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*Managing
the corporate
segment in the
digital era*

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**Challenges for
telecom operators**



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Executive summary



Telecommunications operators are under increasing pressure from corporate customers (e.g., multinational companies and public administrations) to offer advanced digital/information and communications technology (ICT) services. Most are not well positioned to do so; they lack the capabilities to design these solutions and are burdened by inefficient internal processes that have grown up around traditional connectivity businesses that are increasingly commoditized. As a result, telecoms are under threat from new competitors from the digital arena (e.g., over-the-top players such as Google or Amazon) and risk losing revenue, margin, and market share. In response, they need to transform internal operations to allocate resources correctly among services and market segments based on revenue and margin potential. But most important, they also need to put in place a disciplined go-to-market strategy that evaluates, ranks, and pursues digital/ICT solutions based on near- and long-term market potential, the technological skills and capabilities required, the delivery model required (i.e., make, buy, or outsource), and the fit with the telecom's current client and product portfolio. And they should keep in mind that digital/ICT services usually have significantly lower margins than pure connectivity services and could erode the EBITDA of the corporate segment if not managed well.

Telecom at a crossroads

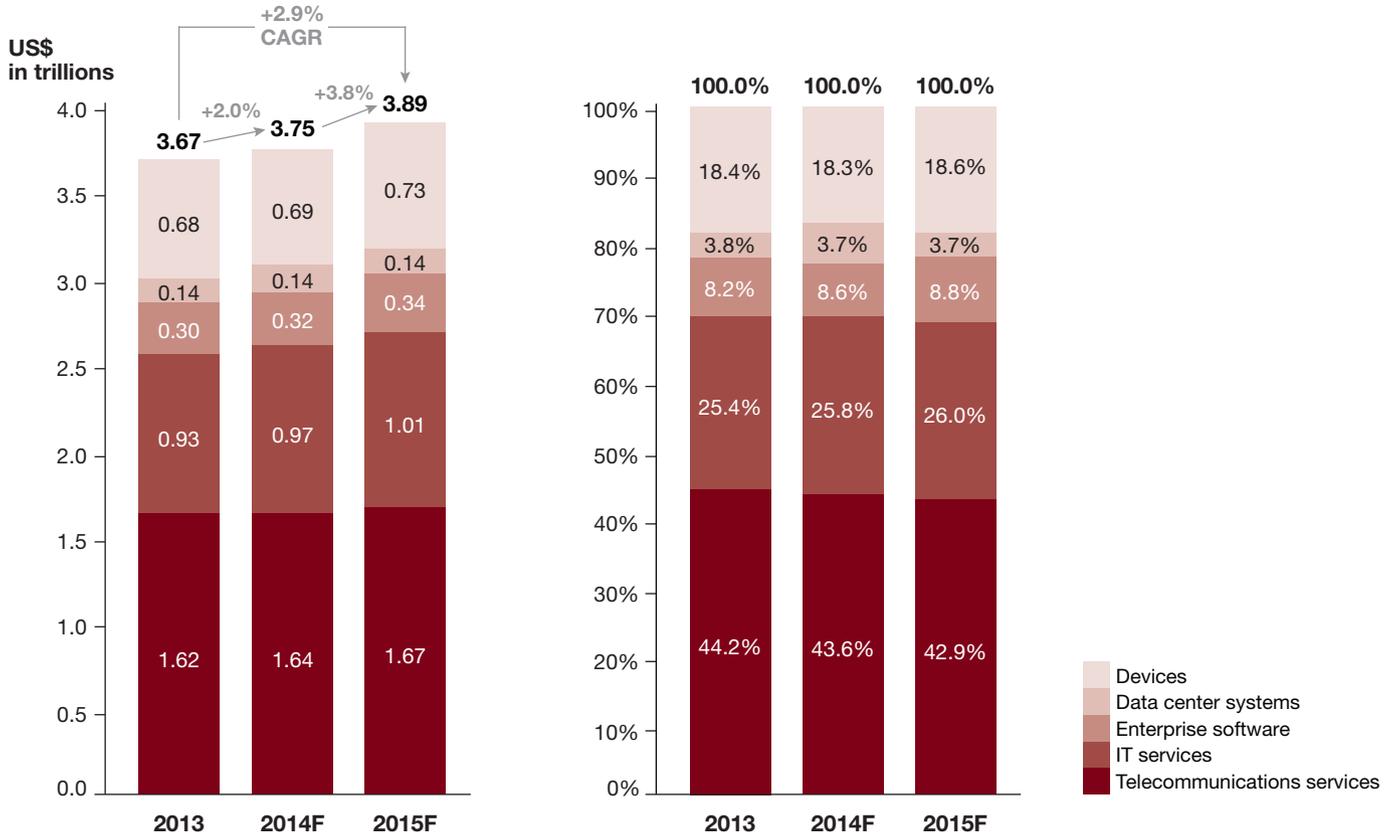
Telecommunications operators are at a crossroads as their corporate clients (e.g., multinational companies and public administrations) increasingly demand advanced digital/information and communications technology (ICT) solutions to lower their costs, improve operations, and better serve their own customers (*see Exhibit 1, next page*). These solutions include, among others, cloud services, machine-to-machine (M2M) services, unified communications, big data, and the outsourcing of many IT capabilities. This trend — which is under way in developed markets and in emerging markets — creates major risks for telecoms on a number of fronts. Revenues and margins are under threat, competitors are proliferating and grabbing market share, and many telecoms lack the capabilities to design and offer compelling digital/ICT solutions to customers on their own.

That's not to say incumbent telecoms have no advantages. They typically have a large customer base and strong brand recognition, are cash rich, and know how to manage large, complex infrastructure projects. They will need to exploit these advantages fully as they build new digital strategies and capabilities.

As the traditional connectivity services they have historically monopolized become increasingly commoditized, telecoms cannot survive on those services alone. Going forward, they need to look within and improve operations to become leaner and more efficient in today's hypercompetitive, lower-margin digital/ICT market; most important, they also need to reshape their product portfolio to include digital services that fit their overall market position and use a disciplined go-to-market strategy.

Telecoms cannot survive on traditional connectivity services alone.

Exhibit 1
Global ICT spending tilts toward digital



Note: Totals may not reflect sums due to rounding.

Source: Chart created by Strategy& based on Gartner press release, "Gartner Says Worldwide IT Spending on Pace to Grow 2.1 Percent in 2014," June 2014, <http://www.gartner.com/newsroom/id/2783517>. Percentages calculated by Strategy&

The digital challenge

There are several reasons that digital/ICT solutions pose a challenge for telecoms. First, margins are much lower for digital services than for traditional connectivity products. Telecom incumbents — which for decades operated as virtual monopolies in many corporate markets — have historically enjoyed margins of 50 to 80 percent for connectivity services. But ICT margins are typically 10 to 30 percent and tend to cannibalize the higher-margin services, as with voice over Internet protocol (VoIP) and traditional fixed-line service, for example. As a result, it's not enough to simply sell one dollar of ICT services for every dollar of traditional communications services lost. For instance, in order to maintain EBITDA margins, the company must sell three or four dollars of cloud services for every dollar of voice services that disappears. This huge difference in the margins for ICT and connectivity services, along with the unplanned and opportunistic transition to ICT offerings that many telecom operators have undergone, has significantly eroded the gross margins and EBITDA of the corporate segment.

Second, owing to their historically high margins, most telecoms have not developed margin and productivity discipline in their corporate segments around portfolio management, sales force, marketing, customer care, back offices, and operations. They generally focus on gross customer additions and the number of revenue generating units (RGU) per client; meanwhile, their view on margin per service, per project, or per client is often deficient or nonexistent. This makes telecoms prone to deploy financial and human resources inefficiently. In addition, a lack of industrialization for many portfolio services drives customization volume for these services, which hurts margins.

The third reason this shift toward digital/ICT solutions is challenging for telecoms is they don't usually have the capabilities to manage a digital services portfolio. For example, ICT solutions in the corporate segment require strong project management capabilities to avoid time-to-revenue delays and problems in the delivery of solutions. These capabilities are difficult to develop, and many operators lack them. Many telecom operators also lack an internal process to review the digital product portfolio regularly. Continuous reviews are necessary

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to evaluate the commercial attractiveness of each service (corporate communications, cloud services, M2M, etc.) and to “prune” the portfolio of uncompetitive, unprofitable services. This is especially critical because many telecom operators have grown their ICT portfolios in opportunistic and disordered ways as they responded to corporate demands for innovative ICT solutions such as cloud and M2M services.

Last, and perhaps most significant, is the proliferation of competitors willing to commoditize connectivity as part of an ICT solution (see *Exhibit 2, next page*). This willingness allows these rivals to take market share and drive down prices and profit margins on connectivity services that have been the traditional lifeblood of telecoms. There are three types of relevant ICT competitors in the corporate segment, each with its own set of differentiating capabilities: systems integrators, such as Accenture; software/hardware manufacturers, such as Hewlett-Packard, Microsoft, Oracle, and SAP; and over-the-top (OTT) players, such as Google and Amazon. (OTT players deliver service over the Internet rather than via a service provider’s own dedicated, managed network.)

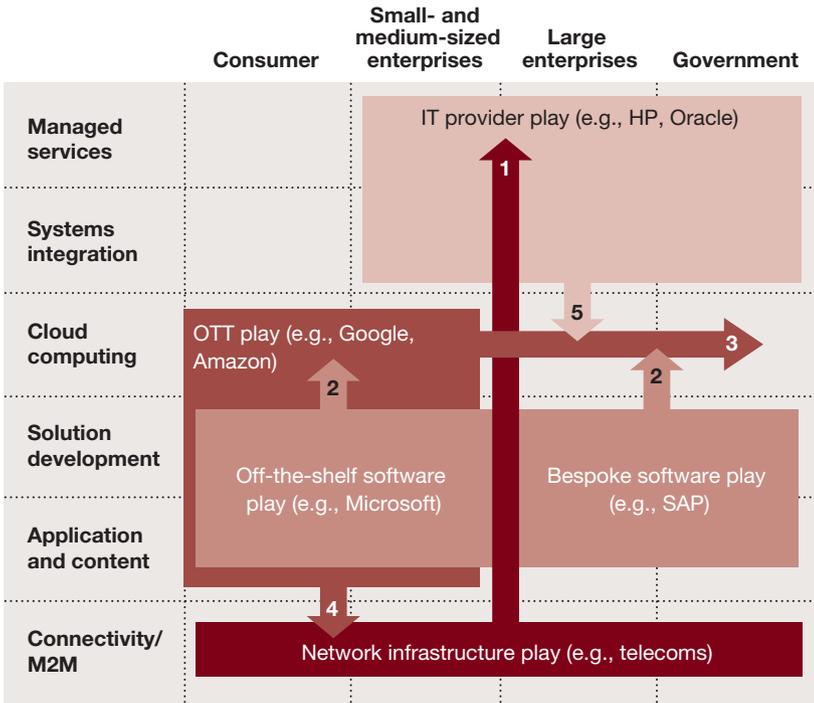
In our experience, many telecoms are waiting too long to offer digital solutions, adopting a reactive approach based on whatever competitors put forth. This is a dangerous choice, given the aggressiveness of new players with disruptive capabilities.

Many telecoms are waiting too long to offer digital solutions. This is a dangerous choice.

Exhibit 2

Competition in the ICT market intensifies as boundaries break down

Global ICT market dynamics



- 1. Telecoms expanding capabilities from connectivity to all horizontals
- 2. Software players moving into cloud computing offerings
- 3. OTT players extending their services to large enterprises and government clients
- 4. OTT players expanding in connectivity
- 5. IT providers and telecoms competing in service space

Source: Amazon, Google, IBM, Microsoft, and Verizon press releases; Strategy& analysis

The incumbent advantage

Despite these significant challenges, telecom operators have some enviable advantages that they should capitalize on as they chart a path forward. Telecoms built huge customer bases over decades of providing traditional services, and they enjoy strong brand recognition. Integrated telecom operators can offer a converged experience — i.e., both fixed and mobile connectivity — for corporate clients. What's more, many telecoms are cash rich and have the means to invest in long-term, capital intensive projects to serve corporate clients. They also have the necessary experience to do so, as they are accustomed to managing large-scale infrastructure projects with many stakeholders and interdependencies.

In fact, some telecoms have already leveraged these advantages to transform themselves from traditional connectivity players into comprehensive ICT service providers.

Not all telecoms need to embrace ICT as completely as these companies have done. However, any operator that wants to be strong in the corporate segment must have an ICT strategy. Broadly speaking, this requires an operator to make adjustments on two fronts. First, it needs to reshape its product portfolios, increasing the degree of service industrialization, adding or beefing up service offerings that advance its chosen strategy, and pruning out services that don't make sense for it. Second, it needs to streamline its operations to become efficient enough to win in the highly competitive, lower-margin digital services market.

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Create a digital services offering

As noted, offering the right ICT services is critical to creating growth and fending off new challengers. To this end, an operator needs to identify the kind of services best suited to its clients and the company's own capabilities, and then design a smart go-to-market strategy for itself.

Step 1: Compile a long list of current and prospective ICT services for each subsegment of the corporate market.

Step 2: Evaluate each ICT service in terms of near- and long-term market potential; maturity level; technological skills and capabilities required; human and organizational skills required; delivery model required (i.e., make, buy, or outsource); potential technological partners; and its fit with the current client and product portfolio, including the connectivity portfolio. This last point is critical; for example, it does not make sense to focus on cloud services without strong capabilities in fixed-line connectivity.

Step 3: Prioritize ICT services based on economic potential, fit with current capabilities, fit with overall strategy and product portfolio, and fit with client portfolio. Then create a short list of ICT services to offer (or discontinue) and sequence the rollout of these services.

Step 4: Define the capabilities that need to be built, the potential technology partners to contact, and the commercial goals and objectives.

For telecoms that offer ultra broadband with virtual private network (VPN) connectivity, the decision might be to offer cloud storage and computing, or advanced cloud services such as software-as-a-service and managed services. Telecoms that focus on M2M connectivity, meanwhile, might decide to provide vertical specialized solutions for various industries.

But no matter what services a telecom chooses to offer, once a digital service portfolio is established, the operator needs to pursue continuous improvement. This means always looking to simplify the services

Offering the right ICT services is critical to creating growth and fending off new challengers.

portfolio; identifying the most effective strategies — e.g., bundling, pricing — to sell core products; improving the portfolio through a periodic review of each service performance; and constantly analyzing internal capabilities to see if they match market opportunities. If the operator wants to move into cloud services, does it have the network and data center capabilities to do so? If not, should the company develop these capabilities or find partners that can bring these capabilities to the table?

Transform internal operations

For starters, operators need to address challenges rooted in long-established but increasingly outmoded ways of doing business (see *Exhibit 3, next page*). Telecoms have top-heavy organizational and cost structures set up to manage a narrowly defined, monopolistic connectivity business, not a multifaceted suite of advanced digital services in highly competitive markets. Managing consolidated services (such as infrastructure colocation) or more recent and innovative services (such as cloud services, cybersecurity, or M2M applications) requires different capabilities.

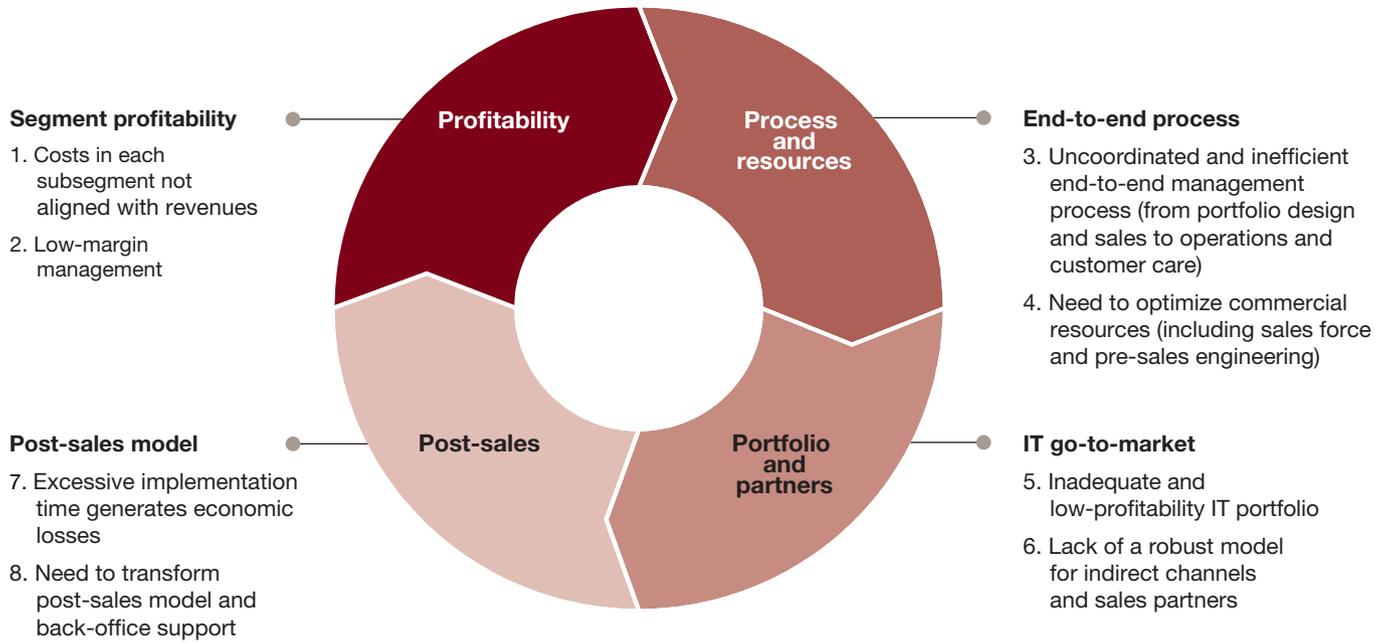
Because of these outmoded ways of doing business, telecoms often don't allocate resources to different business lines based on revenue potential. Higher-performing businesses get less than they need, while lower-performing units get more than they deserve. Often the problem is rooted in an uncoordinated and inefficient end-to-end management process for corporate accounts, a lack of established key performance indicators (KPIs) across the enterprise, and unassigned accountability for meeting those KPIs. This impairs revenue and profitability, preventing telecoms from earning adequate returns on lower-margin ICT services.

Besides needing to probe deeper into the cost drivers to allocate scarce resources more effectively, operators must redesign after-sales customer care models. This is a critical function of the corporate segment, responsible for servicing, developing, and building loyalty among customers. The operator can improve profitability significantly by transforming these support areas — such as the back office and call centers — into an efficient, high-quality customer service capability that can identify cross-selling and upselling customer opportunities.

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Exhibit 3

Common corporate segment issues at telecoms



Source: Strategy& analysis

Adjusting across the value chain

The trend toward digital/ICT solutions is undeniable. Corporate customers are demanding these services, and it's putting enormous pressure on telecoms to preserve margins, reshape internal operations, and roll out new solutions. In response, operators must align all the elements of the value chain — from portfolio design, market segmentation, account prospecting, sales, delivery, and post-sales — and develop the necessary digital services capabilities. The longer a company delays, the harder it will be to compete with the nimble competitors entering the market.

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