



2010 Telecommunications Industry Perspective

The global recession of 2008–09 is seemingly lifting, and the telecommunications sector – with the notable exception of equipment and handset manufacturers – has escaped the worst of its effects. Revenues among operators worldwide have remained mostly steady (with the exception of mobile roaming revenues generated by business customers) and ongoing cost-cutting efforts have enabled them to maintain profitability. The coming year may be different. The industry is entering a period of significant change in which five distinct shifts – in geography, in services, in digital expansion, in operations, and in regulation – will come into even greater focus. Those companies that can take advantage of these changes will find real opportunities for growth; those that can't will be considerably challenged. Expect more variation than ever before in the business models and strategies of companies in the telecom sector.

Growth Shifts to the East and South

Much of the growth in the telecom industry will shift away from mature Western markets and toward developing countries. This trend is already fully in place among handset manufacturers, which build most of their handsets in the Asia/Pacific region. Even among operators, the vast majority of the subscriber growth is happening outside the West. In the first half of 2009, for instance, India added 142 million net subscribers and China added 87.4 million, while the U.S. added just 14 million. In Asia, we still see players with extraordinary EBITDA margins – above 50 percent – that are generating tremendous amounts of cash.

These rates of growth and cash generation are also changing the level of M&A and expansion activity across the globe. Although cross-border activity on the part of U.S. operators is negligible, and it is sporadic on the part of those in Europe, carriers in Africa, the Middle East, and the Far East continue to make deals to expand their influence over large territories, and even into the West. It remains to be seen just how disruptive a global force these rapidly expanding players will become.

Focus Shifts to Value-Added Services

Much of the telecom world is rapidly being commoditized – in areas including connectivity, basic services, low-end handsets, networking equipment, and even the networks themselves – leaving virtually every player in the sector to seek out new sources of value. The clear answer to the problem: services. Everyone is moving up the value chain. Equipment manufacturers are offering networking and field operations services, handset manufacturers are building high-end smartphones complete with added services and fully stocked “app stores,” and operators are moving to provide customers with more and more online applications, including content deals. Meanwhile, Internet and technology players such as Google and Facebook continue to stretch their wings into the telecom space. Expect more media and consumer electronics companies to jump in as well.

As clear a trend as the move to services is, it is still in its infancy. Thus it offers the most innovative players many opportunities for growth, as well as the capacity to be tremendously disruptive to those that can't keep up.

The Digital Generation Sets New Expectations

As rivals in the telecom sector battle to move up the value chain, the world is quickly moving toward an “all digital, all the time” model. Consumers are coming to expect the digital experience – texting, social networking, news and information, high-definition movies, and so on – anywhere, anytime. Telecom operators are already beginning to view their Internet portals as a critical asset in the race to provide services. Yet this trend will affect every aspect of the telecom industry – from the high-speed networks consumers will insist on, to the variety of new devices on which they will expect to be able to connect, to the ever-expanding kinds of applications they will be willing to pay for. And the coming generation of “digital natives,” those who know no world other than always-on connectivity, will only grow more demanding, not less.

Operational Efficiency Becomes Even More Critical

The commoditization of multiple links in the telecom value chain is forcing all players in the industry to create the most efficient operations they possibly can – not just to survive in the near term but to prepare for a future in which they must be more focused, agile, and innovative. Players in front of this curve are already looking at the long-term rightsizing of their organizations, outsourcing non-core functions such as network and field services operations and engineering – even spinning off entire passive infrastructures that are no longer central to creating real value – and completely overhauling their business processes. Many carriers are driving large-scale supply chain and device management transformations as well.

The goal, ultimately, is to free up cash and resources for further investment in strategic assets, such as new services, new technologies, and new business models that will truly differentiate players from their competitors. This will become an increasingly critical capability as telecom companies look to move up the value chain.

Regulators Take a Renewed Interest in the Sector

As telecom players move to add more services that require faster networks, many policymakers and regulators around the world are moving to support these efforts. No longer does the ideology of the free market hold complete sway over regulatory thinking. Instead, regulators are becoming more prescriptive and more interventionist as they look to support economic growth through large-scale broadband network deployment – in some cases even engaging directly in such investments. At the same time, regulators in some geographies are continuing efforts to free up specific markets, such as retail and wholesale telecom services in Europe, and to further ensure “net neutrality,” guaranteeing equal use of the Internet by all players.

Managing the interplay between the continued deregulation of retail and wholesale telecom services and the renewed regulation of national networks will become a critical strategic capability for industry players that hope to succeed in this more highly regulated future.

It is vital for all players in the telecom sector to realize that the shifts we have outlined here are happening now. In fact, they present real short- and medium-term growth opportunities. Operators that can begin to think about moving into services should do so. Such a move may not require full-scale internal innovation efforts; instead, they must think deeply about their business models and how to acquire assets elsewhere or tap into external innovation through cooperative agreements. They must also continue to work on long-term operational efficiencies that can earn the capital and resources to prepare for the telecom industry of the future.

We hope this letter has prompted some helpful thoughts on the coming challenges in the telecom sector. We would welcome the opportunity to discuss these issues with you in greater detail.

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