Mobile carriers’ retail dominance under attack

Shifting tectonics in the U.S. wireless category
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Executive summary

Various factors are driving the commoditization of the purchasing process for mobile phones and wireless services. Most consumers are now very familiar with the wireless category, and pricing structures are simpler. When selecting a plan, consumers no longer need the handholding that carriers once counted on to create the perception of selling an exclusive and often complex product that sits at the intersection of technology and lifestyle.

The implications of this shift in wireless retail are substantial: Carriers are reassessing the value in their large networks of branded retail stores and authorized dealers. Consumer electronics retailers and national discounters can be a valuable low-cost channel for carriers to further increase their retail presence; at the same time, carriers want to keep them at arm’s length in order to retain their primary customer sales, billing, and service relationships. Retailers’ ambitions to launch their own plans and compete with carriers on the service relationship are a serious threat.

Meanwhile, consumers are starting to look online for better deals and more convenient ways to purchase phones and plans. Yet the carriers’ online experience falls far short of meeting consumers’ expectations, and they have not yet succeeded in integrating their offline and online channels. That integration is a key element to driving increases in same-customer revenue and loyalty. Best Buy and others have a chance to leapfrog carriers in channel integration, while online-only players such as Amazon could spark a wireless e-tail “landgrab” with the potential to negatively affect carriers even more than the evolution of wireless retail that has taken place thus far.

Carriers can still shape much of the future wireless ecosystem, but time is running out and swift action is needed to defend against competitors’ attacks on the carriers’ dominance.
Key highlights

With 176 million cellphones sold in 2010, and over 290 million active subscribers generating about $50 revenue per month, the mobile telecom industry is worth $200 billion in annual revenue in the U.S. alone.

More than two-thirds of phone and contract sales are still controlled by carriers, but wireless consumers are increasingly comfortable buying from mass retailers and online, creating a wireless category showdown among carriers, national discounters, and electronics retailers.

Carriers need to recalibrate their channel strategies, tailor product offerings, planograms, and frontline capabilities to specific customer segments, and deliver differentiated shopping experiences, including a closely integrated in-store and online experience.

National discounters (such as Walmart and Target) have an opportunity to “own” value-conscious customer segment, as do online players like Amazon.

Electronics retailers (for example, Best Buy and RadioShack) can take share from carriers and distinguish themselves from national retailers by pitching to customers that they provide the best combination of advice, choice, and objectivity.
The evolution of the wireless category

In the 1990s, carriers opened thousands of retail stores under their own brand names to sell the latest in modern lifestyle and technology — cellphones — as a subscription product with an up-front hardware purchase. Customers needed significant handholding when making a wireless purchase — to understand what they were buying, and sometimes even why. Mobile devices, particularly those that could do more than simply place and receive calls, were initially perceived as puzzling and complex. Worse, consumers needed to wade through a labyrinth of service contracts and, armed with little information, choose the optimal plan for them. Contract structures varied widely from one provider to the next, making comparison shopping onerous.

Although carriers were the source of much of this complexity, they were also the only ones with the distinct know-how to guide consumers through it. They offered novel products and services that attracted new buyers in droves. In this environment, carriers created optimal conditions to build large store networks while using authorized dealers to further grow their footprint quickly with limited investment. Intent on building market share and achieving critical mass for their own stores, carriers had little interest at the time in engaging national retailers, which, in turn, lacked the sales know-how and other necessary capabilities to support sales in the still complex wireless category.

What followed was a 10-year “landgrab” by carriers for customers. All the while, product life cycles shortened and a steady stream of technology breakthroughs — color screen displays for phones, data services, GPS, faster networks, smartphones, applications, and more — continued to fuel consumers’ interest in and need for all things mobile and wireless.

In 2010, 176 million cellphones were sold in the U.S., according to our analysis of Gartner data. (Even more are expected to be sold in 2011, with smartphones being the fastest-growing segment.) Of those, NPD says, 66 percent were sold through 8,000 carrier-owned stores and thousands of authorized dealers; the vast majority of the rest were sold in other retail stores. Online sales accounted for only 5 percent of phone and contract sales in 2010.
So far, the reasons that customers still favor carrier stores over other retail outlets include their preference for dealing directly with the operator, convenience (easy access), and prior experience with specific stores (see Exhibit 1, next page).

On the surface, this points to a position of continued strength for carrier retail. However, as we explore emerging wireless trends more deeply, it becomes evident that carrier-owned retail is facing a serious competitive threat.
### Exhibit 1
Top five reasons customers go to a carrier store (share of respondents)

<table>
<thead>
<tr>
<th>Reason</th>
<th>Share of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>To deal directly with provider</td>
<td>51%</td>
</tr>
<tr>
<td>Convenient location</td>
<td>42%</td>
</tr>
<tr>
<td>Past experience</td>
<td>32%</td>
</tr>
<tr>
<td>Knowledgeable staff</td>
<td>19%</td>
</tr>
<tr>
<td>Variety of handset selection</td>
<td>18%</td>
</tr>
</tbody>
</table>

Note: Carrier stores include Verizon, AT&T, Sprint, and T-Mobile.

Source: Strategy& Wireless Shopper Survey, June 2010 (n = 708)
Key trends in wireless retail

Five key trends underlie our belief that carrier retail will face substantial competition:

• The wireless category has become mainstream.

• Carriers are not succeeding at creating customer advocacy.

• Electronics retailers and national discounters are targeting the category.

• MVNO 2.0 might succeed.

• Wireless retail will move online.

The wireless category has become mainstream

Shopping for a new cellphone or wireless plan is not quite as straightforward as buying, say, a gallon of gas or a bottle of shampoo, but much of the mystique that formerly surrounded the purchase of phones and plans has evaporated. Consumers understand the main product characteristics and differences, know what features they need (or at least want), and have a sense of their own usage patterns based on past experience. Simplified and more transparent pricing structures — including more flat-rate or “all-you-can-eat” plans and prepaid plans, and bundled packages of minutes, texts, and data — have further reduced the complexity of wireless plan purchases and limited the risk of unexpectedly high monthly bills.

In a recent Stategy& survey of wireless customers, 85 percent of respondents said they did not find it difficult to select the right wireless service plan and 67 percent said it is easier than in the past. Furthermore, despite the rise of more complex and feature-rich smartphones, 84 percent of consumers said they find it easy to choose the right phone.
Carriers are not succeeding at creating customer advocacy

Despite customers’ increased comfort with purchasing phones, plans, and accessories, retailers across the board have plenty of room for improvement when it comes to serving their customers well. Our survey reveals low Net Promoter Scores (NPS) among all wireless carrier stores (see Exhibit 2). NPS is a metric that translates customer satisfaction and loyalty into word-of-mouth recommendations. In our study, only a net 8 percent (promoters less detractors) indicated their willingness to recommend their carrier’s retail store to friends or colleagues, while a net 30 percent would recommend their electronics retailer or national discounter store for wireless products. Worse, among the big four U.S. wireless carriers — Verizon, AT&T, Sprint, and T-Mobile — the average score for their online stores was a staggering -18 percent, meaning that detractors far outstripped promoters. In contrast, a highly regarded, customer-service-focused e-tailer such as Zappos scores about 80 percent.

These are sobering results for all wireless retailers but especially for carriers, indicating that their current dominance and even customer preference notwithstanding, the field is wide open to attract millions of consumers moving forward.
Electronics retailers and national discounters are targeting the category

The large category size, simplified product offerings, and more knowledgeable customers who require less specialized sales assistance are making today the right time for national discounters to seize the wireless opportunity. For Walmart (3,500 stores) and Target (1,700 stores), consumer electronics overall have become an important source of expansion — originally driven by CD, DVD, and video game sales and later also by sales of hardware such as laptops, digital cameras, and HDTVs. Wireless services are a natural extension of these categories, and sales through this channel are growing rapidly.

Furthermore, wireless retailers recognize the opportunity to generate significant profits from selling accessories along with the phone: The same Strategy& study found that 41 percent of customers buy accessories with a new phone, spending on average US$44 on their accessory purchases (see Exhibit 3, next page). Top-selling accessories include car chargers and covers, which often yield gross margins of 70 percent or more.

For consumer electronics specialists such as Best Buy, an aggressive foray into wireless was both offensive and defensive: offensive because of the large category size, and defensive because of the rapid cannibalization of other consumer electronics categories such as GPS devices, digital cameras, MP3 players, video cameras, and, soon enough, gaming consoles.

Best Buy has sold wireless services in all of its 1,000 stores for several years and also adjusted its strategy and operating model to account for the disruptive impact of wireless by launching 100 dedicated Best Buy Mobile stores, which offer a wide range of carrier services, phones, and accessories and have a specialized sales staff. RadioShack offers wireless services from three carriers (AT&T, Sprint, and T-Mobile) in its 4,500 company-owned and franchised stores. In 2010, RadioShack also began operating 850 mobility kiosks in Target stores across the country, with plans to cover all 1,700 stores by the end of 2011.

MVNO 2.0 might succeed

Many companies have tried to compete with mobile carriers by becoming mobile virtual network operators (MVNOs) — that is, by leasing network capacity wholesale from operators and retailing it under their own brands to consumers. Almost all of them have failed. This time, it could be different. As T-Mobile and Sprint fall further behind AT&T and Verizon Wireless, they will more aggressively seek out
national retail partners to utilize their networks. Moreover, LightSquared has entered the wholesale network market to provide capacity to MVNO 2.0 players. In this new context, some major electronics retailers and national discounters, including Best Buy and Walmart, are now moving into the MVNO space, offering wireless plans under their own brands by reselling network capacity from network operators such as Sprint and T-Mobile. Even if Verizon and AT&T can fend off major market share losses, prices for wireless service will come down further, benefiting consumers and adding pressure to the traditional carrier business model.

Wireless retail will move online

Although only 5 to 7 percent of sales of mobile phones and wireless plans take place online today, consumers will increasingly turn to the online
Carriers have long-established offline relationships with their customers, but the online experience currently offered by carriers falls short of what consumers are expecting. That leaves the door open to competitors such as e-tail giant Amazon and niche players like Simplexity (consumer brand Wirefly.com), which are moving quickly to seize the enormous online opportunity that will be created as not only phone and plan purchases but also content creation, consumption, and management shift to the online channel. Amazon is relaunching its wireless category and launching an app store and seems poised to capture a sizable portion of the growing online sales of phones, plans, content, and accessories. Amazon's combination of e-tail phones and plans, a platform-agnostic app store, cloud-based content management services, and carrier independence is relevant to consumers and differentiated in the marketplace and could add up to a set of capabilities neither carriers nor national retailers can match. Imagine Amazon's pitch: We have all the carriers, all the phones, all the apps, the lowest prices, we're on your side, and you can buy it all with one click.

Meanwhile, tech giants such as Google and Apple will further squeeze carriers as they attack the $200 billion annual revenue pool that we estimate operators control in the U.S. today. Google, Apple, and others will apply their distinctive capabilities in online customer experience, content integration, and ecosystem design to win customers. Both run their own app stores, sell their own hardware, and own the dominant and fastest-growing smartphone and tablet operating systems. The main difference in philosophy is Google's bet on open architecture versus Apple's closely controlled ecosystem approach. Either way, in the face of this growing number of attractive alternatives, consumers will find less rationale for maintaining their commitment to the carrier relationship.

Taken together, these five trends will create very significant pressure on carriers' retail businesses.
To be successful moving forward, each current wireless retailer segment — carriers, electronics retailers, national discounters — will need to navigate shifting power dynamics and value pools, play to its strengths, and shore up its capabilities, including a comprehensive strategy to integrate offline presence with the online channel.

**Takeaways for carriers**

Carriers can do little to stem the tide of commoditization in the wireless purchasing process. Instead, they need to acknowledge it head-on as part of their customer segmentation and retail strategies to achieve their objectives, which should be to drive device penetration from 100 percent to 300 or 400 percent in the next five years. Broadly speaking, that means innovating new product and service bundles, selling additional mobile devices like tablets with a data plan, or smart home and e-health offerings. To merchandize in a “400 percent penetration world,” carriers need to reinvent their retail strategies to provide a level of customer service and a shopping experience tailored to specific target segments while standardizing those of others. Their specific responses should include the following:

*Think of national discounters and consumer electronics retailers as a segment strategy, not just a channel strategy.* National retail chains can help carriers serve lower-value customers — characterized by higher churn rates, no-frills products, and cash payments — that they might not serve as profitably otherwise. However, different carriers will have different approaches: Serving the value segment requires multiple changes to the business model, from significantly higher customer care requirements to increased store security to stricter cash controls in retail stores. Sprint, T-Mobile, and especially Cricket and MetroPCS have made the price-conscientious customer a central part of their strategy and are making the necessary adjustments to serve the value segment effectively. For them, national discounters are a footprint expansion, selling the same product to the same customers. They represent a channel strategy rather than a segment strategy.

*Carriers should be looking to drive device penetration from 100 percent to 300 or 400 percent in the next five years.*
AT&T and Verizon, on the other hand, are focusing on higher-value, less price-conscious customer segments and have optimized their operations to serve those customers’ needs and to increase the average number of connected devices per customer from one to three or four. For them, national discounters are a way to continue addressing an otherwise de-prioritized value segment — that is, a segment strategy.

*Reinvent branded retail and operate a smaller, more focused store footprint.* Given the increased reach through national retailers, coupled with growing customer interest in the online channel, carriers can rightsize their own network of stores and authorized dealers to reduce operational cost and complexity and transform remaining locations into sales, service, and relationship centers to drive the aforementioned multiple device strategy. Consumers will visit successful carrier stores for what they can buy — including the most desirable and exclusive products — and also for what they can learn and experience about new products. Carriers need to deeply understand the customer segments coming into their stores and tailor their offerings accordingly. Stores frequented by professionals and small and medium-sized business owners should be significantly different from stores frequented by families with children. Tailoring stores to surrounding segments should not be a half measure. Rather, carriers should alter planograms, product offerings, merchandising, frontline hiring, and training to target specific segments. One note of caution: Such store tailoring will require an extremely well functioning supply chain, especially a deeply ingrained, cross-functional sales and operations planning process.

*Establish a multi-channel marketing approach that integrates offline and online channels.* Close integration of offline and online channels — with convenient pathways back and forth for customers — will accrue huge benefits for carriers in the form of superior customer understanding, improved targeting ability, higher-value relationship management, more efficient service operations, and more. At present, carriers have a unique opportunity to take advantage of their retail store presence to draw customers into relationships online. Although more than 95 percent of phone and plan sales take place offline today, 77 percent of customers surveyed by Strategy& in June 2010 said the Internet is a source of information prior to purchasing a phone. By making better use of customers’ usage and billing information, carriers can fine-tune customer profiles and targeting mechanisms to manage upgrade and renewal cycles in ways that keep customers engaged prior to contract expiration. Carriers should take note that online-only players such as Zappos and Amazon have some of the highest Net Promoter Scores. Creating a seamless and extraordinary offline–online customer experience will be a major challenge for carriers in the near future.
Takeaways for electronics retailers

Electronics retailers such as Best Buy and RadioShack have a natural “right to play” in wireless, and will grow their mobile phone sales beyond their current market share of about 10 percent by leveraging their greatest asset, their strong network of stores with knowledgeable staff. In 2011, Best Buy and RadioShack (including its Target kiosks) together will operate nearly 8,000 wireless points of sale, about the same number that the big operators own combined. Specific responses for electronics retailers include the following:

Shift the sources of customer loyalty from those that carriers control to those that retailers can control. Historically, handset manufacturers and mobile carriers have often collaborated on product exclusives. With the increased channel power of Best Buy and RadioShack, some handset manufacturers will become willing to give product exclusives to retailers. Some retailers are going beyond product exclusives and even becoming MVNOs — at the risk of alienating carriers. Other new retail alliances could emerge to promote certain operating systems in the future (such as with Microsoft’s Phone 7). Electronics retailers also need to stress their independence. This theme has not resonated well with customers in the past, but there may be an opportunity to re-create it as a differentiator now. As carriers transition from 3G to 4G, above-the-line messaging has devolved into a “mine is faster” argument that is leaving customers bewildered. Electronics retailers should seize the opportunity to help customers work through the various truths behind the carriers’ claims. Why shouldn’t the RadioShack frontline staff use Consumer Reports’ analysis of network performance by city to help customers choose networks and phones?

Push out non-national multi-carrier dealers, along with low-performing authorized dealers and carrier stores. Best Buy and RadioShack have an opportunity to put the squeeze on non-national multi-carrier dealers (such as Car Toys) as well as many authorized dealers, whose value proposition is evaporating as convenience and proximity to a store is becoming less of a differentiator and customers increasingly trust large, non-carrier retailers. These non-national multi-carrier dealers and many authorized dealers often operate with limited product assortments and little available cash for marketing, store design, or even inventory. It will be more and more difficult to translate such a setup into a compelling value proposition that will resonate with customers. For customers who value expertise and advice, consumer electronics retailers are a serious alternative; for everyone else, even national discounters can do the job, often at better prices.

Low-performing carrier stores with precarious store economics face a similar threat from electronics retailers. Over the next three years, the
carrier-controlled store network, including carrier-owned and authorized dealers, may shrink by as much as 30 percent as sales volumes shift to electronics retailers or national discounters, and non-national multi-carrier dealers will likely shrink even more severely.

Leverage expertise and objectivity to develop a distinct and defensible value proposition against national retailers. Store employees at Best Buy Mobile, and to a lesser extent at Best Buy and RadioShack, understand the wireless category, and technology in general, better than those at most national discounters, so they are well positioned to help customers choose among various carriers and options. To clearly distinguish themselves from national retailers, electronics retailers can offer a higher-touch shopping experience that includes breadth of offering coupled with product education.

**Takeaways for national discounters**

National discounters will continue to have a disruptive effect as they exploit wireless trends and exert pressure on prices. Their optimal response will be to continue doing what they do best:

Apply proven business models to the wireless category. For Walmart and Target — and soon even lower-priced and regional discounters — the value of consumer electronics overall, and wireless in particular, is a function of scalability. They excel at selling high volumes of highly standardized offerings at aggressive prices via low-touch sales interactions, with an emphasis on high inventory turnover. They should not change that model for wireless.

Dominate the value segment. There is a rapidly increasing group of frugal, value-seeking customers who could be optimally served by national retailers, which provide attractive alternatives to premium-priced carrier stores. Price is the main reason that consumers switch providers, and national discounters are the natural owner of this large and growing segment. The trade-off for consumers is that they will not have the most knowledgeable staff serving them and they will be likely to miss out on some products not sold in the value channels, but many consumers will be happy to get a better price for those sacrifices. And some carriers might be equally happy to focus their high-touch sales reps’ time on higher-value customers in their own stores.

Treat the wireless category like a mainstream consumer packaged good (CPG). Wireless is now a sizable and growing category in national retail stores, so retailers should begin treating carriers, original equipment manufacturers (OEMs), and accessory manufacturers as classic CPG category vendors. That includes, for example, having them compete for
and manage their own shelf space, including price setting and inventory management/product replenishment. Finally, national discounter
should bear in mind that they hold the carriers in a “prisoner’s dilemma”: Carriers will not want to exit the national discounter channel because it has become a significant source of growth; pulling out would lead to market share losses. Thus, the national discounter’s position is stronger than they imagine.
The mobile ecosystem has been and will remain dynamic and very competitive. This level of speed and change will expand to include wireless retail. Carriers will need to focus on tailoring their customer experience by segment and integrating their offline presence with more sophisticated online capabilities to sustain their current edge over other retailers and e-tailers. If they don’t succeed, players such as Amazon will quickly disrupt their channel dominance in much the same way that Google and Apple disrupted their customer experience and data services revenue models through their ecosystems of handsets (Apple), operating systems, and media and app stores. Given carriers’ existing relationships with customers and the quality of their retail staff, they have a head start. However, many competitors are breathing down their necks for a share of the $200 billion annual revenue the ecosystem generates in the United States.

National discounters have a finely tuned business model that works well with the wireless category now that it is relatively mature. Now they must relentlessly focus on value-conscious customers and apply a CPG business model to OEMs and carriers. In other words, sell standard offerings in high volumes and relegate shelf space and margin management to carriers. Electronics retailers have a defensible position against national discounters and carriers based on the quality of their staff, the objective guidance they can offer to customers, and their larger and potentially better product assortments. Meanwhile, the fast-growing and fast-moving mobile and wireless ecosystem is picking up steam online, with potentially disruptive effects that should leave all retailers feeling the need to invest in online capabilities and be prepared to quickly adjust as needed to remain relevant and viable participants in this dynamic market.

Research Methodology: The survey polled 708 U.S. consumers, representative across demographics, geographies, product categories, and retail formats. The polling was conducted online during June 2010. The results of this sample were integrated with Strategy&'s perspectives on key trends currently shaping consumer behaviors, based on recent client experiences across the digital marketing and mobile ecosystem and across a broad set of consumer spending categories.
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