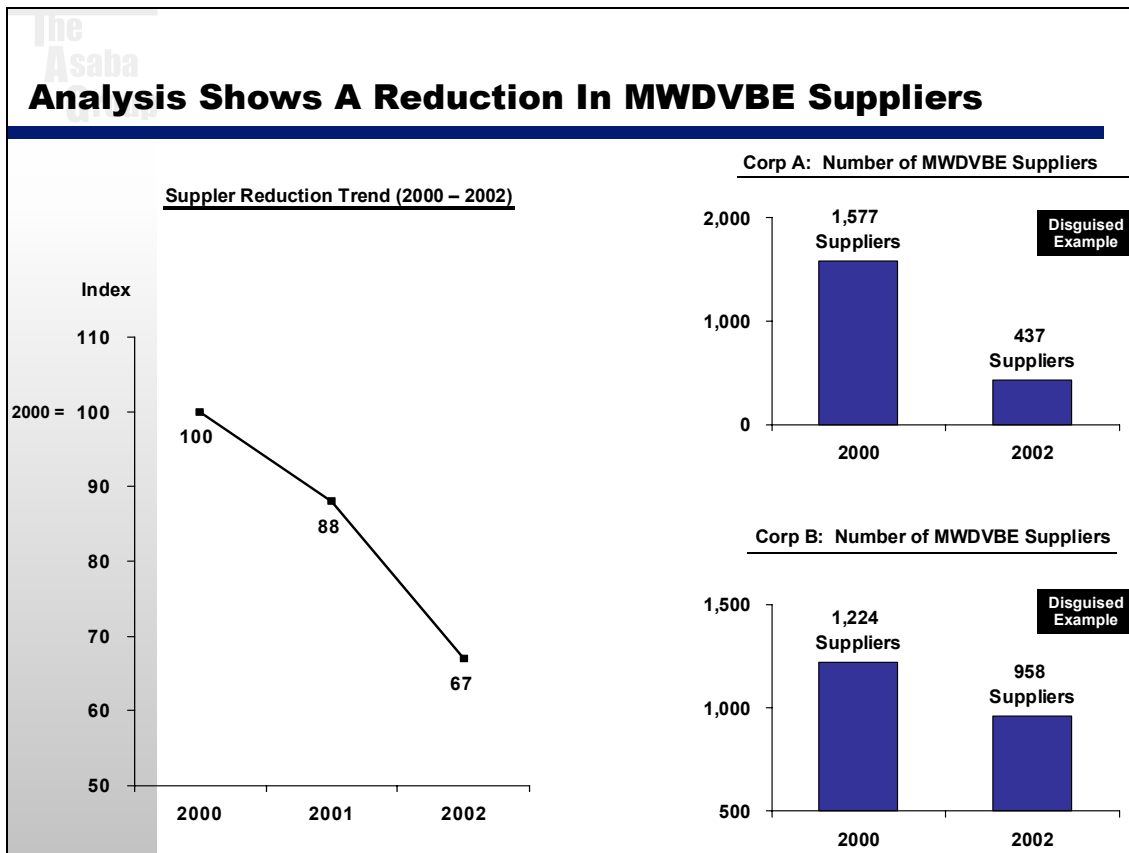
The trend of MWDVBE revenues is very similar to the industry’s declining CapEx patterns. The resulting drop in MWDVBE spending has led to a number of MWDVBES filing for bankruptcy. We estimate close to \$1 billion of MWDVBE revenues was lost to firms declaring bankruptcy. Figure 3 of the previous chapter shows MWDVBE revenue correlation to CapEx and subsequent bankruptcies. With the level of resources deployed on growing MWDVBES, losing \$1 billion in MWDVBE revenues is indeed very devastating to a host of stakeholders: entrepreneurs, employees, and the community, to name a few.

B) MWDVBE Supplier Rationalization and Consolidation

The pervasive industry cost focus and desire to reduce operating expenses have driven the proliferation of strategic sourcing initiatives such as vendor rationalization, supply

base consolidation, and so on. It should not come as a surprise to find these initiatives emerging within the MWDVBE spend. Our analysis of the MWDVBE spending data provided to us shows over a 30% reduction in the number of active MWDVBE suppliers (Fig. 4). In prior years, due to high emphasis on supplier outreach, many programs had too many suppliers with fragmented spending. Today, we are seeing a move toward a rationalization of the suppliers.

Fig. 4

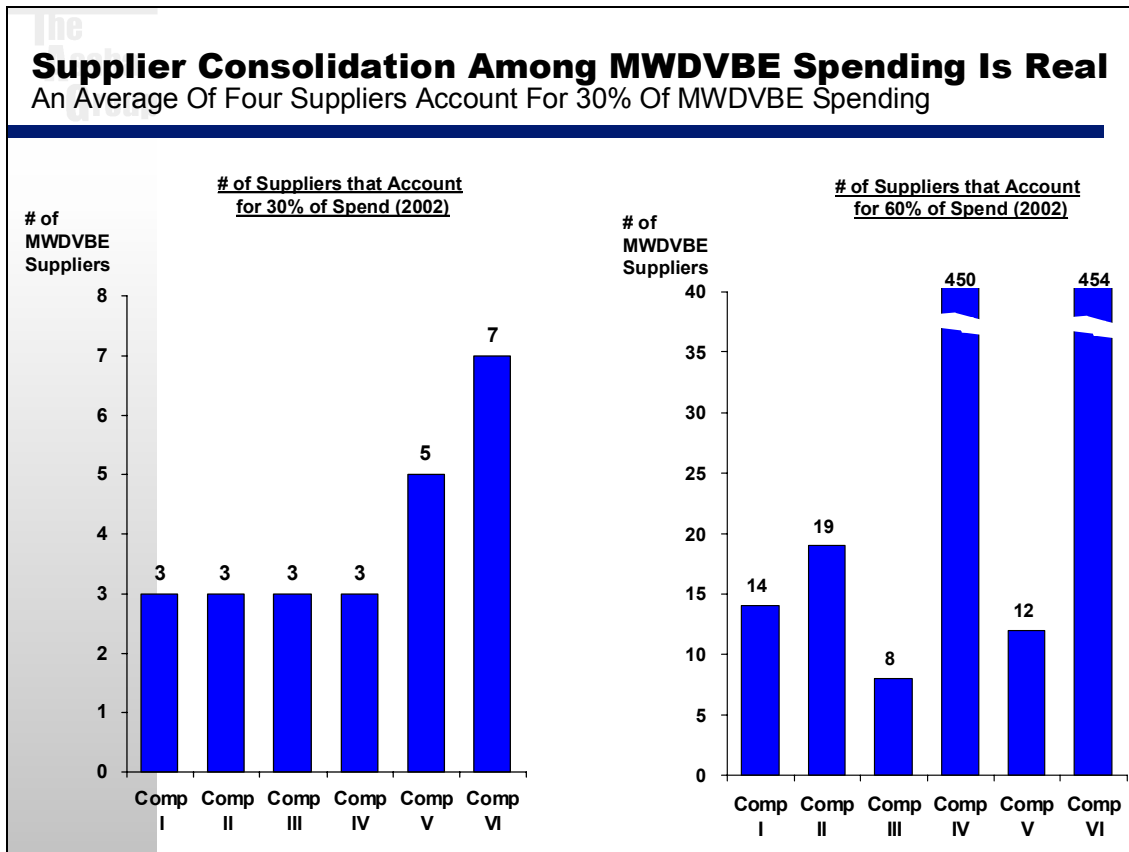


Industry interviews conducted with supplier diversity and procurement managers indicate that they expect to continue rationalization in the near term.

Additional analysis also reveals spend consolidation with fewer MWDVBE suppliers. What is not known is how explicitly, as a policy, the MWDVBE spend consolidation is being implemented. The observed consolidation in Figure 5 may have resulted from

recent reduction in spending or implicit consolidation resulting from some MWDVBE suppliers in financial distress. During our interviews, some program managers indicated they were actively pursuing spend consolidation while some indicated it was not an active initiative. This may explain the fragmentation associated with some of the reported data.

Fig. 5



C) Commodity Concentration and Weak Margin Positions in the Value Chain

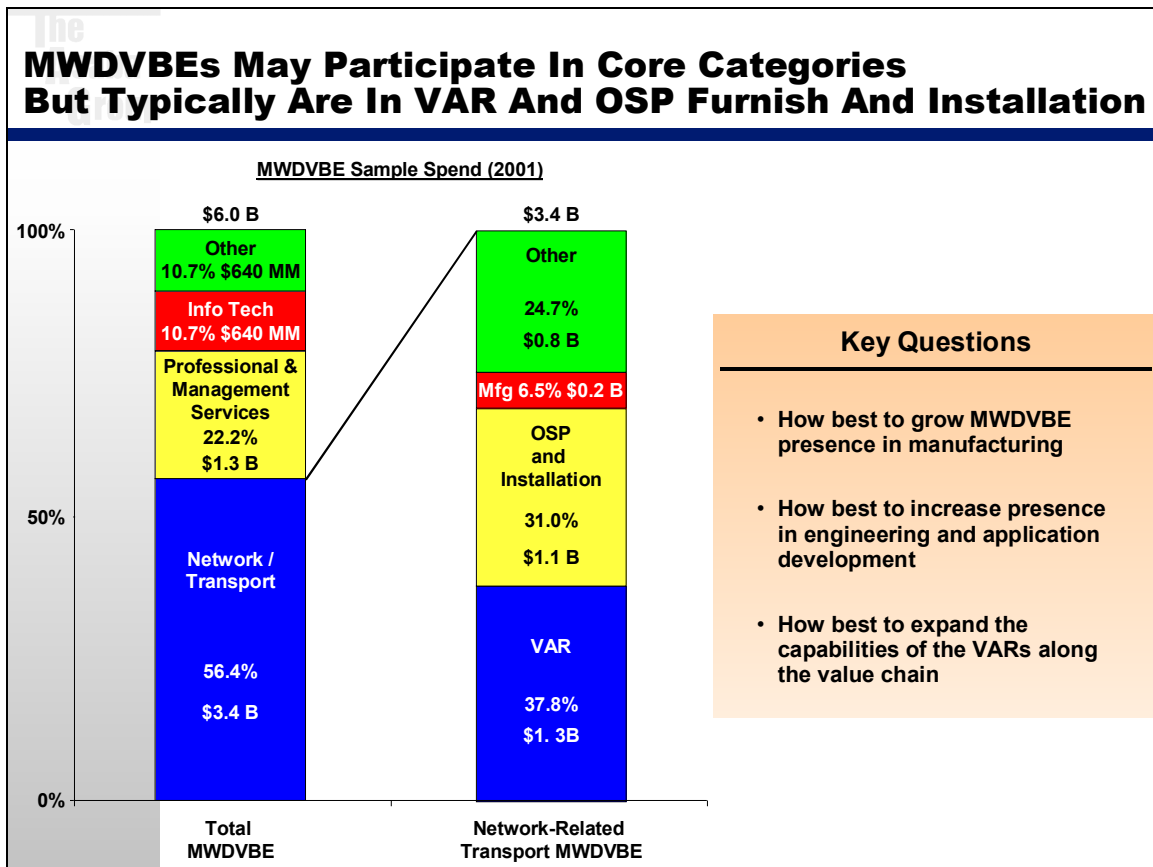
As we mentioned earlier, we observed that MWDVBE revenues appear somewhat correlated to industry capital expenditures. One of the underlying reasons for MWDVBEs revenue decline has been their concentration in commodities and services sensitive to CapEx spending trends and limited margin control. The primary example is a Value Added Reseller (VAR). The VAR role is largely based on distribution and

warehousing of finished goods and the ability to sustain margins as a function of shortened delivery times and higher service levels to service providers. As the business increases in size and geographic scope, volume becomes critical in sustaining profitability. In a declining volume environment, it becomes difficult to sustain operating profits. This dynamic is one of the reasons why some MWDVBE VARs went out of business.

The issue of margin sustainability is typically a function of what roles a supplier plays within the value chain (value creation) and how much strategic control or influence they have in sustaining it (value migration™). The current reporting process of MWDVBE spending does not readily allow for observation of this issue. However, several anecdotal observations point to MWDVBE preponderance in commodity categories in which they have limited value creation opportunities and weak strategic control in sustaining the value they create. Strategic control of margins is usually a function of superior buying/purchasing power (a function of size), consumer branding, proprietary technology, and innovation. Our analysis of telecommunications service providers' MWDVBE spending shows a large portion of their spending under such core category as Network Transport, but a deeper dive within that area reveals that more than two thirds of this spend is VAR and Outside Plant (OSP) services (Fig. 6). An initial observation of the data shows that 55% of total MWDVBE spending is in the attractive Network category. For a better understanding of the quality of that spend (we define it as “what is done by the supplier”), one should make one extra step and not simply look at the general category to which the spending is related (i.e., Network versus Office Products), but rather determine what is the specific activity an MWDVBE is engaged in (i.e., VAR versus Manufacturing). This determines how much margin control exists. To illustrate, one MWDVBE might be reported under the Network category while in essence being just an equipment distributor/reseller (VAR), whereas another MWDVBE in the Office Products category might actually manufacture the paper it supplies. The latter has more control in preventing value migration compared to the former.

Thus Figure 7 paints the landscape of MWDVBE participation based on the firms' primary activity, not the commodity category to which that activity is related. (We were provided by the Telecommunications Industry Group [TIG] names of eighty-one MWDVBE suppliers with annual revenues greater than \$10 million. From this sample we were able to obtain financial data for 71 suppliers – first group. We also conducted an

Fig. 6

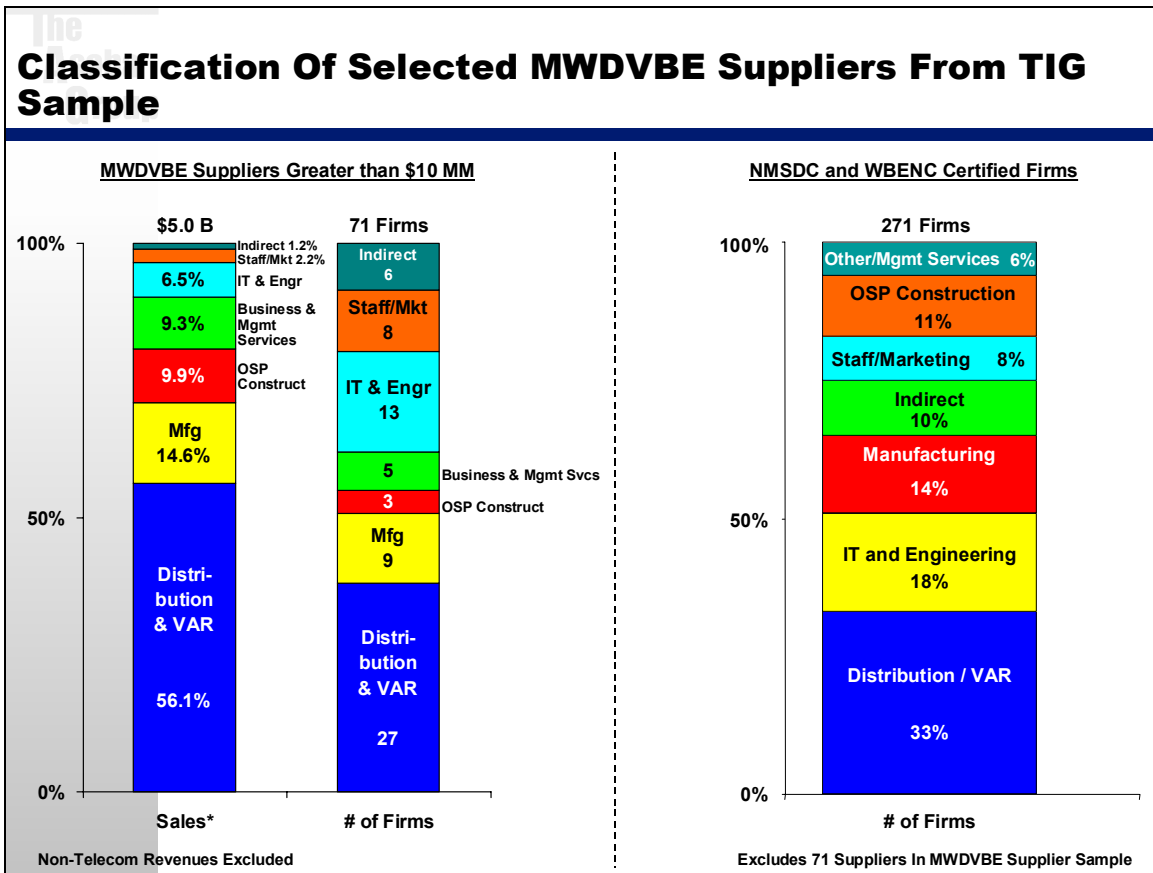


identical analysis to determine if other MWDVBEs in the telecommunications industry not included in our sample exhibited similar characteristics. For this purpose we used those firms that are certified by either the National Minority Supplier Development Council [NMSDC] or the Women's Business Enterprise National Council [WBENC] – the second group).

Fifty-six percent of revenues for the 71 MWDVBES from TIG suppliers comes from being a VAR. Out of 271 MWDVBES registered with NMSDC or WBENC, 33% played the VAR role (revenue breakdown was not available).

Second, our analysis focused on categorizing the two groups of MWDVBES in two areas:

Fig. 7



- 1) Size and scale competitiveness (Fig. 8). This is determined based on whether a supplier's revenues were greater than the average sales of all companies in its commodity category.
- 2) Degree of value added in their corresponding products/services area (Fig. 9). This is defined by the amount of technology or innovation required to deliver their products/services.

We discovered that out of the 71 suppliers with revenues over \$10 million, 81% of the firms are in commodity or service category with low technology/innovation requirements. Analysis of NMSDC- or WBENC-certified firms revealed a strikingly similar pattern: 85% of these firms were in low technology/innovation commodity categories. It is therefore hardly surprising that total MWDVBE telecommunications

Fig. 8

The Asaba

Size Analysis Of Selected MWDVBE Suppliers

MWDVBE Suppliers Greater than \$10 MM			NMSDC and WBENC Certified Firms		
Activity Category	Supplier Average Size	Size Threshold	Activity Category	Supplier Average Size	Size Threshold
Distribution & VAR	\$97 MM	\$57 MM	Distribution & VAR	\$8 MM	\$57 MM
Manufacturing	76	100	Manufacturing	2.8	100
OSP Construction	154	68	OSP Construction	3.2	68
Business & Management Services	87	---	Business & Management Services	3.4	---
IT & Engineering	23	50	IT & Engineering	4.2	50
Staffing & Marketing	13	114	Staffing & Marketing	10.9	114
Indirect	10	57	Indirect	7.9	57

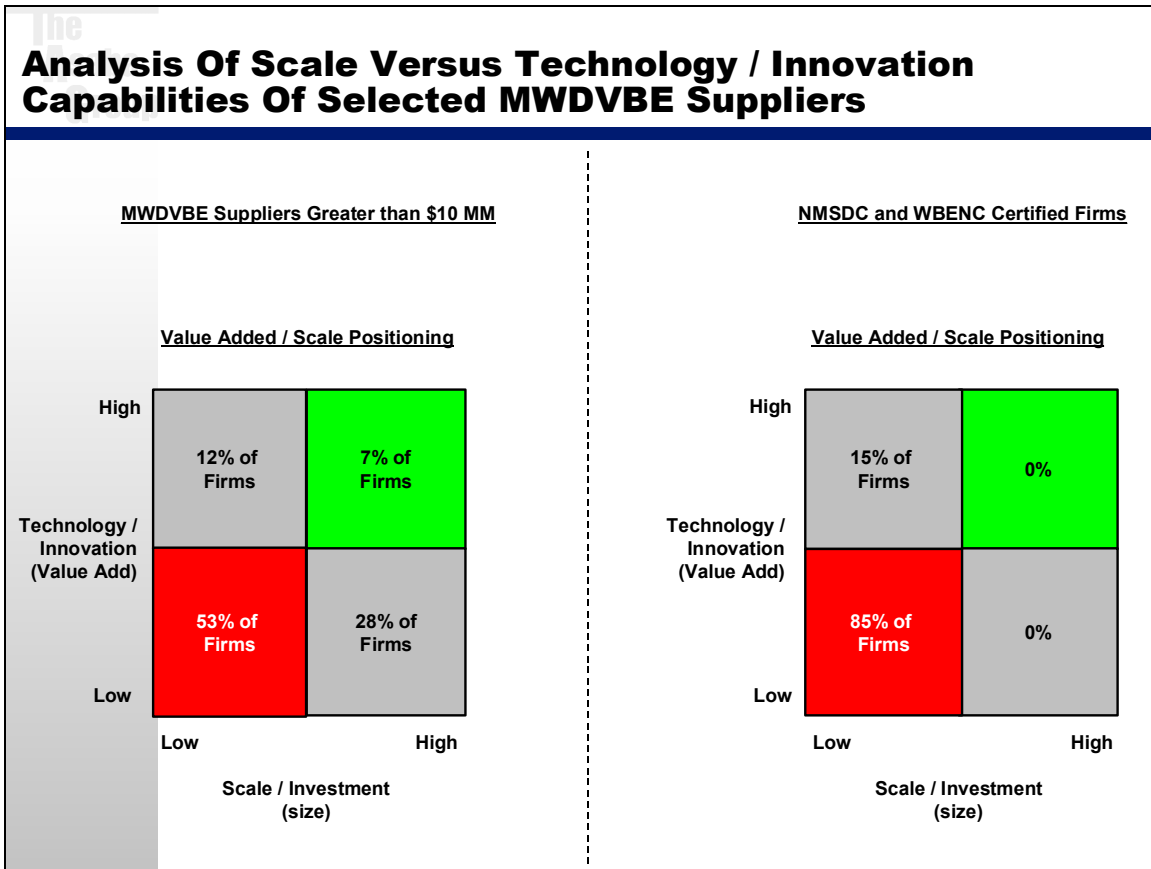
revenues are declining in difficult economic times. From the analysis above we can surmise the following:

- 1) MWDVBES are weakly positioned, with a significant share of revenues and firms concentrated in the VAR category;
- 2) VAR revenues are also closely correlated to CapEx (Fig. 10);

- 3) The prior focus on creating large MWDVBEs based on a VAR business model may not be sustainable in the current environment.

The limitations and unsustainability of the VAR model are driven home by the chart on the right of Figure 10. The “Other” VARs (top bar) are not just losing market share over

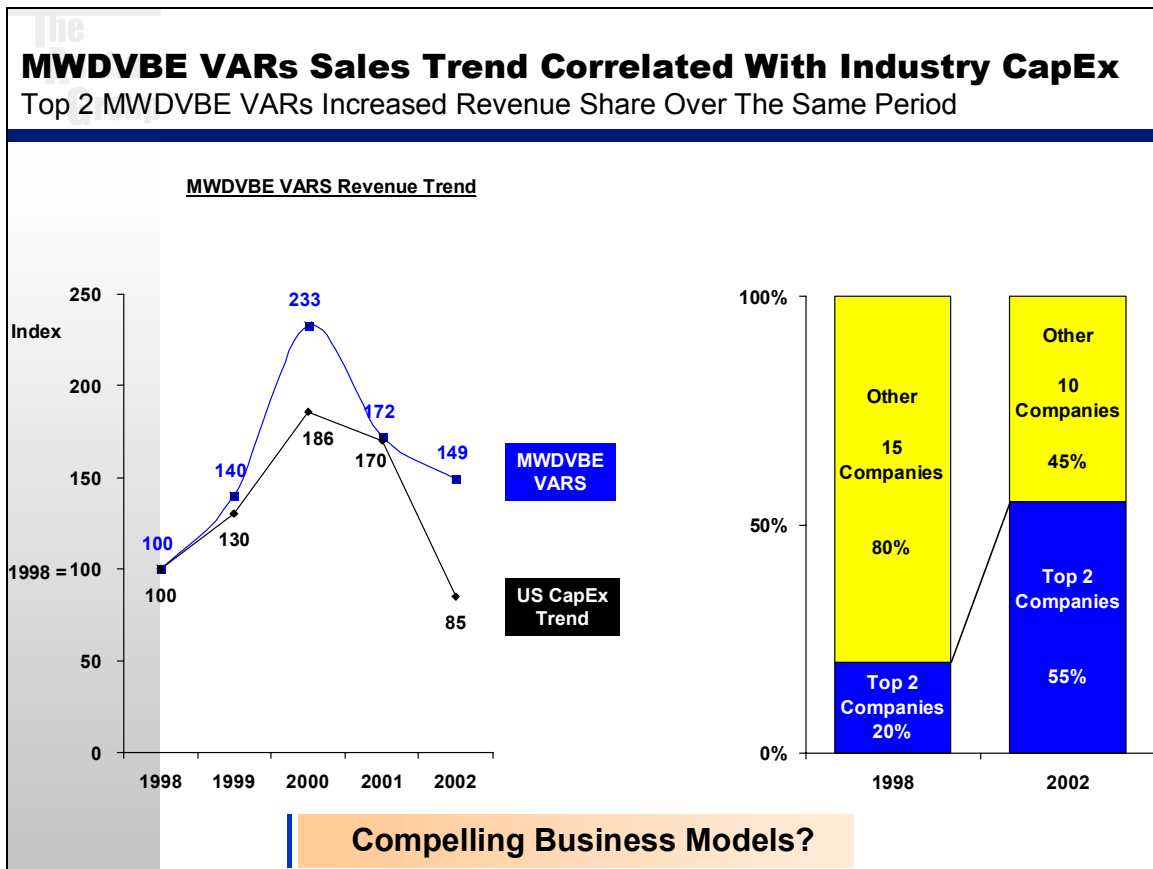
Fig. 9



time, but are also exiting the business (there were 15 of them in 1998 and only 10 in 2002). The rapid expansion of MWDVBEs VARs in the late 1990’s was most probably arbitrary rather than based on existing industry demand for their services and thus created “over-saturation” of the VAR space. As CapEx levels started to decline, market forces began a shakeout of the landscape, and the end result is that those VARs who added little value (but served as mere distributors) either went bankrupt or lost big chunks of market

share. Ultimately, we do believe that there exists a place and a role for Diversity Suppliers who are truly Value Added Resellers (with emphasis on “value” rather than “reseller”). In Figure 10, the “Top 2 Companies” component certifies to that; it is just that VAR business models must be well articulated and executed for long-term survival in the tough telecommunications industry. These companies created value not just by reselling products but by embedding their process within the customers. An example of

Fig. 10



their value added services is providing supply chain visibility on product lead times and deployment schedules.

D) MWDVBE Suppliers' Size and Scale Limitations

The analysis in the previous section also revealed the size and scale challenges of MWDVBE suppliers. Competitive size (largely defined by revenues or employees) enables a company to leverage buying power to achieve superior cost performance. Scale enables a firm to leverage fixed costs and achieve superior levels of marginal cost advantage. Scope defines the firm's ability to provide a broad suite of products/services or cover a large geographical area with superior service levels. On Figure 8, we determined the average size of Diversity Suppliers within each category (VAR, Manufacturing, etc.). Then we compared those averages to industry-wide averages (under the Size Threshold heading). We found MWDVBES to be much smaller in most cases. Finally, when we compiled our findings on Figure 9, which demonstrates, on an individual firm basis, that 53% of MWDVBES with sales over \$10 million and 85% of WBENC- and NMSDC-certified firms operate on a lower scale compared to corresponding industry means.

As we have described earlier, given the current cost, efficiency, and productivity focus within the industry, it becomes increasingly challenging for MWDVBES to create sustainable cost competitiveness compared to non-MWDVBE suppliers. When a purchasing manager has to select between an MWDVBE supplier and a non-MWDVBE incumbent, it would prove difficult for a Diversity Supplier to match cost performance without impacting its long-term profitability.

Supplier Diversity – Program Effectiveness

In this chapter we shall present some observations about Supplier Diversity programs within the telecommunications industry. After extensive interviews with managers of these programs and analysis of the effectiveness of the programs, the following issues were observed:

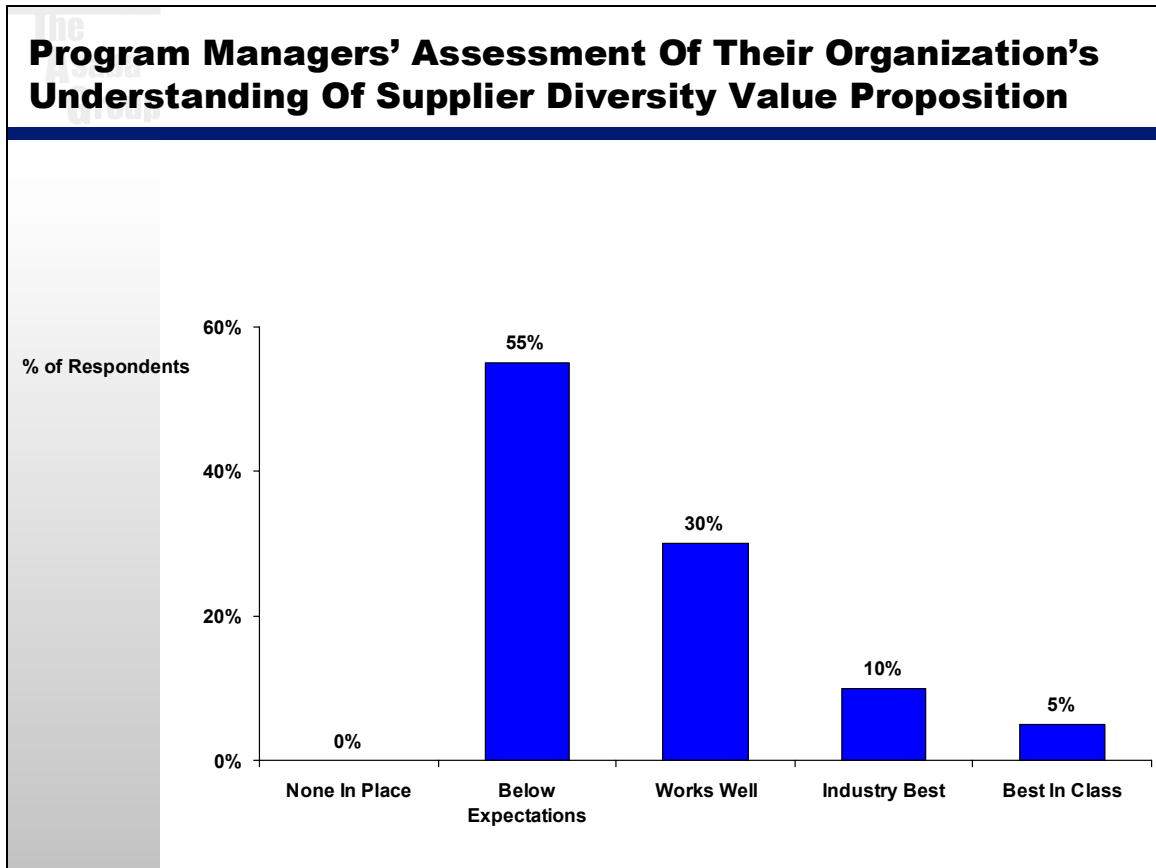
- 1) Articulation of the Supplier Diversity value proposition;
- 2) Allocation of time and resources;
- 3) Degree of collaboration among TIG members;
- 4) Program Manager effectiveness.

Figure 1 shows one of the results of a self-assessment questionnaire completed by program managers. This figure deals with the program managers' assessment of how well their organizations understand and articulate the Supplier Diversity value proposition; and how well it is understood across the corporation. Fifty-five percent of respondents believe the current understanding and articulation are "Below Expectations." This reinforces earlier comments from procurement managers regarding using MWDVBE suppliers.

We also conducted an analysis of how program managers spend their time. This analysis revealed that, on average, 71% of their time is spent on activities not geared to current MWDVBE suppliers. On Figure 2, the bulk of program managers' time relates to activities that have little to do with development of those MWDVBES who have already managed to make the first step through the door. Program managers spend less than a fifth of their time (18%) trying to locate the next internal opportunity for these suppliers. In terms of budget spending, a similar pattern emerges: 78% of budgeted spending is not targeted to current suppliers but is geared toward external activities, which are mainly programs that support external advocacy organizations. Such activities include trade

shows, advertisements, and sponsorships. Training and development of current suppliers was only 6% of total budget. While trade fairs and matchmakers are able to command

Fig. 1

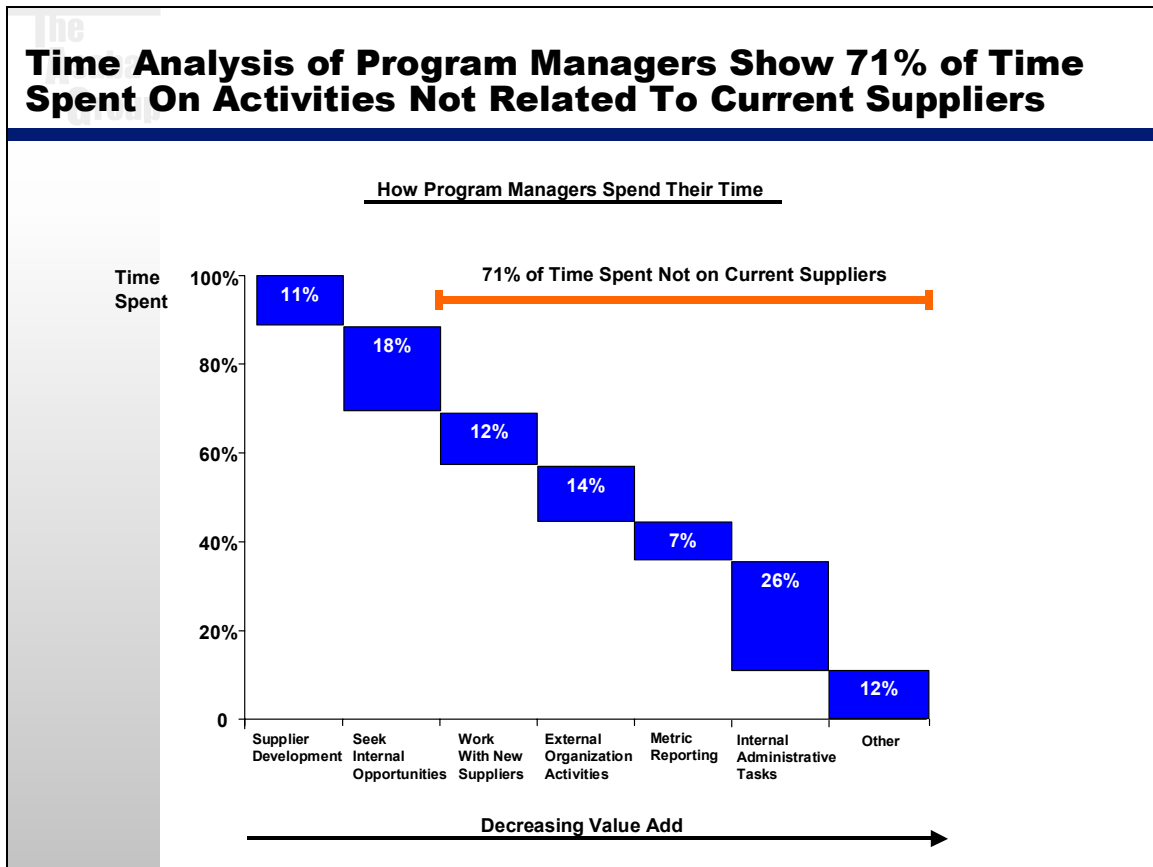


almost a third of the spend (31%), our industry surveys show a consensus around the notion of the limited value-add derived from the trade fairs. Here is what the program managers say about the value they derive from these activities:

“Trade fairs are valuable mostly in terms of networking. Relationships are very important in this business.... However, MWDVBEs cannot expect to get a contract out of such meetings immediately.”

“Trade fairs have no value to me. Too many names, too many companies, zero quality time. I do them just to be accessible and to avoid negative publicity.”

Fig. 2



“Matchmakers could be useful, but only if contract managers come with solid potential opportunities and allocate time to each potential supplier; this rarely happens.”

“I view attendance as an obligation and not to get a black eye.”

“PR is the only real value of trade shows... The MWDVBEs we end up doing business with are not the ones we meet at trade shows. We are significantly falling back on our spend allocated to this activity. The reason we will continue attending such gatherings is simply because it would mean too much negative PR not to.”

“These (trade shows) are a primary revenue stream [for advocacy groups].... (They) need to find alternative ways to generate money.”

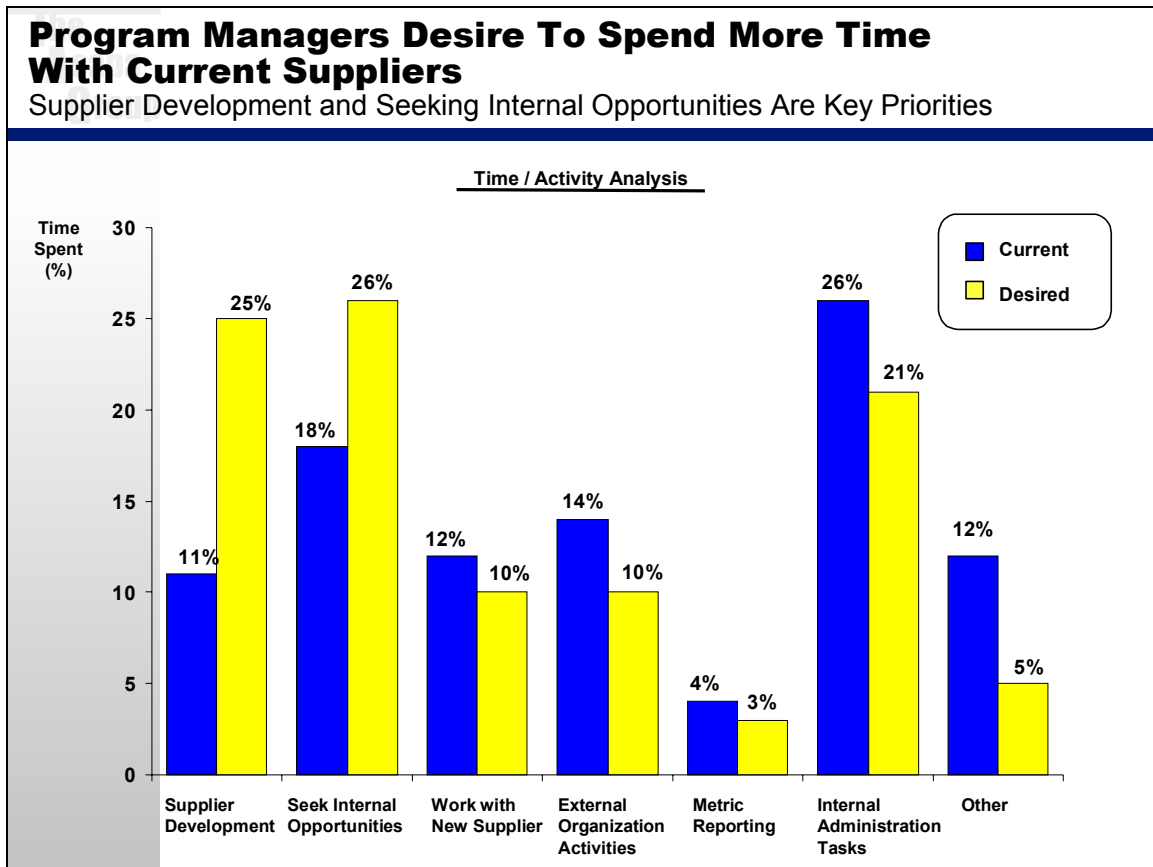
Several respondents to our survey expressed concerns about negative PR to their corporations if they ceased attending the trade shows. Most respondents expressed a strong desire to support these organizations but would like to see services that bring value.

Ways must be found today to limit corporate exposure to negative PR mentioned in the quotes above. This would allow Supplier Diversity efforts to be directed where they are needed the most, versus pandering to the sensitivities of advocacy groups. Both MWDVBEs and corporations suffer from this waste of valuable and limited resources. Figure 3 shows where program managers would like to refocus their attention: it is precisely those two internal areas that are receiving so little resource allocation today (supplier development and seeking internal growth opportunities). An interesting point to note: every one of the external activities is to receive less mind share of the program managers. In the self-assessment of program managers, they were asked to rate how well their internal programs use processes in place (if any) to identify growth opportunities for current suppliers. Figure 4 shows that 45% rated their program’s processes as “works well;” 5% say their processes can be considered “best-in-class”; 40% say their processes are “below expectations;” and 10% have “none in place.” One can imagine how much improvement in MWDVBE spending and development can be achieved by moving the

under-performing 50% (“below expectations” and “none in place”) to “works well” or the 45% of “works well” to “best-in-class.”

Another issue was the absence of supplier sharing among the various corporate Supplier Diversity programs in Telecommunications Industry Group. It is understandable to expect

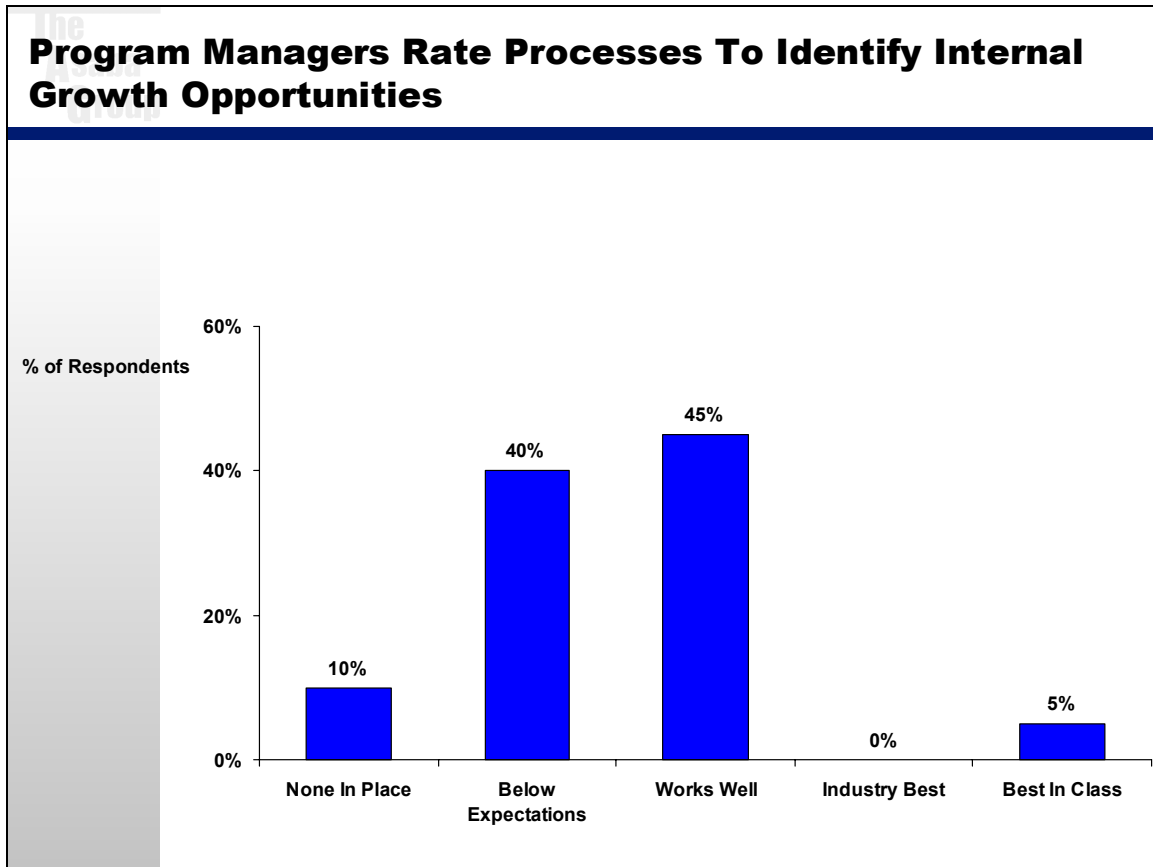
Fig. 3



in this era of supplier rationalization and consolidation (occurring not just in the general supplier base, but, as mentioned earlier, with MWDVBE suppliers also: see Figures 4 and 5 in the previous chapter), that the efforts of a number of entities all striving for the same goal had been united to ensure maximum effectiveness. Surprisingly, analysis of Diversity Suppliers to corporations in our sample revealed that quite the opposite is true (Fig. 5). Out of 71 MWDVBEs, there was only 1 that was a common supplier to 5 corporations in the sample. Sixty-four suppliers provided services to just one corporation. What is missing? A stated objective or goal within TIG is to share best practices and suppliers among members. Such unity of corporate diversity efforts would

have identified and consolidated spending with only two or three best-in-class MWDVBEs in each commodity category. This is an approach to creating large, competitive, and sustainable Diversity Suppliers for the long run.

Fig. 4



TIG did spend some effort trying to achieve supplier sharing through sharing of supplier information. However, the ability to share suppliers may have been impacted by competitive issues, regional differences, and/or program managers' limited ability to influence internal sourcing decisions.

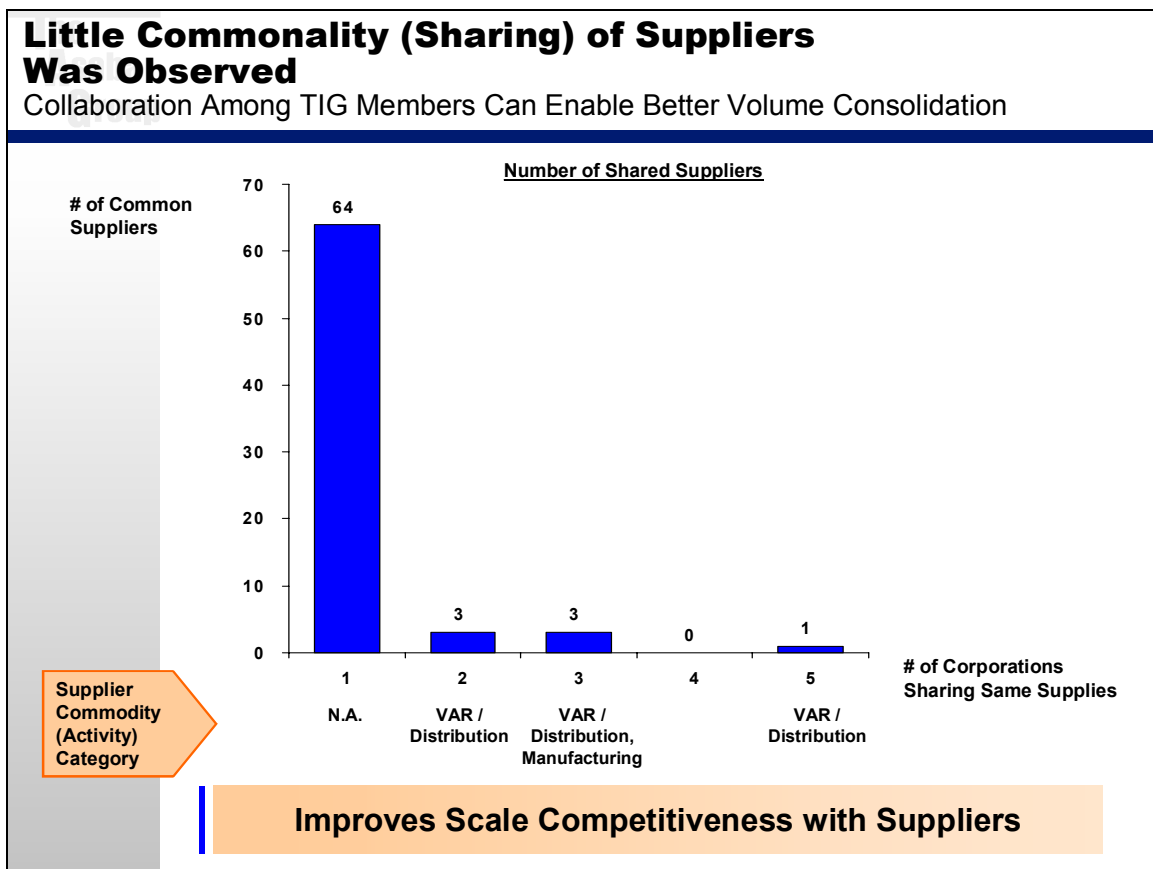
Lastly, 40% of program managers rated their effectiveness within the organization as "Below Expectations." This can be attributed to some of the factors mentioned above:

- 1) Lack of a strong enough business case for Supplier Diversity to take priority over some other internal initiatives;
- 2) Lack of time resources to spend on activities they believe add value;

3) Inability or limitation in achieving collaboration within TIG (i.e., sharing of suppliers and best-in-class processes).

In addition to the above, interviews revealed that internal organization perception of the program manager’s position is an inhibiting factor: some program manager positions are not regarded as core or critical to an organization’s competitiveness. This is reflected by the career track of supplier diversity managers (Are these positions considered a key

Fig. 5



pathway to senior leadership positions?), and the level of resources dedicated to supplier diversity compared to other strategic corporate initiatives.

Also revealed in our interviews was the need for program managers to have a higher profile in order to be effective. Below are some quotes from our interviews:

“There is lack of a rotational track within the purchasing organization – we are not really appreciated in the company.”

“I can’t take on a developmental role with suppliers when I don’t have access to decision makers and resource controllers.”

“A successful program manager must be able to affect change through clear and powerful communication with the decision makers. Such a manager must be able to evaluate and mentor suppliers: that is, get involved with risk management, merger and acquisition activities, setting up alliances, and finding growth opportunities.”

“Negotiation skills, positioning within the organization, and a good understanding of commodity-specific purchasing policies are essential qualities for a successful Supplier Diversity Manager.”

In summary, the ability to achieve MWDVBE sustainability is directly related to the level and effectiveness of resources deployed by the corporations. The sourcing opportunities and processes to engage MWDVBEs, the resources that interfere with MWDVBEs, are the determining factors on how MWDVBEs structure their companies and evolve their capabilities. If the available opportunities are not reflective of true market/industry dynamics, then the businesses that diversity entrepreneurs would create will reflect these short-term opportunities, and not long-term strategic trends. Sustainability is achieved by aligning the business to the latter.

A critical component in evolving the quality of opportunities is to remove the barriers (identified earlier in this chapter) to program effectiveness.

Key Issues in Addressing MWDVBE Sustainability

A) Evolving Current Approaches to Supplier Diversity

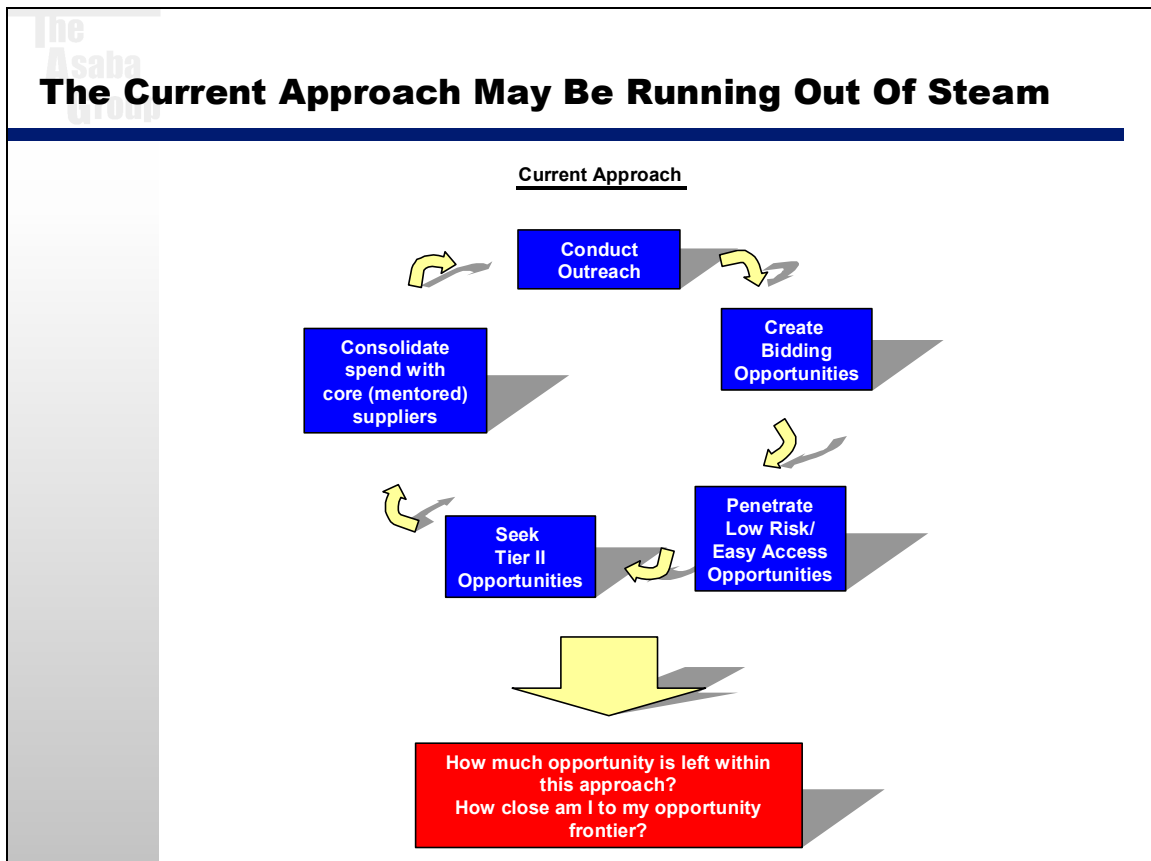
The current approach to Supplier Diversity has been predicated on providing MWDVBE suppliers access to bidding opportunities and opening the marketplace to diversity businesses. This approach originated from the Federal Government when the Small Business Administration and the Office of Minority Business Enterprise (now called Minority Business Development Agency, MBDA) were created with a specific mandate of establishing a way that channels government purchasing opportunities to socially and economically disadvantaged small business owners. These agencies developed approaches that opened up bidding opportunities for minorities and women.

Most traditional approaches to Supplier Diversity are built along similar objectives and are created under the auspices of advocacy and good corporate citizenship. Creating bidding opportunities meant working on identifying and recruiting suppliers through outreach activities (tradeshows, advertisements, etc.), using company ownership certification processes to reduce the propensity of abuses, and ensuring representation on the bidders list. To ensure that actual spending occurred with diverse suppliers, targets were established and usually met by sourcing lower risk commodities to diverse suppliers. These commodity categories typically required low entry barriers, and product and service specifications were uniform and independent of the type of vendor. As a result, vendors were interchangeable, with price being the determining factor for vendor selection.

When additional Supplier Diversity “dollars” were needed, the current approaches were once again evolved from the Federal Government. The Federal Government demanded that contracts over a certain dollar threshold (\$500,000) required prospective bidders to provide a plan of how they intended to utilize small disadvantaged businesses within the contract. This began the second tier sourcing initiative in the corporate environment, whereby the corporations leveraged their buying power with their first tier suppliers to provide second tier sourcing opportunities to diverse suppliers.

With the increased levels of competitiveness and continued pressure to create shareholder value, most corporations focused on purchases, which accounted for a significant share of total cost, to meet profit targets. This pressure led to the emergence of strategic sourcing initiatives that reduce cost in the procurement process. Strategic sourcing focused on improving productivity and leveraging buying power in “how you buy” and “what you buy.” It made sense to rationalize vendors, consolidate spending with fewer vendors, and use bundling as a contracting tool. Supplier Diversity programs began to reflect these dynamics within their spending patterns. As we mentioned earlier in this report, supplier rationalization and spend consolidation were observed in our analysis of MWDVBE spending by the telecommunications companies in our sample – even though these companies continue to engage in and spend significant resources on supplier outreach programs. Figure 1 provides an illustration of the current approach to Supplier Diversity.

Fig. 1



It should be noted that the sourcing opportunities created were in commodity categories that do not necessarily grow with corporate profits. An example is MRO-related categories, such as janitorial, office products, and such. As corporations seek to deliver on their primary mission – creating shareholder value – they typically do not consume more of these products or services. In most situations, the desire is to reduce the product and transaction-related costs associated with acquiring these products and services.

Earlier in this report we made the following observations about the issues and challenges our study identified within the supplier diversity landscape:

- Slowing growth or decline in MWDVBE spending by corporations
- High level of MWDVBE sales and performance volatility to industry cycles (capital expenditures, volume, etc.)
- Limited MWDVBE supplier presence in the critical (core) value added activities
 - “What activities the supplier performs” versus “What commodity category is served”
- MWDVBE presence in mature commodities with highly fragmented spending
- Size, innovation, and access to capital identified as potential MWDVBE growth inhibitors
- Inability to clearly articulate (and, where possible, quantify) the economic value proposition for Supplier Diversity to corporations
- The organization’s resource allocation decisions are impacted by a lack of a coherent value proposition
 - How many senior executives of the large telecommunications corporations have experience in supplier diversity?
- Increased levels of business distress and underperformance with some MWDVBEs
- A dichotomy of business and industry realities with stated objectives of supplier diversity initiatives
- Inconsistency in defining the measures and goals that determine success

These can be viewed either as symptoms of poor implementation of current approaches or as symptomatic of the inadequacies in the current approach. We believe that the

answer depends on the program's objectives. If the underpinnings and baseline objectives are based on creating access to bidding opportunities, then the current approach works, but if the goal is to achieve long-term sustainable development, then it requires new methods and thinking that reflect industry and business realities: realities which are based on wealth and profit creation. This requires creating processes that lead to the emergence of competitively-viable MWDVBE suppliers – the enabling environment .

In order to enable the competitively-viable suppliers, supplier diversity stakeholders need to evolve from the current mindset and create a new paradigm. It requires the following shift:

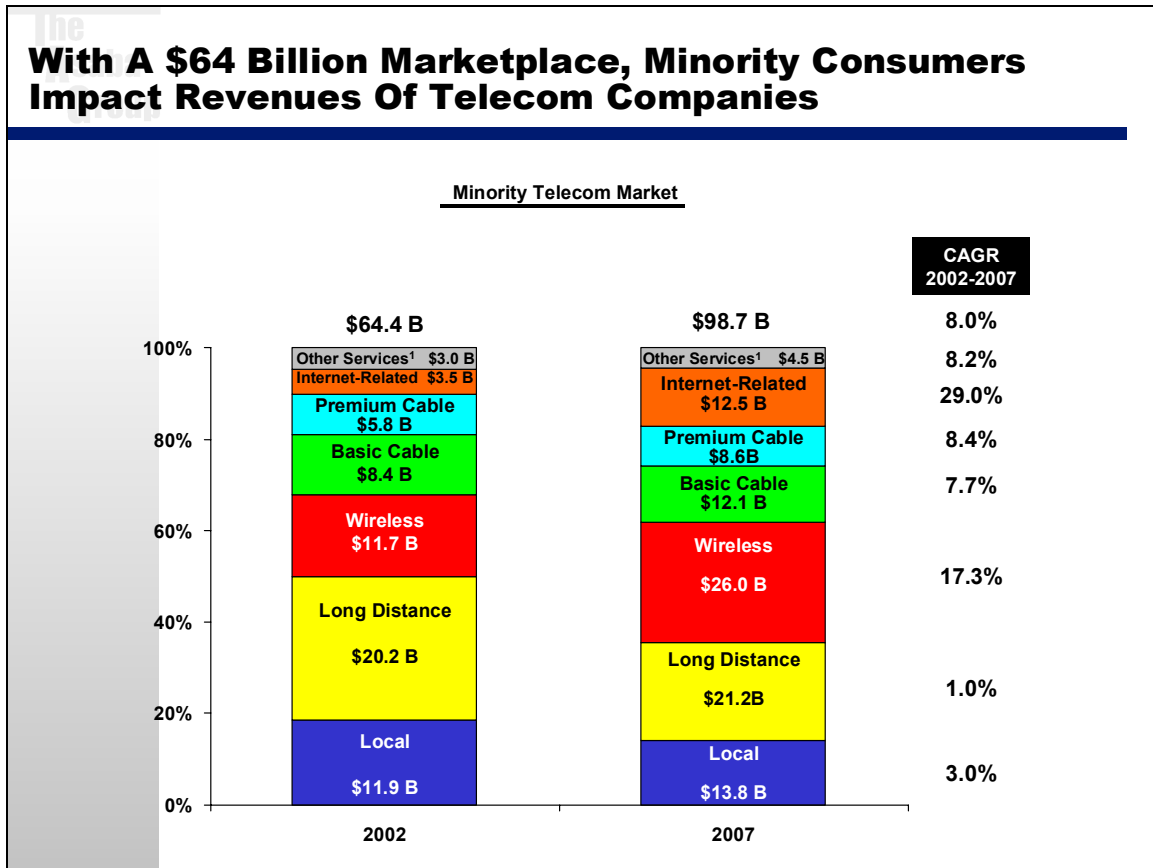
- i. From creating minority jobs to creating business capacity
- ii. From creating access to bids to creating a strong competitive set of suppliers
- iii. From supplier diversity as “corporate altruism” to “how can it enhance and enable competitiveness”

B) Linking Supplier Diversity to Market Opportunities

A large number of supplier diversity stakeholders has stated the much quoted demographic trends about minority population growth and increase in purchasing power as a key reason for engaging in supplier diversity initiatives. The studies showing these trends predict that the minority population will account for 50% share of the U.S. in 2050, and that currently minorities account for approximately \$1.3 trillion in buying power. These are compelling statistics for an attractive market segment. What has been missing is direct linkage that shows how supplier diversity enables a corporation to access the minority market or, more importantly, gain relative market share over its competitors without a supplier diversity program. With the minority telecommunications market estimated at \$64 billion and forecast to grow to \$99 billion in 2007 (Fig. 2), there

is compelling reason why it makes sense to leverage any initiative that enables a corporation to gain share within this market.

Fig. 2



Industry statistics from the FCC and the U.S. Census show that large minority-concentrated states account for a significant share of total wireline and wireless revenues. Minority consumers can potentially impact a service provider's revenue performance in key markets. Also, it should be noted that several marketing studies and surveys show that minority consumers consume a disproportionately larger share of telecommunications products and services. They are also regarded as very brand loyal consumers. So how does Supplier Diversity create minority market opportunities?

Some supplier diversity practitioners have drawn similarities with advertising and research & development, where under-investment or no investment impairs

competitiveness over the long term. However, the applicability of this relationship to supplier diversity remains vague and, at best, anecdotal. Our study found very little emphasis on the part of program managers on creating a link to the market opportunities; and in situations where minority markets are targeted, ethnic marketing approaches are somewhat undifferentiated (Fig. 3).

Fig. 3



For service providers, using supplier diversity and ingredient-branding concepts can potentially create unique marketing differentiation that is difficult to replicate compared to other ethnic marketing approaches. Ingredient-branding enables a company to leverage suppliers’ products (used in its own products) to create a marketing differentiation. This is not limited to product and services used in creating consumer products: it can be adherence to unique processes, philosophies, or doctrines that appeal to a particular consumer segment. An example is being environmentally-friendly. In

Figure 4 are examples of successful ingredient-branding approaches that have created unique market positioning and differentiation.

Fig. 4

Examples of Ingredient Branding
An Implicit Seal Of Approval Which Creates Differentiation

Company Product	Brand Position / Message	Observed Impact
. Intel Corporation / PCs	"Intel Inside"	<ul style="list-style-type: none"> PC's with price premium over PCs with AMD processors Same functionality but brand perception of "Intel Inside"
. Moisture Resistant Clothing	Gore-Tex	<ul style="list-style-type: none"> Price premium on clothing. Risk minimization to enhance the purchase decision and validates moisture proof claim
. Sugar Free Products (Diet Coke, etc)	NutraSweet	<ul style="list-style-type: none"> Validation that a product contains no sugar (low caloric value)
. Audio Visual Industry (Entertainment)	Dolby NR	<ul style="list-style-type: none"> Defacto standard for noise reduction in sound devices Product Perceived below standard without Dolby NR incorporated Dolby Equals Good Sound
. BASF	BASF	<ul style="list-style-type: none"> Creates a perception of innovation
. Ford Explorer	Eddie Bauer	<ul style="list-style-type: none"> Higher-end Explorer with unique image

Can We Create Supplier Diversity Differentiation Within Minority Markets?

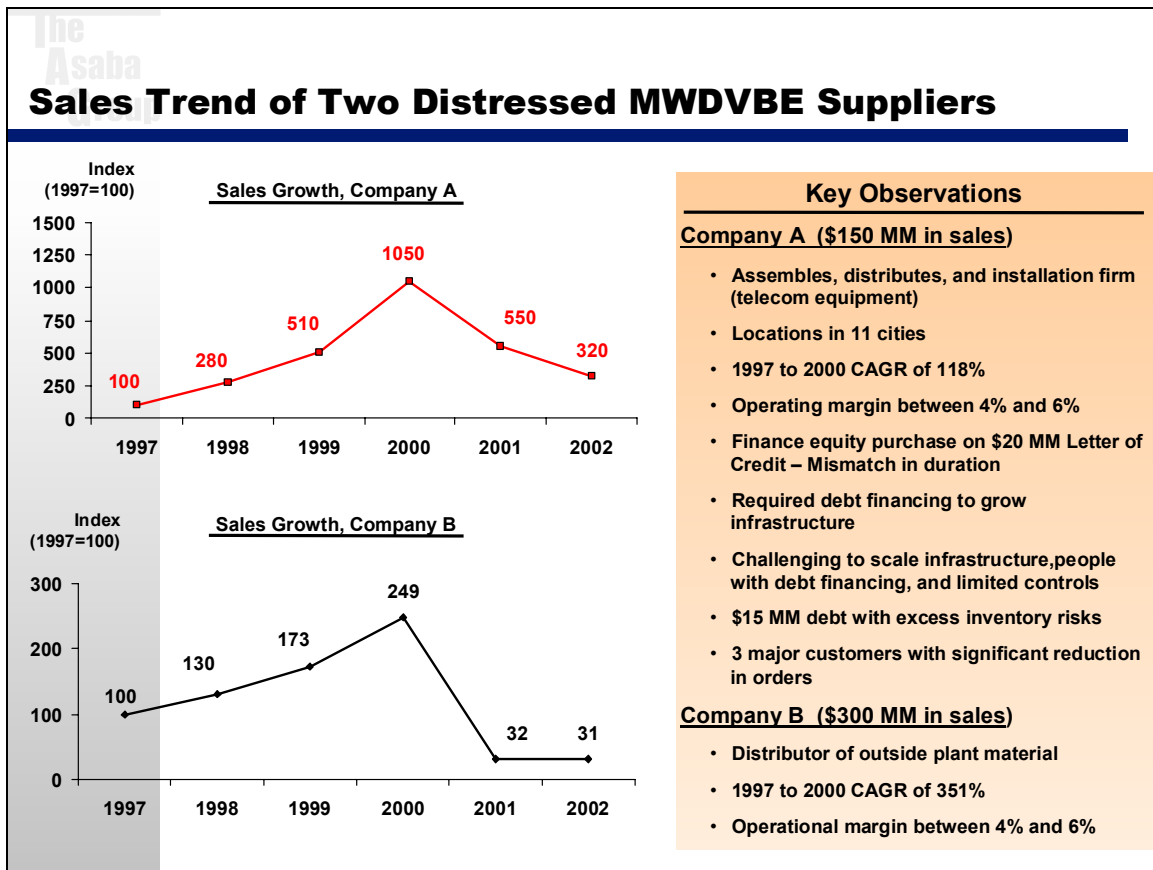
C) Supplier Risk Management and Development

During the last two years, the industry witnessed a number of MWDVBE suppliers go into financial distress and bankruptcy. While some of the reasons for distress can be attributed to the external industry dynamics, sustainable businesses find ways to manage through these downturns and risks. We conducted an analysis of two MWDVBE suppliers that were Value Added Resellers, experienced financial distress, and were eventually liquidated. Our objective was to better understand the causes of financial

distress and determine if it could have been avoided with supply chain risk management practices.

Both MWDVBE businesses had triple digit growth from 1997 to 2000, were highly leveraged with debt, and required significant increments in fixed cost to support the revenue growth. Revenues were concentrated within the industry and with two to three customers – very little revenue diversification. Figure 5 shows the growth trends and some key observations from both companies.

Fig. 5



While the growth trend from 1997 to 2000 mirrors industry capital expenditures trends, we observed that this growth was all organic and not a function of a merger or an acquisition. In both cases, the growth was driven by MWDVBE sourcing practices of the

corporation focused on achieving MWDVBE spending targets. For the MWDVBEs to accommodate the revenue growth, it was required to achieve geographic scope and scale quickly with significant debt financing. It is very challenging to replicate business processes consistently across a number of geographic locations within a short time period. One of the suppliers had locations in 11 cities within 3 years. These challenges of rapid expansion created high levels of operating and financing leverage that were difficult to manage when orders from customers began to decline.

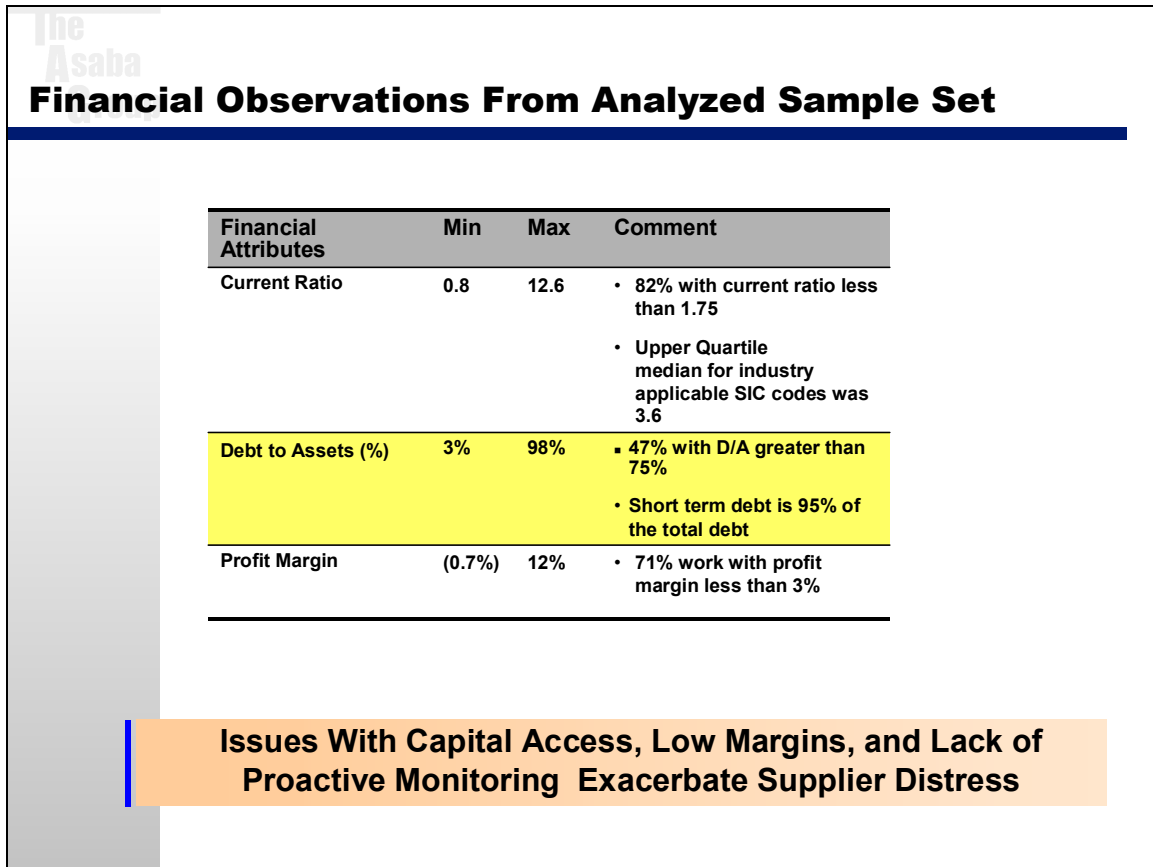
A quick risk assessment of either company would have revealed a number of growth constraints and inability to take on additional business without significantly impairing the ability to survive in the long term. The assessment would have also revealed the cash flow issues associated with making interest payments, the borderline liquidity issues, a mismatch in the duration of financing instruments, and risks stemming from high levels of inventory carried by these companies. During our industry interviews, some program managers mentioned observing these companies experiencing difficulties in getting overdue account receivables issues resolved because of inadequate order processing processes and systems. These are leading indicators or performance predictors (early warning beacons) that problems were imminent for these MWDVBE suppliers.

Additional analysis was conducted on 25 suppliers from the sample of 71 MWDVBE suppliers with revenues greater than \$10 million. The objective was to determine, on a high level, the degree of solvency and liquidity risks with these suppliers. The 25 companies had the following profile based on 2001 financial statements:

- Revenues ranged from \$22 million to \$800 million
- Commodity categories were business services, distribution, distribution/value added resellers, and manufacturing
- Most had experienced significant growth from 1997 to 2000

Assessment of firm liquidity was determined by looking at current ratios (a ratio of current assets and current liabilities). Eighty-two percent of our sample had current ratios less than 1.75 compared to the upper quartile industry benchmark of 3.6. Debt leverage was determined by looking at the debt-to-assets ratios; 47% of the sample had debt-to-assets ratios greater than 75%, with short term debt at 95% of total debt. Given the challenges most MWDVBEs have with access to capital, these liquidity and debt leverage statistics are quite common. However, with 71% of the sample with operating profit margin less than 3%, it significantly increases the risk levels of these companies. This is why proactive monitoring and development become critical in ensuring long term sustainability of MWDVBE suppliers. Early involvement with under-performing suppliers increases the available options to address underlying issues before a crisis occurs. In most cash flow crisis situations, the options are limited to bankruptcy and liquidation. Figure 6 shows some financial attributes of the analyzed MWDVBE suppliers.

Fig. 6



Supplier development programs must include proactive monitoring of suppliers to better manage supply chain risks, but they should also focus on building competitive capabilities that enable the supplier to provide added value to the corporation. An example of this can be assisting the supplier to develop lean manufacturing competencies whereby the supplier shares the cost saving and productivity gains with the corporation in price reductions or higher service levels. Also supplier development can help address some problems associated with access to capital, such as working capital management. Programs that minimize inventory obsolescence risks (i.e., inventory givebacks), improve cash flow (i.e., short payment terms), and financing duration for capital investments (i.e., low cost financing or equity) will improve the financial stability of MWDVBE suppliers.

D) Identifying Growth Opportunities

Our survey of supplier diversity program managers reveals that program managers desire to spend more time seeking internal procurement opportunities for MWDVBE suppliers. Currently most MWDVBE revenues are in categories sensitive to capital expenditures and with low margins. In addition, most of the MWDVBEs had limited strategic margin control and experienced profit squeeze or value migration™. Our interviews with procurement managers about new opportunities for MWDVBEs indicate a consensus opinion about moving into higher value added categories. There is also the expectation for MWDVBE suppliers to proactively move up the value chain. Below are some comments from the industry interviews:

“Create MWDVBE suppliers with technology and innovation capabilities.... Touch labor is not the way to go.”

“We need to change the mindset from ‘give equal chance to participate’ to creating sustainable long term suppliers.”

“If you can’t provide value, you can’t be sustainable.”

“One positive aspect of the VAR model is that it gets MWDVBES through the door.... It is up to them to go up the value chain and I have seen some companies do just that!”

“MWDVBES must stop relying on their [minority] status..., but need to figure out what customers need and strive to fulfill that need. Getting contracts just because you are a diversity supplier is outdated.”

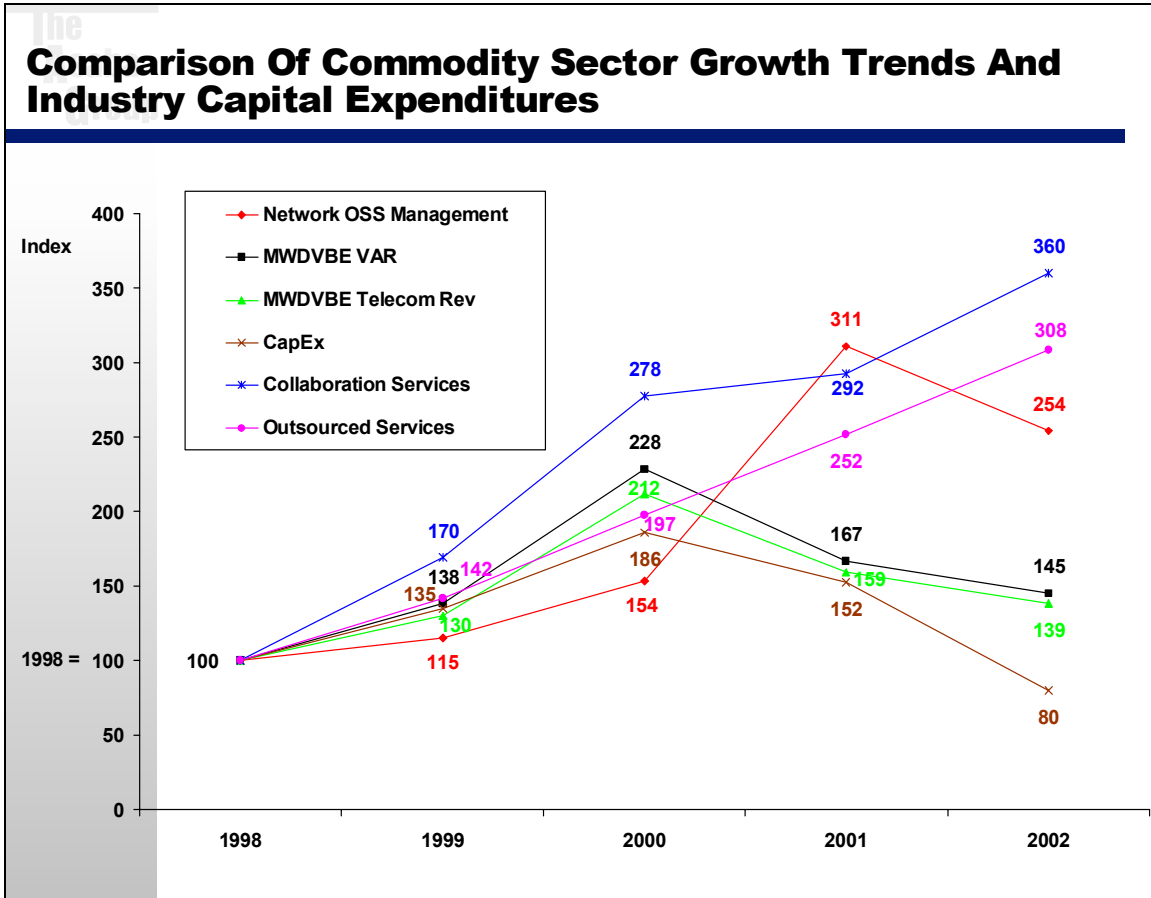
“Technology, innovation, and services which reduce OpEx [operating expenses] are where the growth is. We look to our suppliers for cost reductions.”

Interviewees from the larger MWDVBES say that difficulties in getting access to corporate decision makers, particularly those outside the purchasing function, limit their ability to move up the value chain. Access to these individuals enables MWDVBES to better understand the business issues facing the corporation. A better understanding of the needs and requirements is essential to developing the relevant solutions, products, and services.

Program managers seeking internal opportunities should target those in the high growth areas on the value chain. The logic behind this is that MWDVBE suppliers are entrepreneurial in nature and have created their companies based on where they believe the sourcing opportunities exist. In the current supplier diversity approach, most opportunities exist in low value added and price competitive sectors, where it is tough to bring in new suppliers that are competitive. In high growth commodity groups, it is easier to introduce new suppliers compared to low growth competitive sectors. In the current environment, high growth opportunities do exist in the supply chain. These

opportunities are characterized as reducing operating expenditures and technologies that improve productivity and efficiencies – categories that enable profit growth for corporations. Figure 7 shows that suppliers in sectors such as outsourced services, collaboration services, and network management have grown (compared with MWDVBE revenues) despite the capital expenditure slump occurring in the industry.

Fig. 7



In the future, the predicted high growth opportunities shall exist in wireless, broadband access, and data networks categories. Wireless growth will be driven by applications seeking to make the internet experience nomadic, while the “Last Mile” (cable to the home) and impact on signal degradation will drive spending in the area of broadband access (Fig. 8). The transition from circuit switched to IP networks, especially with enterprise customers, is expected to drive growth in spending for products and services

Fig. 8

The Asaba Group

Potential Future Growth Opportunities

Sector	Growth Drivers and Trends	Likely Applications and Devices
Wireless	<ul style="list-style-type: none"> ▪ Nomadic user internet experience ▪ Tetherless devices <ul style="list-style-type: none"> – Away but remotely connected 	<ul style="list-style-type: none"> ▪ Mobil Access ▪ Video migration ▪ Data Synchronization
Broadband Access	<ul style="list-style-type: none"> ▪ Reduce length of copper from electronics to the house 	<ul style="list-style-type: none"> ▪ Signal degradation ▪ Passive Optimal Network ▪ Security and Authentication
Data Networks	<ul style="list-style-type: none"> ▪ Transition from circuit switch to packet switching 	<ul style="list-style-type: none"> ▪ IT/ATM applications

Opportunities Primarily In High Technology Sectors

related to network deployment and new applications. The challenge will be creating and mechanizing processes within Supplier Diversity that can identify these opportunities and share the knowledge with the MWDVBE supplier community.

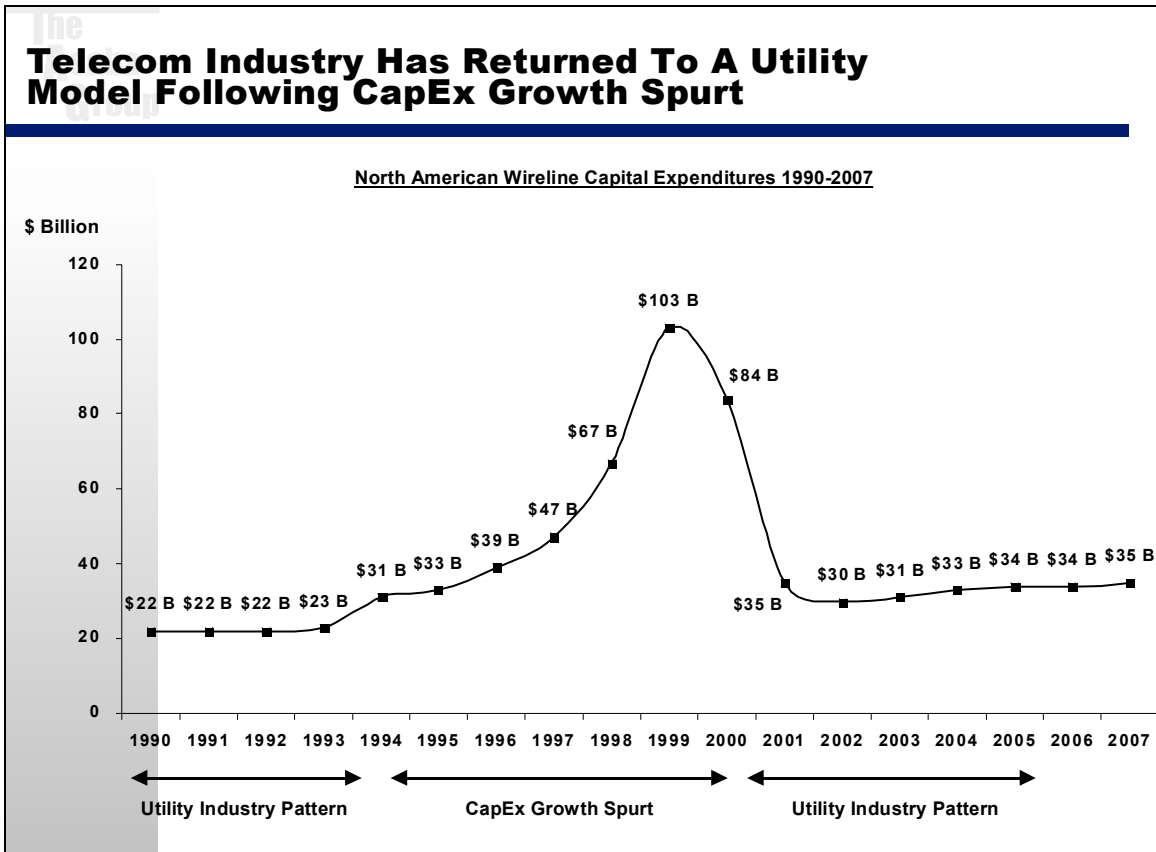
E) New Realities, New Approach, and New Practices

In the first section of this report, we discussed at length the industry realities and competitive dynamics. A significant driver of the past expansion in the telecommunications industry was a surge in capital expenditures from 1997 to 2001. During this period, industry spending with MWDVBES also experienced significant growth, and supplier diversity programs were adopted by industry participants. We have also shown that significant share of the MWDVBE growth was a direct result of these capital expenditures – MWDVBE revenues were highly correlated to CapEx because a

large number of these suppliers serves as intermediaries between the Original Equipment Manufacturers (OEMs) and the service providers.

As we look into the future, one can assume that the current industry slump is temporary (similar to being at the bottom of an industry cycle) and wait for an upturn in demand and return to business as usual. However, we believe that the industry is not cyclical, and that the prior five years were an aberration and not reflective of real industry demand. When we analyzed industry capital expenditures over two decades, an interesting pattern emerged. Prior to 1997, capital expenditures grew in line with demand and mirrored a utility industry investment pattern. With overcapacity in the network and no foreseeable mass-market applications that would drive full consumption of installed capacity, most analysts conclude that future capital expenditures will most likely grow in line with the pattern observed in the early 1990's. Figure 9 shows the utility patterns of the 1990's and the forecast through 2007.

Fig. 9

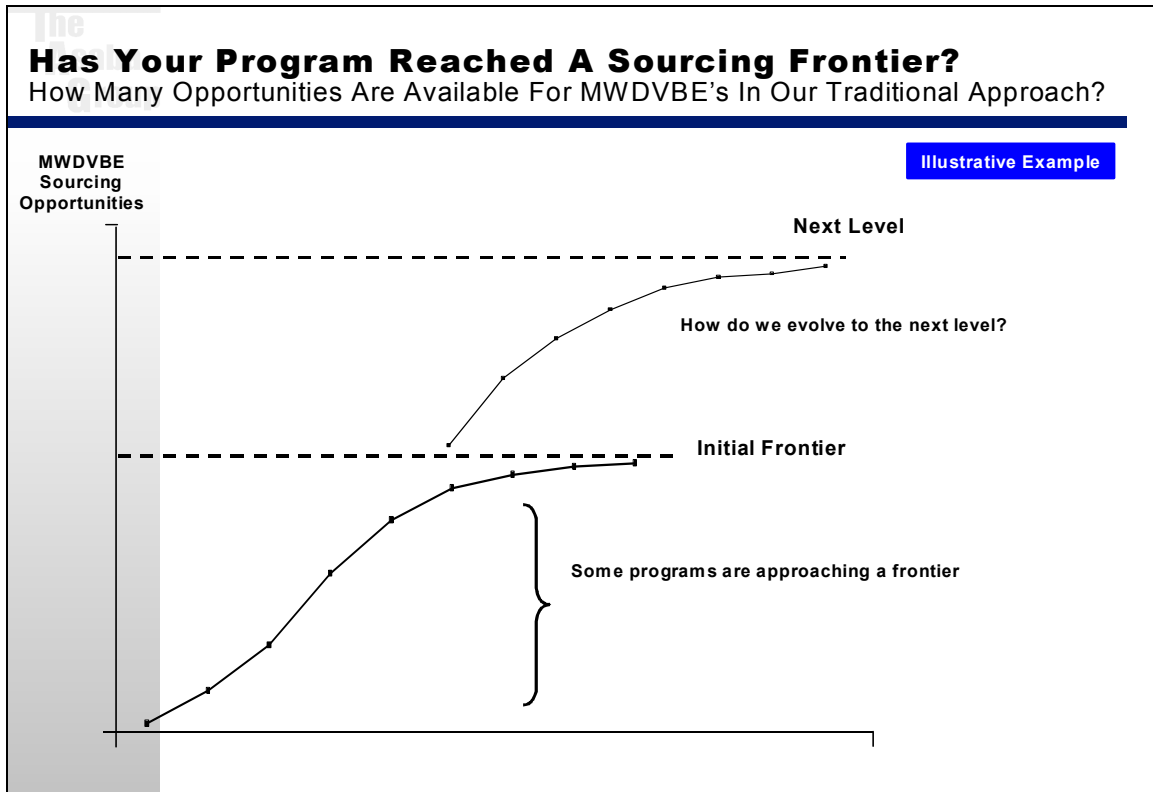


In a utility environment, what worked for MWDVBE sourcing during the CapEx growth spurt would, more likely than not, fail. The issues and challenges with supplier diversity programs (some of which were key reasons for conducting this study) came to the fore between 2000 and 2002. This should be ample empirical evidence that current approaches are not suitable in a future that looks like a utility environment. This does not mean that supplier diversity practitioners must dump past practices, but rather that they need to critically answer these two key questions:

- How much of MWDVBE sourcing opportunities exists within my current approach?
- How close am I to my opportunity frontier? (The frontier where incremental efforts provide marginal benefits, Figure 10)

If the answers reveal a situation where it is increasingly difficult to increase MWDVBE opportunities, the next questions are “What do we evolve in our programs, and how?”

Fig. 10



The automotive industry provides some insights about how to evolve to the next level. In studying the Big 3 (Ford, GM, and DaimlerChrysler) minority spending, from 1991 through 1996, we observed that it grew at about 20% Compounded Annual Growth Rate (CAGR), but that from 1996 to 1998, minority sourcing slowed to 7.5% CAGR. In 1998, the Big 3 collectively committed to grow minority spending to about 5% of purchases (\$6.2 billion in tier one and \$2.6 billion in tier two) by 2001. Declared results by the Big 3 automakers show total spending at \$8.5 billion in 2002. What enabled the Big 3 to achieve this level of growth and spending in three years, in an industry with a very lean supply chain and fierce price/cost competitiveness? What can we learn from the automotive sector that can translate to the telecommunications industry?

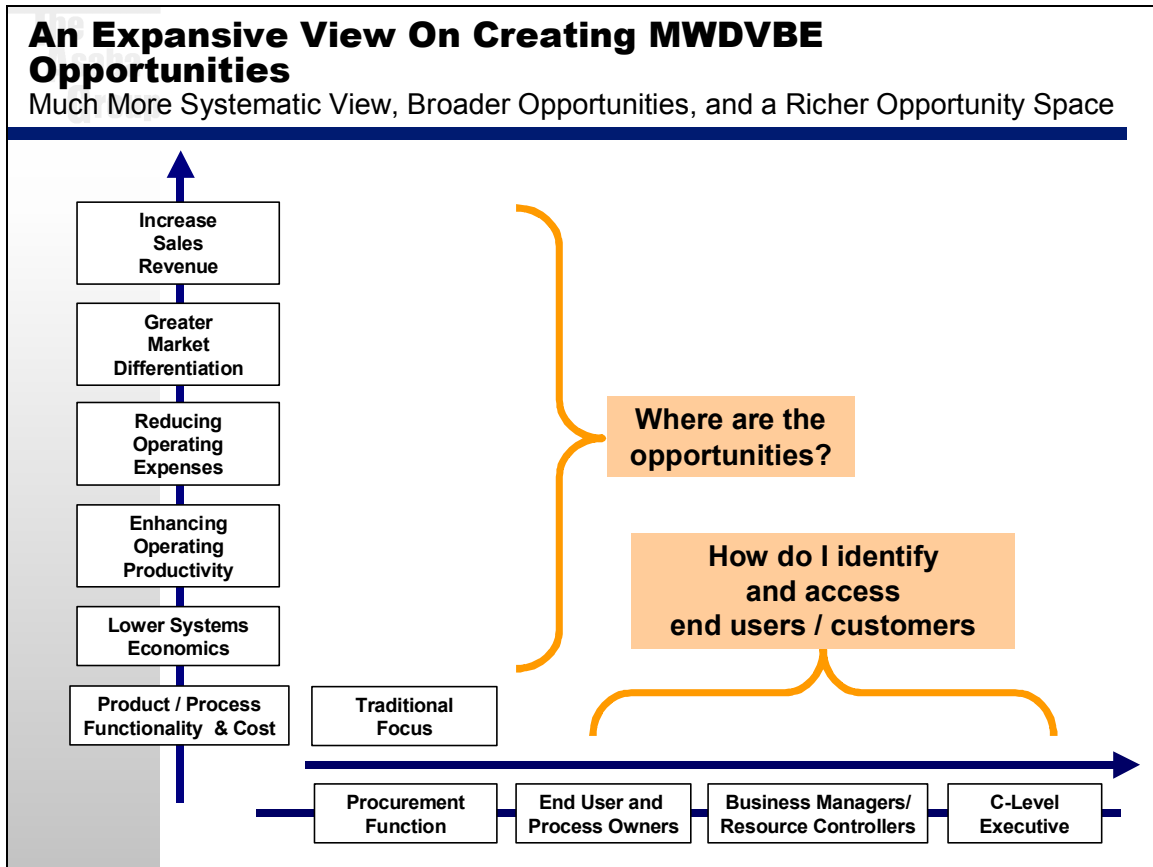
Our research shows that the automotive supplier diversity practices focused on the following: using corporate development approaches as a tool for growing minority spending; concentrating scarce resources on fewer suppliers (“strong horses”); proactive development of supplier capabilities; active programs to address access to capital issues; deploying superior levels of investment and implementing resources; and, lastly, a clear commitment by senior leadership to make supplier diversity a core initiative within the corporation.

For the telecommunications industry, some of these practices are transferable but may require different approaches for implementation. At a minimum, we suggest that the next-level programs contain the following elements and practices:

- Develop an expansive view for identifying and creating MWDVBE opportunities
 - Requires a shift in perspective about sourcing new opportunities
 - From procurement to a wider view of how to alter the corporation’s economics and identify who is the end user/customer (typically resides outside of the procurement function, see Figure 11)
- Use of corporate development growth approaches
 - Such as outsourcing, joint ventures, strategic alliances with large Tier I corporations

- Corporate development transactions are typically two to three times larger compared to procurement commodity buying, and are more value added with some leverage on controlling profit margins
- Focus on a core set of suppliers to consolidate future spend – select strong horses!!!
 - Set a target to spend incremental dollars on a defined set of mentored suppliers
- Supplier development programs focused on acquisition of knowledge, transfer of technology, and managing risks
 - Building competencies within the supplier
- Proactive support (hands-on) processes for financial and technical assistance
- Performance monitoring, benchmarking, risk management systems (Quality, Service, Technology, and Price)
- Comprehensive business assessments to identify constraints to current performance and future growth
- Emphasis on two-way collaboration between MWDVBE suppliers and corporate leadership
 - Internal minority supplier councils
 - Corporate executive mentors
- Financial assistance with improving cash flow and cost of capital issues with MWDVBE suppliers

Fig. 11



F) New Roles and Partners for the Future – “The Pentagon of Stakeholders”

As mentioned above, to implement some of the new practices will require new partnerships and new roles. We have identified five key constituencies that are critical to achieving success:

- Telecommunications Industry Group (TIG)
- Corporate supplier advocacy organizations (e.g., NMSDC, WBENC, USHCC, USPACC, etc.)
- Advocacy “watchdog” organizations (e.g., Rainbow/Push, NAACP, etc.)
- The Corporation and Supplier Diversity Program Managers
- MWDVBE supplier community

1. The Telecommunication Industry Group will have to champion the industry effort. TIG can establish programs, standards, and best-in-class processes for the following:

- Risk management and capability certification for suppliers
- Mentoring and development programs
- Supplier diversity economic models
- Sharing (commonality) of suppliers

Secondly, TIG can lead a collaborative effort where they work with corporate treasury groups to provide an incentive to pension fund managers to offer equity funding for telecom MWDVBE suppliers or create an investment fund that can be funded by the fund managers.

2. Suggested roles for corporate advocacy groups

- I. Stratification of suppliers' needs

- a. Defining the "entry points" and table stakes
- b. Driving the tiering structure in outreach and cascaded mentoring and development

- II. Evolve into "think tank" or "center of knowledge"

- a. Defining industry trends, researching and communicating new emergent possibilities
- b. Beyond procurement issues to business trends

- III. Innovation and technology incubators

- a. Clearing house for applied technology

- IV. Leverage corporate relationship and become a platform to address collective issues

- a. Standardization of Supplier Diversity Program Manager Position

- V. Facilitate offshore partnerships between MWDVBEs and offshore companies

3. Suggested new roles for advocacy "watch dog" organizations

- I. Enhancing the brand; consumer and market response to supplier diversity program

- a. Reinforcing the link to corporate revenues and profits
 - II. Ensuring clear visibility and inclusion along the supply chain
 - III. Developing a clear and consistent metric measurement for supplier diversity
 - a. Expectation for audit and verification procedures
 - b. Emphasis on transparency and sustainability
 - IV. Support the notion that few, large Tier One MWDVBEs is the best long run solution
4. Corporation and program managers – Must begin to elevate the profile and responsibilities of the program managers. This is critical to improving the position’s effectiveness within and outside of the corporation. Figure 12 shows current position attributes and the proposed view.

Fig. 12

The Asaba

Evolving the Program Manager Position and Role

Attributes	Current View	Proposed Change	Implications
Position	Staff (Peripheral to Purchasing)	Line (Within Purchasing and/or Corp. Development)	<ul style="list-style-type: none"> • Access to resource controllers and process owners
Hierarchy	Low to Mid	Executive Level	<ul style="list-style-type: none"> • Internal clout to generate opportunities
Value Creation Orientation	Risk/Expense Reduction	Profit/Revenue Enhancing	<ul style="list-style-type: none"> • In line with business design/strategic objectives
Focus	Supplier Outreach	Supplier Development	<ul style="list-style-type: none"> • More time to support current suppliers
Monitored Metrics	Spend Level and/or Spend Share (%)	Profitable/Sustainable Revenues Value Created	<ul style="list-style-type: none"> • Relevant metrics that ensure sustainability and accrued benefits to Corporation
Career Track	Static/Limited Options	Development position for top performers	<ul style="list-style-type: none"> • Enhance profile within the organization • Benefits of having top performers grow benefits
Breadth of Experience	Limited	Broad	<ul style="list-style-type: none"> • Enhances overall effectiveness

Secondly, “market-facing” corporations (such as the service providers) should be more aggressive in creating second tier opportunities. They should adopt a practice of the

automotive sector where some major programs are awarded to those tier one suppliers with credible majority-minority joint ventures.

5. MWDVBE supplier community

The supplier community must understand that the industry dynamics have changed and the future shall reflect a utility model. Also, these enterprises must invest in understanding future trends and how best to reposition their business to be competitive. MWDVBES must take an expansive view of defining the opportunity landscape. This involves viewing the business issues outside of procurement and creating solutions that address these issues. MWDVBES should view the current lack of shared suppliers as an opportunity to create processes that will increase the likelihood of becoming a supplier to other corporations. The benefits from gaining customer diversification and cost competitiveness are significant. MWDVBES also need to better manage growth and its associated financing risks, and, more importantly, pursue a risk diversification strategy (industry and customer). Where possible, they should proactively seek partnering and joint venture situations with large majority companies that provide much needed capabilities or product scope.

Industry Roundtable Recommendations

The prior chapters of the report have identified the challenges encountered by MWDVBE suppliers in the industry and suggested new approaches to enable sustainable development. In addition, it highlighted areas, external to the suppliers, such as the program managers' activities and advocacy organizations that contribute to the challenges associated with achieving sustainable supplier diversity growth in the industry. In developing recommendations for sustainable development, three forums were held: two roundtables in New York with representatives from industry, the supplier community, and advocacy organization and a meeting with the Telecommunications Industry Group (TIG) in Dallas. At these forums, the data and information were presented to the groups and some consensus was reached on best ways to move forward and enable sustainable development. This chapter presents the recommendations from these forums.

A) New Roles for Corporate Supplier Development Organizations

The advocacy organizations are expected to take on additional roles and in some instances improve their value proposition to their corporate customers. For the corporate member organizations (such as the National Minority Supplier Development Council [NMSDC], Women's Business Enterprise National Council [WBENC], U.S. Hispanic Chamber of Commerce [USHCC], or the U.S. Pan Asian American Chamber of Commerce [USPAACC]), improving the supplier outreach services was recommended. The roundtable suggested that there should be better segmentation and targeting of trade fair events. In addition, there should be greater emphasis in conducting matchmaker events. There was a consensus at the roundtables that the matchmakers created valuable and richer opportunities for corporate buyers and MWDVBE suppliers.

Another area in which the corporate membership advocacy organizations were asked to play a role was in creating a truer sense of realities about the procurement landscape to MWDVBE prospective suppliers. The groups are expected to work with their corporate members to create brochures that define the entry points and criteria that a supplier must meet to do business with the corporation. While these are not absolute definitions, they

begin to set the expectations within the MWDVBE supplier community about the likelihood and propensity of doing business if they have not met required criteria. The potential benefit to the suppliers is the enhanced return on their marketing and business development investments.

The entry points will also define the likely size and scale requirements for the commodity and service categories. The size criteria will be cognizant of the difference across commodity groups and between services and commodities. Utmost care will be taken that it is not perceived as a denial of access for small suppliers.

B) Increased Involvement of Advocacy Organizations

There is a need for advocacy organizations that represent specific constituencies and play “watchdog” roles (such as Rainbow/Push and the National Association for the Advancement of Colored People [NAACP]) to collaborate and establish a recognition program for corporate supplier diversity efforts. With many recognition programs already in existence, with differing criteria on how the awards and recognitions are granted, a coalition of the advocacy organizations would meet to agree on a consistent methodology and rating criteria. To gain widespread impact, adoption, and acceptance by senior corporate managers, this recognition program should be in partnership with major business news publications (Wall Street Journal, Business Week, etc.) and would most likely take the form of a Top 50 Corporation or Top 20 CEO list.

Another recommendation to the advocacy organizations is to be more proactive in reinforcing the link between the corporations with active supplier diversity programs and their various constituencies. The advocacy organizations should communicate to their constituency the need for them to show a strong purchase preference for products and services from these corporations. This will reinforce the link between the corporate supplier diversity programs and the market competitive differentiation

C) Corporate Supplier Diversity Program Managers

A key recommendation was improving the articulation of the value proposition of supplier diversity within the corporation. For corporations that sell products and services directly to consumers, program managers are expected to work with their marketing organizations to determine the relevant market opportunity and seek ways to include supplier diversity as a marketing lever to these constituencies. Where possible, the program managers should investigate opportunities to create ingredient-branding possibilities (similar to the “Intel Inside” concept in the personal computer industry).

In addition, the program managers need to create a corporate-specific supplier diversity economic model that can capture the economic benefits and linkage to shareholder value creation. The economic benefits exist at three levels: sourcing, corporate, and macro corporate/corporate citizenship. The value at the direct sourcing level is related to cost, delivery, and services benefits associated with switching or introducing a new supplier. The corporate benefits come from incremental revenue and market opportunities, favorable regulatory and legislative acts, etc. The macro corporate citizenship benefits result from creating wealth within consumer sectors that buy the corporation’s products, and the economic development of stakeholder communities.

Developing a widely understood and internalized value proposition will enable the move to creating contractual requirements on the large tier one suppliers that are key to creating second tier MWDVBE sourcing opportunities. In setting these requirements, one needs to be backed up with some teeth – a rewards and sanctions regime that will ensure compliance. Making it a customer requirement in determining new sourcing opportunities or keeping current business will ensure supplier diversity is comparable to similar customer requirements such as quality certification, insurance bonding, etc., that are needed to conduct business with the service providers.

To increase the effectiveness of program managers recommendations came in two areas: enhancing the supplier diversity position and instituting new processes geared at driving growth of sustainable MWDVBE dollars. The recommendation for the program

manager's position was a need to elevate the position and create the linkages to corporate development managers and resource controllers in the corporation. In elevating the position, it needed to be viewed as a career track for high-potential employees who are likely to become leaders in the future – a track to senior management. Also, it was mentioned that the position must remain within the core purchasing organization and not moved to Human Resources or to a function where sourcing decisions are not made. In creating new processes, it is essential that program managers begin to define opportunities outside of the procurement activity. These opportunities are such as outsourcing, asset sales and divestitures, and new product development: areas where the vendor selection decisions, in most instances, are outside of the procurement function.

D) An Active Telecommunications Industry Group (TIG)

The Telecommunication Industry Group forum creates a platform for collaboration and shared resources without the risk of anti-trust or unfair competitive practices. TIG should take a leadership role in creating a development initiative that helps improve the capabilities, performance, and competitiveness of the MWDVBE suppliers. As described earlier in this report, the MWDVBE development challenge requires a tiering approach in creating relevant development solutions. For smaller suppliers, TIG can create development programs that bridge capability gaps, create a standardized methodology or certification that addresses risks with suppliers, and assist with issues around access to capital/financing. For the larger, well-established MWDVBEs, access to key senior managers outside the procurement activities is an area TIG needs to address. TIG can create forums or platforms that encourage the building of relationships between the MWDVBE executive team and the corporate senior leadership. These forums should be created as mini “Davos” summits.

The roundtables also recommended the need for TIG to actively provide information about industry trends and emerging opportunities. This can be done in partnership with a corporate supplier organization (such as NMSDC, WBENC, USHCC, or USPAACC) or with specific trade associations. TIG can create mini “think tanks” or “centers of

knowledge” for issues that are beyond procurement and reflect business and competitive dynamics. This will assist MWDVBEs in positioning their firms and acquiring the necessary capabilities for future growth. This is the kind of information most larger firms obtain to develop winning strategies and capabilities to meet future and emerging requirements.

Another recommendation for TIG was the active collaboration and sharing of best practices and suppliers. TIG needs to find ways to document and institutionalize processes that enable easy access to supplier diversity best practice knowledge, such as a creation of a knowledge repository with NMSDC or its trade association, the Telecommunications Industry Association (TIA). These best practices will contain knowledge that is specific and unique to the telecommunications industry and also practices and processes from other industry sectors (such as the automotive) that can help achieve MWDVBE sustainability. It is also important to develop a process that ensures greater sharing of suppliers: this creates customer diversification and provides the MWDVBEs with the volume benefits of achieving critical mass/scale.

Conclusion

The TIG industry study identified a number of issues that inhibit MWDVBE growth and sustainability. Most of the issues require the pentagon of stakeholders to take on new roles and adopt new practices. But to ensure long-term success, TIG must be in the driver’s seat: it must take a leadership role to ensure that suggested initiatives are implemented and create conditions such that Supplier Diversity becomes an embedded practice within the industry – Supplier Diversity as a utility.

Appendix

Who We Interviewed

<u>Company</u>	<u>Name</u>
1. Motorola	<p>Roger Callanan • Director of Supply Chain Management</p> <p>Lester McCarroll, Jr. • Vice President and Director, Strategy and Operations</p> <p>Nannette Kelley • Supplier Diversity Manager</p> <p>William Payne III • Director, Advanced Wireless Engineering</p>
2. SBC	<p>S. G. Welch • President, Procurement/Corporate Real Estate</p> <p>Joan Kerr • Executive Director, Supplier Diversity Program</p> <p>Roger Kachiu • Senior Account Manager, Public Sector-Bay</p> <p>Charles Geer • Director – Supplier Diversity, Business Development</p> <p>James Keown • Executive Director, Project Management</p> <p>Mark Hummel • Executive Director, Strategic Sourcing</p> <p>Claudet McCauley • Account Manager, Government Accounts</p> <p>Margaret Rawls • Director – Business Operations, Supplier Diversity</p> <p>Jesse Torres • Director, Loop Technologies Contracting</p>

3. Cisco

Perry Bakke

- Purchasing Manager, Corporate Purchasing, CSM

Janis DeRoche

- Director, Global Supply Management

Charleen Hamel

- Supplier Diversity Specialist

Jim Pappas

- Manager, Corporate Purchasing, CSM

Diane Thelen

- Manager, Corporate Supply Management

4. Verizon Communications

Joe Anderson

- Executive Director, Supplier Diversity

John Coyle

- Sourcing Process Leader

Jeannie Diefenderfer

- Group President, Systems, Billing, Process Assurance

Sherry Embrey

- Manager, Supplier Diversity

Evelyn O’Gilvie

- Director of Multicultural Marketing, Communications & Branding

5. Saturn Electronics & Engineering

Wallace Tsuha, Jr.

- Chairman, CEO & President

6. Lucent Technologies

Heather Herndon-Wright

- National Director, Supplier Chain Diversity

Robert A. Piconi

- Vice President, Wireless & Optical Networks Supply Chain, Supply Chain Design and Optimization

- 7. Tellabs** John Kohler
• Senior Vice President, Global Operations
- 8. WBENC** Susan Bari
• President
- 9. NMSDC** Harriet Michel
• President
- 10. Jackson & Tull** Knox Tull, Jr.
• President
- 11. Telcordia** Roy Read
• Senior Director, Solution Quality Assurance
- John Haskard
• Corporate Vice President, Global Sales
- 12. WorldWide Technologies** David Steward
• Chairman and CEO
- 13. Telamon** Albert Chen
• President & CEO
- Stephanie Chen
• Director, Business Development
- 14. AT&T** Fernando Hernandez
• Supplier Diversity Director
- Debra Bell
• Chief Procurement Officer, Supplier Management
Division
- Matt Connelley
• Group Procurement Director
- Stephanie McNeil-Bates
• Supplier Diversity Manager

- 15. BellSouth Corporation** Chris Tsai
• Executive Director of Policy & Planning, Procurement & Logistics
- Deberah Stone
• Manager, Supplier Diversity
- 16. Comerica Bank** Brenda Schneider
• First Vice President, Director of Business & Development Services
- 17. ASG Renaissance** Lizabeth Ardisana
• Chairman & CEO
- 18. JP Morgan Chase** Cesar Vallegos
• Senior Manager, Enterprise Technology
- Harvey Butler
• Supplier Diversity Manager
- 19. NetCom Solutions** Emmit McHenry
• Chairman & CEO
- 20. CTDI** George Ehrgott
• Materials Manager, Supplier Diversity
- 21. Graybar** Karen Burkart
• Manager, Minority/Women Business Development
- 22. Solectron** Amy Goudy
• Program Manager, Global Materials Services
- 23. ASDV** John Lopez
• Chairman

Verizon Roundtable Attendees

1. Joe Anderson Verizon
2. Susan Allen US Pan Asian American Chamber of Commerce
3. Stephanie Bates AT &T
4. Susan Bari Women Business Enterprise National Council
5. Julian Birdsong Verizon
6. Albert Chen Telamon
7. Ed Curran Verizon Wireless
8. Courtland Cox The Joint Center for Political and Economic Studies
9. George Dowell Verizon
10. Victor Edozien The Asaba Group
11. George Ehrgott CDTI
12. Sherry Embrey Verizon
13. Marsha Gambles Verizon
14. Amy Goudy Solectron
15. Dennis Grousoky Graybar
16. Fernando Hernandez AT&T
17. Carlton Jenkins Yucaipa Corporate Initiative Fund
18. Paula Mann Sunbelt Telecommunications
19. William Massani Tellabs
20. Harriet Michel National Minority Supplier Development Council
21. Deborah Mullins Verizon
22. Roy Read Telcordia
23. Earl Scott Dynis
24. Brenda Schneider Comerica Bank
25. Dave Steward World Wide Technologies
26. Michelle Stone Lucent Technologies
27. Margaret Simms The Joint Center for Political and Economic Studies
28. Chris Tsai BellSouth
29. Gwen Wilson Verizon Wireless

AT&T Roundtable Attendees

1. Susan Allen US Pan Asian American Chamber of Commerce
2. Joseph Anderson Verizon Communications
3. Stephanie Bates AT&T
4. Linda Bean Diversity Inc.
5. Evangelia Biddy Diversity Inc.
6. Courtland Cox The Joint Center for Political and Economic Studies
7. Victor Edozien The Asaba Group
8. Fenimore Fisher Rainbow Push – The Wall Street Project
9. Carol Foster Minority Business News
10. Fernando Hernandez AT&T
11. Roland Jones Nextel
12. Marie Long Rainbow Push – The Wall Street Project
13. Kurt McHenry NetCom Solutions International
14. Harriet Michel National Minority Supplier Development Council
15. Vincent Nall Washington Cable Supply Inc.
16. Sujatha Rao Asian Women In Business
17. Ramon Mas MasTec
18. Colleen Molter National Association of Women Businesses
19. Earl Scott Dynis
20. Michelle Stone Lucent Technologies
21. York Wang York Telecom

Information Sources

1. U.S. Census
2. Federal Communications Commission
3. Wall Street Journal
4. Merrill Lynch Research
5. Waterhouse Research
6. Goldman Sachs Research
7. U.S. Department of Commerce, Minority Business Development Agency
8. National Minority Supplier Development Council
9. Women's Business Enterprise National Council
10. Dun & Bradstreet
11. Crain's Detroit Business
12. Telecommunications Industry Association (TIA)
13. Cellular Telecommunications Industry Association (CTIA)
14. Telecommunications Industry Group (TIG)