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Customer value management

The path to profitable growth in telecom

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Executive summary

As the telecommunications industry becomes even more competitive, operators are struggling to find paths to profitable growth. Markets are saturated, new subscribers are getting more expensive to acquire, and current subscribers are apt to leave ("churn out") in their search for a better deal.

In this business environment, operators need to stop depending solely on metrics such as gross adds and market share to measure growth. Instead, they need to develop a capability we call customer value management (CVM) — a holistic way of evaluating individual subscribers in terms of their overall profitability, now and in the future. This capability covers subscribers at every stage of their relationship with their operator, and should be considered by mobile, fixed, and integrated telecom companies.

Relying on a combination of tactics, including customer payback period, budget rebalancing, tailored customer rewards, and cross- and up-selling campaigns, CVM has the potential to boost EBITDA (earnings before interest, taxes, depreciation, and amortization) as much as 5 percentage points among certain customer segments, which is no small amount for operators determined to boost earnings.

Competitive pressures

Most telecom operators in developed economies around the world continue to struggle to maintain profitability. Their markets are almost entirely saturated, especially in mobile telephony, where intense competition has led to penetration rates as high as 150 percent. As a result, average revenue per user (ARPU) is declining, and churn is on the rise. Yet the need for capital investments remains high, and the cost of acquiring and retaining customers keeps increasing.

Thus, few operators are increasing their customer base, and fewer still have been able to boost the profitability of the customers they do have. Spending the money to replace customers churning out of the base only results in lower ARPU overall and thus further delays the time it takes to recapture the cost of acquiring them.

Clearly, the industry's long-standing orientation toward boosting market share, increasing the number of subscribers, and thus focusing on "gross adds" is no longer working. If operators want to keep growing profits, they will have to focus not just on market share but on the value of each and every customer in their current base. To do so, they will need to take a page from online retailers, which have already significantly advanced what we call customer value management, or CVM. CVM techniques help companies analyze which customers are the most valuable, and why. Indeed, this approach will soon become a key capability in a world where the potential customer base simply isn't getting any bigger.

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A value orientation

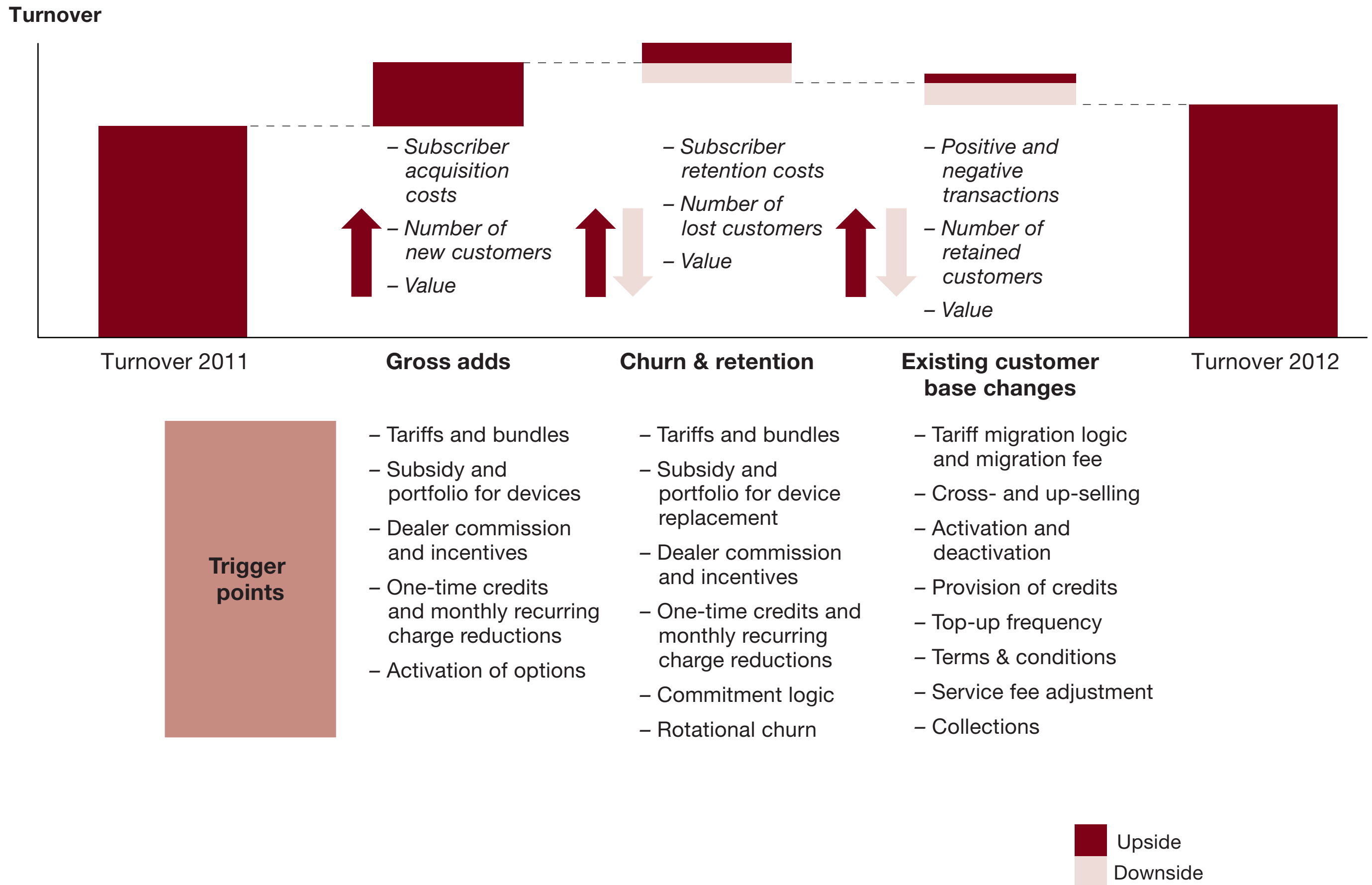
Most telecom operators have already set up business intelligence (BI) units and analytical teams. Their goal is to leverage the large sets of operational and customer data at their disposal in order to derive reports and recommendations on traditional measures, such as gross adds, while ensuring that legal requirements for data security and privacy are met. Most BI initiatives, however, have not succeeded in analyzing the mountains of data at the level of depth and breadth required, or at the speed required, to help in extracting the maximum value from customers. CVM, on the other hand, is a methodology that looks at customers from a holistic point of view, weaving together technology and business processes to develop a complete view of every individual customer.

Thus, CVM is designed to address the major activities that bear on the revenue and profitability potential of telecom customers: (1) the effort to acquire new customers, (2) the challenge of retaining them, and (3) the various means of increasing their value. At the same time, the program should operate sequentially. That is, when the level of saturation increases in a particular market, shrinking the potential for adding new customers, operators should switch to an emphasis on the second and third elements — and the resources in terms of both people and money devoted to each element should be shifted accordingly.

The financial impact of each of the three areas will vary depending on the current state of the operator's CVM effort and the nature of the operator's business, whether fixed-line, mobile, or both (*see Exhibit 1, next page*).

Any of these elements can be applied by mobile, fixed, or integrated operators, although the impact of each trigger will differ depending on the nature of the business. Deriving greater value by optimizing mobile subscriber acquisition costs (SAC) with a focus on the devices offered, for example, is far more complex than sorting out offers of a limited number of set-top boxes in the fixed-line business.

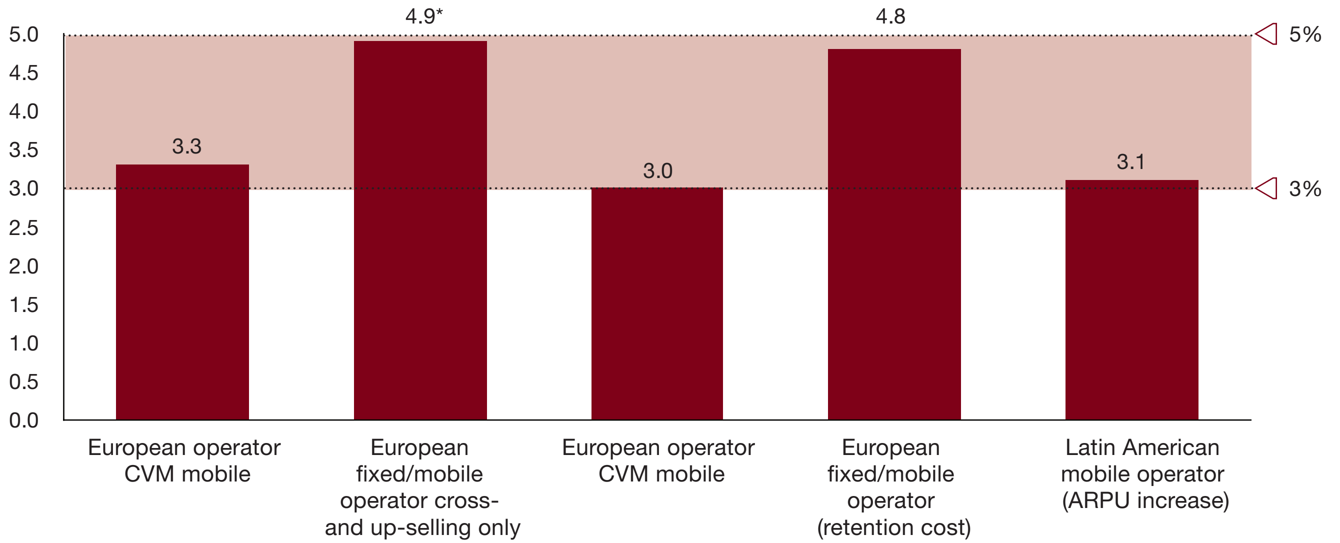
Exhibit 1
CVM improvement areas and trigger points



Source: Strategy& analysis

Once a CVM program is implemented, it typically yields an improvement in EBITDA of at least 3 percentage points, and in some cases as much as 5 percentage points (*see Exhibit 2, next page*). And as the exhibit makes clear, these results are for targeted CVM customer segments only. A holistic program addressing all the possible levers will likely yield significantly higher returns.

Exhibit 2
Improvement in EBIDTA as a result of selected CVM programs



* This EBITDA improvement was achieved within three years.

Source: Strategy& analysis

The initial analysis

No matter which of the three target areas the CVM program is aimed at, development of the program should begin with a thorough response to several key questions regarding the number and nature of the customers to be considered as part of the project, and the value considerations driving the investment levels required to deliver the desired results.

Customers:

- What selection mechanism should be used to qualify customers and customer segments for each campaign?
- How many customers and customer segments should be addressed by the program's initiatives and campaigns, and how often should they be tapped?
- How should the customers and customer segments to be excluded from various campaigns be determined? Might certain customers whose loyalty is doubtful not yield sufficient payback?
- How do you distinguish between loyal and disloyal groups of customers?
- What causes different customers to become loyal or disloyal?

Value:

- How much money should be invested in each trigger area per customer and segment in order to boost ARPU?
- How much money should be invested in each customer in order to yield a return within the customer's life cycle?
- How should the payback from multiple investments in the same customer be measured?

Development of a CVM program should begin with a thorough response to several key questions regarding the number and nature of the customers to be considered as part of the project.

- Can the program determine whether the amounts invested in each customer support the overall objective, rather than simply lowering ARPU?

- How easily can customers lower their costs by manipulating service offers? Are there barriers in place to minimize such losses?

Five levers

The goal of asking the initial questions discussed above is to set the terms for the breadth and depth of the overall CVM program. The program's benefits, however, will be a function of the analysis itself, as the following five value levers make clear.

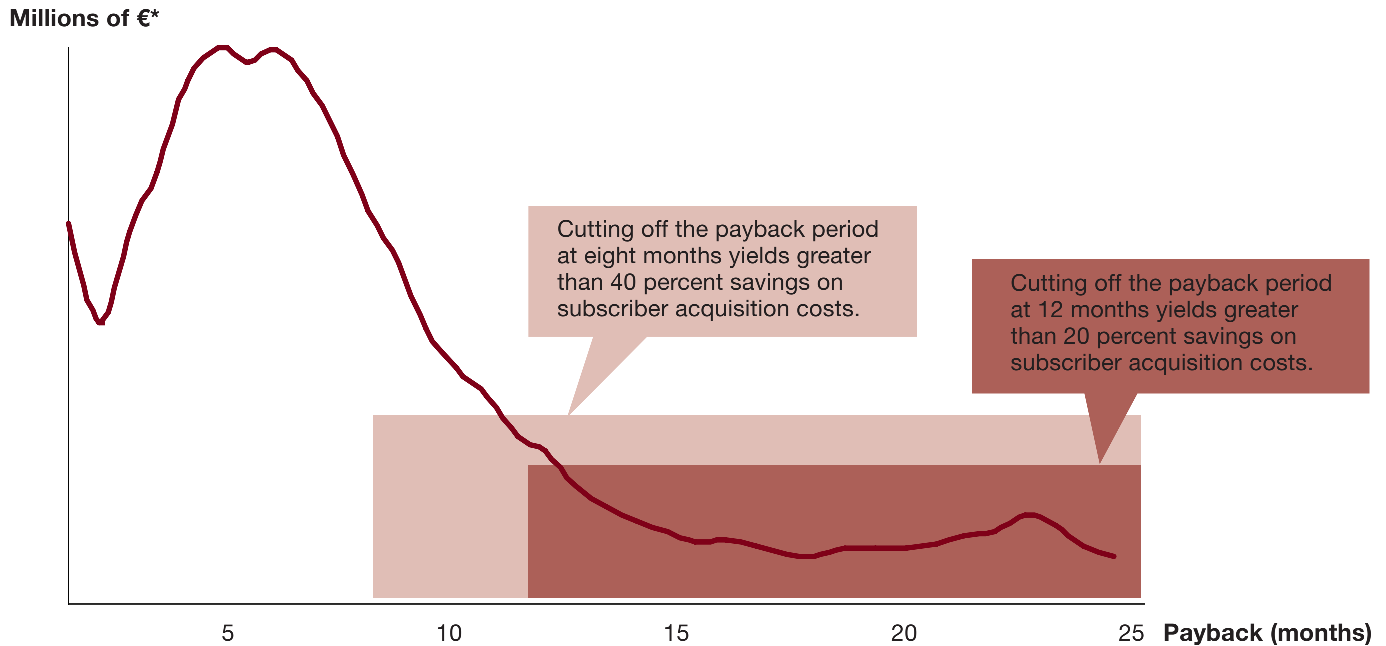
Payback period: The time it takes to restore a customer to profitability given the subsidies provided for the devices he or she chooses, and the commissions paid to dealers to attract and retain customers, has a real effect on the bottom line. Thus, determining the appropriate length of time before payback begins is key. Results will vary, but in one case, the operator was able to save 15 percent of the cost of acquiring new subscribers by avoiding payback times longer than eight months. Even cutting off the long tail of payback periods beyond 12 months resulted in substantial savings (*see Exhibit 3, next page*).

In order to ensure that they get the greatest return from this lever, operators need to regularly review the payback times of their customers, and work both to shorten them and to rebalance new-customer credits and the subsidies they provide for devices. To do so, they need to regularly test the price elasticity of certain customers and customer segments with regard to subsidies and credits. Dealer commissions, too, have an effect on payback, so they must be carefully set to ensure profitability. The process of managing the payback period must be strictly governed, and the necessary payback calculations must be included in the business case for every segment.

Budget rebalancing: As noted earlier, as operators refocus their attention from a concern with market share to a concentration on their existing customer base, they must rebalance their budgets accordingly. Too often, operators have made the strategic shift yet kept their high subscriber acquisition costs, and they have made little effort to spend similar sums on retaining existing customers.

In highly competitive markets, the ARPU of new customers is usually lower than that of churners. This is because the cost of acquiring new customers is usually higher than the cost of retaining customers, and

Exhibit 3
The effect of different payback periods on profitability (an example from one company)



*Note: The actual amount of savings depends on the size of the operator and its budget for acquiring new subscribers.

Source: Strategy& analysis

new customers typically have the latest, most competitive tariffs. So in these markets, where the churn rate is increasing and the rate of gross adds is declining, a rebalancing of the budget is required. We recommend testing customer reactions to various fees and subsidies by running pilots with small samples of customers in the most important segments.

Tariff migration logic: When customers want to upgrade or downgrade their subscription plans, it has long been common practice for operators to allow them to migrate at no cost to plans with higher monthly fees, while either prohibiting them from moving to plans with lower monthly

fees or charging them for the change. This approach, however, is simply not profitable. Our analysis shows that 50 percent of customers who upgraded at no cost actually generated less revenue than customers who didn't upgrade.

If operators are to turn this situation around, they must assess each individual customer's eligibility to move to a different plan, by simulating their ARPU under all the available plans. At the same time, they must ban all ARPU downgrades during a fixed contract period.

Tailored customer rewards: Giving out credits and other rewards to entice customers to return or to stay is a common practice among operators, and particularly among independent dealers. Clearly, it is critical to keep customers from receiving double and even multiple rewards, but doing so requires a holistic understanding of each customer's past behavior and the implementation of strict rules governing who can and cannot receive rewards, and under what circumstances. Dedicated campaigns must be implemented for each individual customer retention and win-back effort, which must include the rules determining when additional rewards are permitted. The IT systems controlling these campaigns must be able to track double rewards in order to identify potential misuse — not just by customers but by dealers and agents as well.

Cross- and up-selling campaigns: Many operators approach the process of cross- and up-selling to existing customers by first defining a campaign and then selecting customers who appear to more or less fit it. If such campaigns are to yield higher returns, operators must define a tailored offer for each individual customer, based on his or her individual affinities and value, that includes several options, perhaps from the first to the third best. This approach can improve the success rate of such campaigns significantly (*see Exhibit 4, next page*).

In addition to ensuring that campaigns are individualized, several other key levers can further boost the profitability of existing customers:

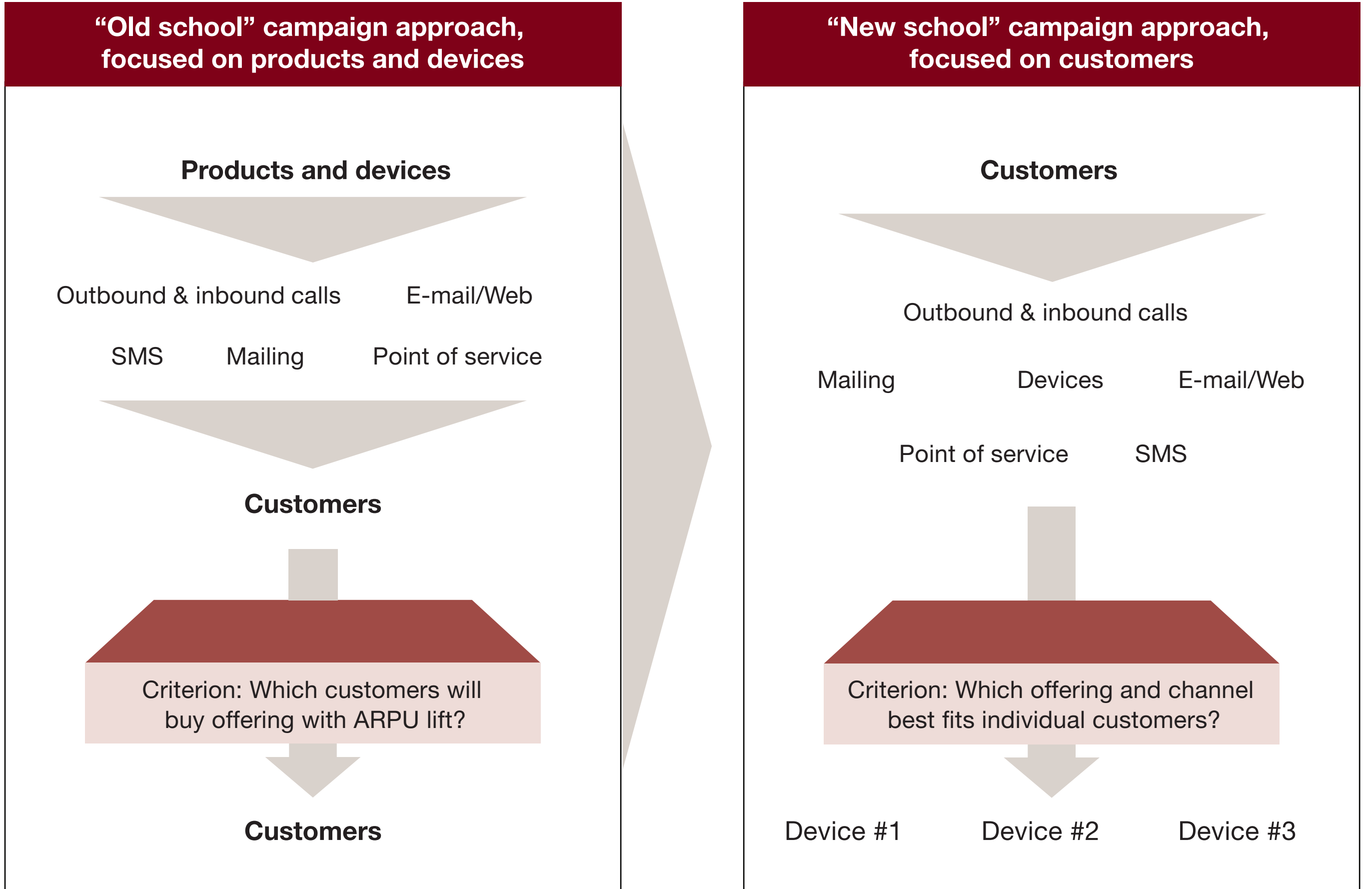
- *Alignment of channel activities:* How many different touch points do you have with customers, and are they aligned with one another?

- *Optimization of customer contacts:* Are your contacts with customers as productive as possible, through every channel?

- *Improvement of product portfolio:* Are the products and services you offer customers sufficiently appealing to attract and keep them?

Exhibit 4

Cross-selling and up-selling campaigns should be focused on the customer, not the product or device



Source: Strategy& analysis

Key capabilities

The effort to launch and run a competitive CVM program requires a systematic approach that begins with building the proper analytical capabilities, and putting together a team with the necessary expertise and talent to ensure that it works. Adjustments to both business processes and IT systems will also be necessary as the operator shifts over to the new approach. Managing CVM successfully will require that the company budgeting and reporting are focused more on what drives value rather than on market-share numbers such as gross adds or average ARPU. Operators must also concentrate their measurement and reporting efforts on value drivers such as the value of each retained customer and the value lost when a customer churns away. Finally, the entire company must be converted to the new way of doing business, through training, a change management program, and appropriate incentives (*see Exhibit 5, next page*).

Exhibit 5
Key elements of a CVM program

Source: Strategy& analysis

Program approach

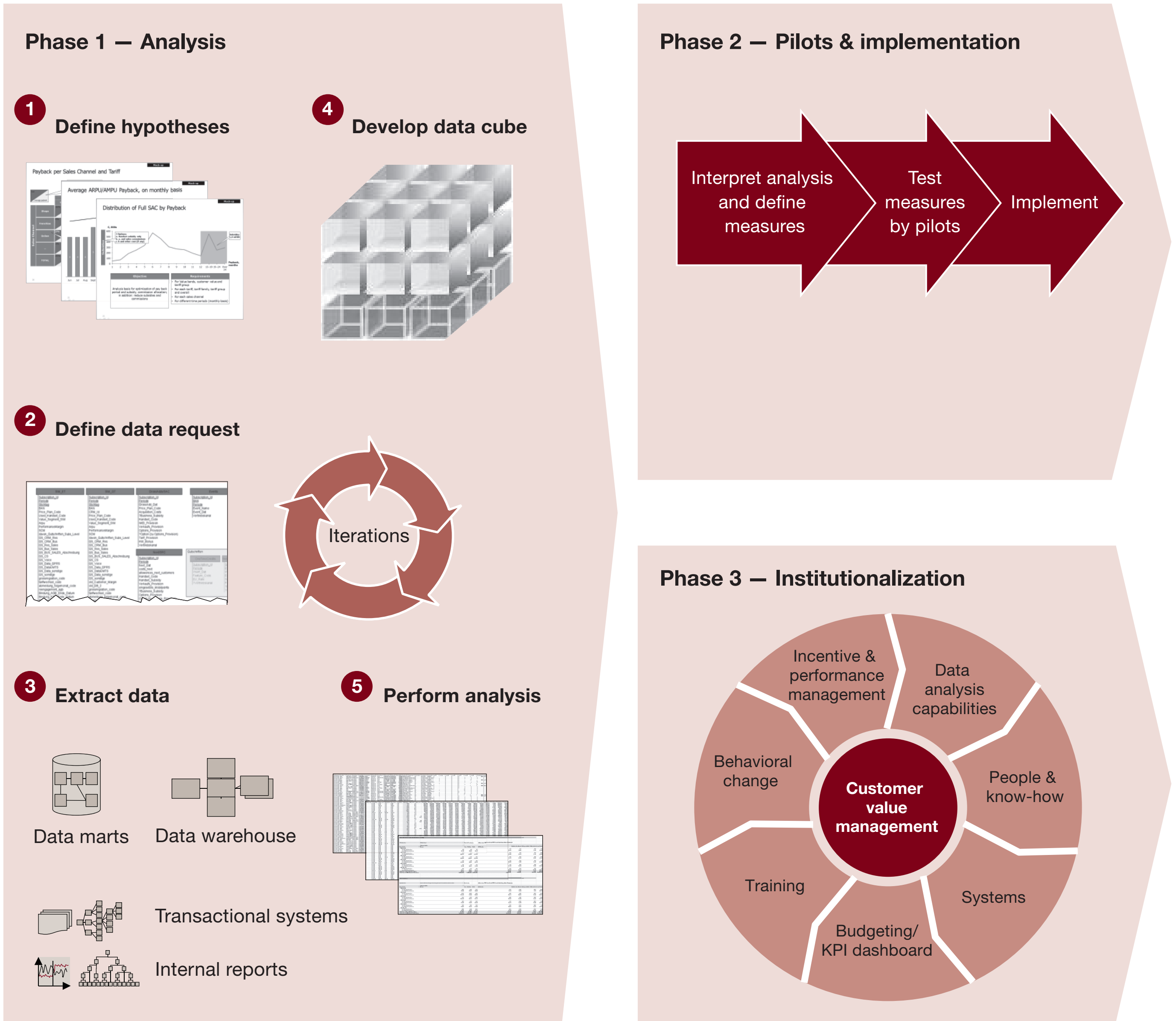
When operators are implementing this core capability, our experience shows that a three-phase approach is most efficient (*see Exhibit 6, next page*).

Analysis: Before performing any analysis, it is critical to make sure that the applicable data is structured in such a way that it can be easily analyzed in all relevant dimensions. In conducting the analysis itself, the initial hypothesis and how the data will be cut must be defined, whether it be channel split, tariff breakdown, customer segmentation, or another form. Once these are defined, the system must be able to extract the necessary data from various sources, including the data warehouse, billing systems, and data marts, and then segregated in a data cube for final analysis and interpretation of the results. All of these steps are highly interdependent, and the entire process requires multiple iterations to ensure that the data is consistent, stable, and accurate.

Pilots and implementation: Using the results of the analysis, the CVM team must define the CVM improvement measures to be applied company-wide, all of which must be fully quantified and understood in relation to the possible losses the CVM measures might generate. Pilot programs should be conducted in order to test hypotheses and readjust as necessary, before implementing the measures company-wide. These pilots should aim for quick wins to validate the system before implementing the full-fledged solution.

Institutionalization: As soon as all the above elements are in place, three more steps should be taken. A training program must be set up to ensure that all those using the new system understand its goals and operating details, a change management program must be implemented in order to cement the cultural changes necessary, and an incentive program must be designed that matches incentives more closely to the value-driven goals of CVM.

Exhibit 6
Creating a CVM program: Three stages



Source: Strategy& analysis

Conclusion

A complete CVM system has many advantages. It can provide an in-depth understanding of the behavior and needs of customers based on a carefully tailored analysis of each individual. This in turn enables operators to use clearly defined, executable value improvement levers that can deliver short-term, measurable results, and ultimately offer a way to consistently improve value and profitability under changing market circumstances.

Given the increasing saturation of markets in the developed world, the rising pressure to retain existing customers, and the need to improve contributions to the bottom line, every operator should view CVM as more than a nice addition to their analytical skills. It can be a true competitive capability in the race to increase profits in the years ahead.

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