

strategy&

2017
Telecommunications
Trends

&

**Aspiring to digital
simplicity and clarity
in strategic identity**



Contacts

Beirut

Bahjat El-Darwiche
Partner, Strategy& Middle East
+961-198-5655
bahjat.eldarwiche
@strategyand.ae.pwc.com

DC

Dan Hays
Principal, PwC US
+1-240-388-7187
dan.hays@pwc.com

Dubai

Jad Hajj
Partner, Strategy& Middle East
+971-4-390-0260
jad.hajj
@strategyand.ae.pwc.com

Düsseldorf

Stefan Eikermann
Managing Director, PwC Strategy& Germany
+49-211-3890-140
stefan.eikermann
@strategyand.de.pwc.com

London

Rolf Meakin
Partner, PwC UK
+44-20-7213-1707
rolf.e.meakin@pwc.com

New York

Florian Groene
Principal, PwC US
+1-212-551-6458
florian.groene@pwc.com

Paris

Pierre Péladeau
Partner, PwC France
+33-1-5657-8558
pierre.peladeau
@strategyand.fr.pwc.com

Rio de Janeiro

Paolo Pigorini
Partner, PwC Brazil
+55-21-2237-8448
paolo.pigorini@pwc.com

Stuttgart

Christine Rupp
Partner, PwC Strategy& Germany
+49-711-34226-916
christine.rupp
@strategyand.de.pwc.com

Sydney

Steven Hall
Partner, PwC Australia
+61-2-9321-2835
steven.hall@pwc.com

Tokyo

Toshiya Imai
Partner, PwC Japan
+81-3-6757-8600
toshiya.imai@pwc.com

About the authors

Bahjat El-Darwiche is a thought leader in the communications, media, and technology sectors for Strategy&, PwC's strategy consulting group. He is a partner with PwC Middle East, based in Beirut. He has approximately 20 years of experience in the telecommunications industry, acquired through various engagements in the Middle East, Europe, North America, and Asia.

Pierre Péladeau is a leading practitioner on strategic transformation for telecommunications operators for Strategy&. He is a partner with PwC France, based in Paris. He is part of a global telecom team and has led many strategy assignments on industry trends, new business models, digital transformation, customer facing strategies, and deployments for operators across EMEA.

Christine Rupp is a thought leader in the communications and technology industry serving clients across Europe. She specializes in strategy development, strategic cost and business transformations, and operating model design. Christine is a partner with PwC Strategy& Germany, based in Stuttgart. She is part of a global telecom team and has led many strategy-based transformation programs for operators across Europe.

Dr. Florian Groene is an advisor to executives in the communications, media, and high-technology sectors for Strategy&. A strategy and technology consultant for more than 15 years, he is a principal with PwC US, based in New York. He plays a key role the firm's strategy consulting work for the U.S. communications sector and oversees the U.S. technology strategy for the information services and communications industries.

Introduction

Senior executives at telecommunications companies around the world have heard for several years that their industry is approaching a tipping point. When it hits, they are told, their business might not survive the disruption. And yet they continue to do business. They might well think the warning from telecom industry specialists (including us) is overblown. Telecom customers are often locked into a long-term plan; many are loyal to their carrier. Doesn't this suggest that the industry will continue as it is for some time?

To be sure, business upheaval often happens more slowly than people expect, and no one can predict exactly when the moment of truth will strike for any given company. But to judge from several trends that have roiled the telecom sector during the past few years, the time for preparation is over. You must now pick the businesses where you have a competitive edge and focus your strategy on them. Even if you think your current business model has several years of life left, you can't be sure — and strategic focus will help you, no matter how far away the time of change.

Tightening competition

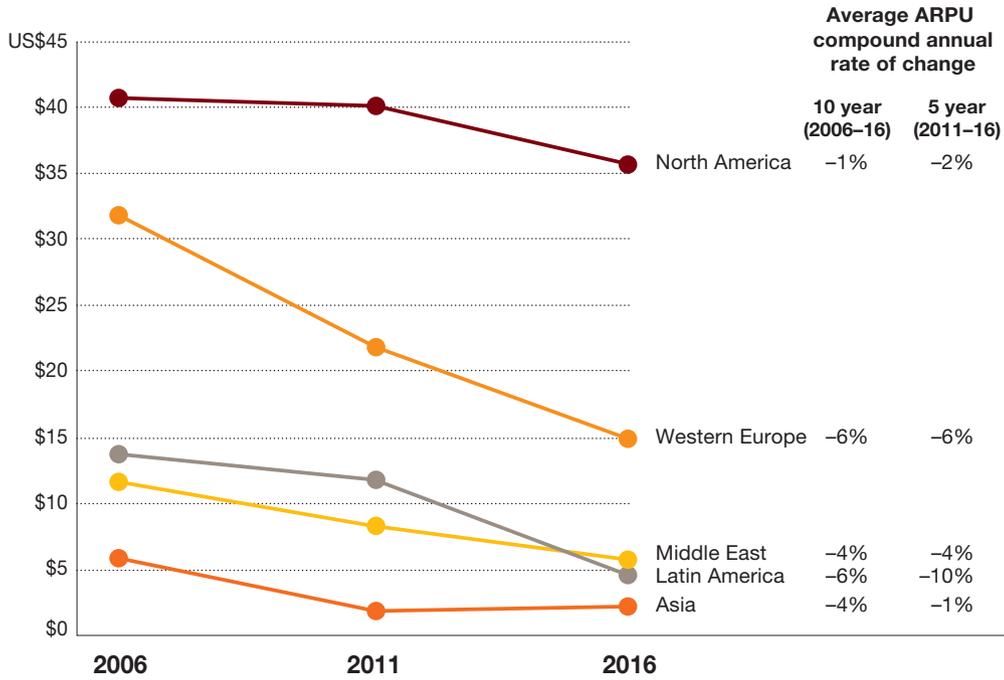
How have we come to the conclusion that the tipping point is close enough to warrant change? By observing the state of the industry today. To a large extent, telecom companies have not succeeded in their efforts to monetize the flood of data running through their networks. Their services have become more commoditized. Their ability to reinvest in network upgrades and digital advances has been severely constrained. At the same time, many carriers have tried to be all things to all people, delivering a wide variety of services to their customers. But as a group, they have not managed to excel at any of those services. So now they are vulnerable to competition.

The competition has arrived. Over-the-top (OTT) players, which offer apps and streaming content directly to consumers through the Internet, have increased their dominance, even in core communication services such as messaging and voice. WhatsApp, Viber, and Apple's iMessage already represent more than 80 percent of all messaging traffic, and Skype alone accounts for more than a third of all international voice traffic minutes. As a result, many telecom carriers are facing significant decreases in their basic communication service revenues: drop-offs of as much as 30 percent in SMS messaging, 20 percent in international voice, and 15 percent in roaming. Combined with intense competition due to lagging industry consolidation, this pattern has led to steep declines in average revenue per user; at best, minimal revenue growth; and tightening margins.

If you are a telecom executive at this critical juncture, you need to make two different moves at the same time. First, begin the task of modernizing operations. Second, redefine your strategic identity (your value proposition) for the future — specifically, what you can expect to offer customers five or 10 years from now. It may well be — perhaps it *should* be — that after going through this journey, your company will look very different from today's version.

Exhibit 1

Average revenue per user in the telecom industry is falling in virtually every region



Source: Strategy& research and analysis

Modernizing operations

Telecom companies have been so frugal in recent years that their basic operational structure has foundered. Before moving into new revenue channels, you need to be sure you have a “right to win” there by exhibiting the capabilities needed to compete successfully, even against digital upstarts. To revitalize your operations, focus on the following fundamental goals.

Simplification

At most telecom companies, reducing complexity in commercial offerings and market-facing activities is a haphazard and ill-conceived effort, chiefly reliant on targeted cost-cutting campaigns designed to support or improve profit margins. But although slashing expenditures is often vital, especially when traditional telecom products and services are commoditized, it is certainly not the endgame.

Instead of going after costs, take a more dynamic approach to simplification, one that could serve as a basic foundation for growth. The purpose of this drive should be to pare basic offerings down to a limited portfolio of products and digital services. But they should be essential enough to your customers that you can maintain a deep and loyal customer base, and they should allow your company to transition to the cloud for infrastructure needs. Depending on your own most distinctive capabilities, you could gain a reputation as “the quality-of-service telecom company,” the “ultimate cybersecurity telecom company,” the “most innovative Internet telecom company,” or the avatar of some other powerfully charged strategic identity.

For this simplification program to work, however, you may have to address your organizational and structural complexity, flattening some aspects of your hierarchy and learning to move fast to experiment with innovative service offerings. That may require some culture change.

One company that illustrates the value of a simplification strategy is France’s Free Mobile, a subsidiary of Iliad. The company launched in

Instead of going after costs, take a more dynamic approach to simplification.

2012 with a no-frills business model — including customer service kiosks placed in retail locations to avoid management and overhead of a large store network; primarily Internet-based marketing and customer service; and a bring-your-own-device policy designed to eliminate administrative costs for handset sales — and its flagship low-priced all-you-can-use domestic service plan has caught on with consumers. Since its launch, Free has boosted its subscriber base to more than 12 million; it now has an 18 percent share of the mobile market in France. As a result, the company boasted €1.5 billion (US\$1.6 billion) in revenues over the first three quarters of 2016, up more than 11 percent compared to the same period in 2015.

Digitization

You should be on the vanguard of adopting digital technologies, both in services and in the back office. For example, all customer contact and sales channels (online, mobile, and physical) should be linked digitally so that consumer activities are maintained in a single database, making interactions with customers in all channels less costly in terms of expended time and resources and enhancing customer convenience and satisfaction. Ideally, customer communications should be migrated toward messaging systems and well-designed mobile apps, with minimal human intervention.

To reach this stage, you may need new capabilities, including data analytics expertise, to accurately segment and generate maximum value from each customer. Separate your traditional corporate IT functions from your customer-focused digital efforts, and appoint a chief digital officer who can facilitate business unit digitization efforts.

Network upgrades

The single most compelling thing you have to offer is network speed and throughput; every customer is hungry for it. Investments in telecom network improvements — fiber and 5G upgrades or other networking technologies — are critical to preparing for more dynamic, competitive environments. Every successful telecom company will be armed with a state-of-the-art infrastructure, sufficiently flexible to handle new and profitable monetization opportunities. Network enhancements could also position your company to take back the technological advantage from OTT providers.

Redefining strategic identity

After developing a modernization program — and even while implementing it — work on adopting one or more new strategic identities that are relevant to customers, offering them distinctive services and experiences with real value.

You may choose your core connectivity business to be your strategic identity. This is essentially the approach Free Mobile has taken, betting everything on offering basic wireless services at the lowest possible cost. So far, Free's strategy is unusual, in part because it had the distinct advantage of building its business as a startup, without the huge legacy costs that weigh down other telecoms. That's why Free's approach is not a profitable option for most operators; for them, it would be a one-way ticket back to more rounds of cost cutting just to stay afloat. And it would obviate the investments needed to compete in the current telecom environment.

A more extreme business model makeover is another option, but tread carefully. Carriers have at various times tried to market their own devices, build portals for apps and entertainment, and provide outsourced IT services. The results, however, have been mostly disappointing, due largely to corporate cultures and capabilities gaps that put telecom companies at a disadvantage in broad, commercial markets, and to the structural challenges of selling global products in geographically bounded physical networks.

A promising choice for telecom companies is a strategy that could be called seeking adjacent verticals — that is, providing branded content, financial services, lifestyle services, and e-commerce services over your pipes as an ancillary business. In the ecosystem of digital content, operators hold a critical card: a central position in the distribution value chain and a direct line to customers. France's Orange, for example, has made an ambitious move into smartphone- and tablet-based banking and now boasts more than 15 million mobile payment customers in Africa and 300,000 mobile banking accounts in Poland. In early 2016, the company bought 65 percent of Groupama Banque in order to use it as a foundation for expanding digital banking services, first in France and then elsewhere in Europe.

In the ecosystem of digital content, operators hold a critical card: a direct line to customers.

A further strategic opportunity for telecom companies lies in revenue streams keyed to connectivity, a particularly favorable option once companies have upgraded their networks so they can handle even the most sophisticated applications. Included in this category are machine-to-machine communications, telematics systems, easy payment options (such as using the phone to process billing transactions from other companies and accounts), and networking for the Internet of Things. The customer base for these services is wide and potentially lucrative: utilities, industrial supply chains, smart homes, smart cities, and cybersecurity providers, among many others. Indeed, most large operators, including Orange, AT&T, Telefónica, and Verizon, have adopted some form of this business model, charging a fee to providers as well as consumers to manage and maintain connected services.

The allure of M&A

It will be difficult for telecom companies to embrace a new strategic identity by themselves; many of them don't have the capabilities required to create the product offerings and services needed for repositioning in the marketplace. For that reason, acquisitions are an attractive vehicle for entering new markets. In 2016, telecoms spent US\$224 billion on M&A, an increase of 137 percent over the prior year, according to Capital IQ.

Many of the largest deals in the past few years involved companies buying rivals within the telecom industry to double down on their core networks, hoping to gain market share and prop up prices. For example, by purchasing Kabel Deutschland in 2013, Vodafone gained access to the cable company's 8.5 million households in Germany and was able to offer a "quadruple play" of telephone, television, broadband, and wireless. And Verizon's recent decision to acquire XO Communications will boost its presence in the small and medium-sized enterprise market.

Several other transactions are targeted at the adjacent industries strategy — in particular, AT&T's pending purchase of Time Warner and its vast storehouse of content. And the primary attraction in Verizon's acquisition of AOL in 2015 was AOL's vaunted automated online advertising program, another possible avenue of growth for telecom companies within the nearby media spectrum. Verizon has also made a string of acquisitions, including Hughes Telematics and smart-city startup Sensity Systems, that give it a leg up in connectivity markets. Deals like these have the potential to reshape the industry, especially if they allow companies to build scale while focusing their expertise.

How to survive

The situation in the telecom industry is dire. But it is survivable, by intelligent, innovative companies that have the courage to fund essential modernization and the farsightedness to embrace new strategic identities suitable for their capabilities, market, and culture. If you're a telecom company leader, the need to clarify who you are and what you can be is more pressing than ever before.

Strategy& is a global team of practical strategists committed to helping you seize essential advantage.

We do that by working alongside you to solve your toughest problems and helping you capture your greatest opportunities.

These are complex and high-stakes undertakings — often game-changing transformations. We bring 100 years of strategy consulting experience and the unrivaled industry and functional capabilities of the PwC network to the task. Whether you're

charting your corporate strategy, transforming a function or business unit, or building critical capabilities, we'll help you create the value you're looking for with speed, confidence, and impact.

We are part of the PwC network of firms in 157 countries with more than 223,000 people committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at strategyand.pwc.com.

www.strategyand.pwc.com

© 2017 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details. Mentions of Strategy& refer to the global team of practical strategists that is integrated within the PwC network of firms. For more about Strategy&, see www.strategyand.pwc.com. No reproduction is permitted in whole or part without written permission of PwC. Disclaimer: This content is for general purposes only, and should not be used as a substitute for consultation with professional advisors.