Conference Insights

Booz & Company *Annual Communications Leaders' Summit 2011*

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INTRODUCTION

In February 2011, Booz & Company convened its fourth annual CEO Communications Summit in Dubai, bringing together 14 leaders from telecom organizations to share their insights and outlooks for the year ahead. For this session, representatives from telecom companies in India, Turkey, and Russia joined their counterparts from the foremost telecom organizations in the Middle East.

Discussion in prior years focused predominantly on the global economy—first coping with the downturn and then preparing to emerge from it. This year, the conversation kicked off with a focus on innovation, and participants weighed in on what role, if any, telecom operators can play in introducing new services, applications, or business models. Participants took a markedly different stance than in prior years, concurring that a sense of urgency was needed in forging partnerships to spur innovation in the application space while the industry operators focus their attention on continuing to introduce new services and processes. Attendees also discussed the likelihood and implications of renewed industry consolidation, with even single-market operators recognizing the benefits of competing in multiple markets. The CEOs agreed that although consolidation will be a driving force, they need to be mindful and responsive to mounting shareholder demands for accountability for and return on all expensive investments.

Finally, peering ahead, the telecom leaders on the whole expressed cautious optimism, noting some concern about the near term and then turning upbeat about the sector's long-term prospects.

Several broad themes served as conversation generators, including:

- Did innovation materialize effectively in 2010—and if so, in what areas?
- Which business models will drive operators' growth in the coming years?
- What are the likelihood and implications of consolidation in the sector?
- What is the industry outlook for 2011?

PRESENT AT THE SUMMIT

COMPANY	ATTENDEE	POSITION
Avea	Kadir Boysan	Chief Strategy Officer
Emirates International Telecommunications	Deepak Padmanabhan	Chief Executive Officer
Emirates Investment Authority	Mauricio Franca	Investment Director
Etisalat Group	Ahmad Abdulkarim Julfar	Group Chief Operating Officer
	Nasser Bin Obood	A/Chief Executive Officer, UAE
	Kamal Shehadi	Group Senior Vice President for Regulatory Affairs
Google	Mohamad Mourad	Gulf Regional Manager
Mobily	Dr. Fahad Almubarak	Member, Board of Directors
MTS India	Cheenu Seshadri	Chief Strategy Officer
Omantel	Dr. Amer Al Rawas	Chief Executive Officer
Qtel Group	Dr. Nasser Marafih	Group Chief Executive Officer
Saudi Telecom	Ghassan Hasbani	International Chief Executive Officer
Tata Communications	Vinod Kumar	Managing Director and Chief Executive Officer
VimpelCom Group	Boris Nemsic	Advisor

Dr. Fahad Almubarak, Mobily; Ahmad Abdulkarim Julfar, Etisalat Group

INNOVATION

For the second consecutive year, innovation was a major theme of the discussion as operators discussed their strengths in this regard. In the communications sector, innovation is wide-ranging; it extends from the evolution of new business models to the deployment of advanced infrastructure and encompasses the creation of content and applications. Most participants recognized the critical role innovation plays within the sector. Said one participant: "We see innovation as a do or die thing. Innovation is a journey and it happens on multiple fronts."

Yet the attendees admitted that innovation does not come naturally to telecom operators. "Telecom operators are not used to innovating every day," said one participant. "It's not necessarily in the DNA." This is especially true regarding cutting-edge applications and content—an important area, as telecommunications operators in recent years have been ceding control (and some of their revenue base, as well) to applications providers.

As a result, the prevailing sentiment was that telecom operators will benefit from shifting their attention away from applications innovation and focusing instead on internal innovation, materially changing the way they go about their business. "Innovation doesn't mean you have to go outside the course of your normal business," said one operator. "Doing your business differently and smartly can make a huge leap." Another participant agreed. "Our current business as telecom operators is still building infrastructure, creating top-quality customer service, managing efficient and effective distribution and retail channels, and creating lifestyle services. That is the core business. Everything around it we can innovate." Another operator said that this type of innovation already is taking place, a reflection of the reality of the marketplace and the stepped-up competition to provide new applications to customers. "Innovation of the back office is working well now," he said.

Opportunities abound for operators to innovate internally. "There are new revenue streams to compensate for the decline of traditional revenue streams," said one participant, "and there is no limit for innovation in all these areas." Another operator said that over the last several years, his company has placed an emphasis on new service creation and innovation, "rolling out new services that have quite often taken us completely out of our comfort zone." His company, for example, hired IT professionals and now gets about one-seventh of its revenue from IT services. "Are they completely, radically, new and highly innovative services? Maybe not. But when you combine the IT services with the network offering, we think the innovation is in the service bundle that you create."

Attendees cited utilities and banking as industries from which the telecom sector could learn lessons. "Electricity companies don't tend to make toasters and refrigerators and invest in appliances that use electricity," said one participant. "They allow other people to innovate on that front, and they innovate in generating and transporting electricity to consumers—doing it more effectively, more efficiently, and in an environmentally friendly way." Another participant used the banking sector to show the potential pitfalls of trying to be on the cutting edge of innovation. "Look at the banking industry—probably the least innovative industry since the 16th century. They've been doing the same thing since the Medicis. They've been growing and growing and making more and more profit." Another participant noted that the banking sector ran into massive, catastrophic troubles when it began innovating with derivatives and structured products.

The operators also addressed the sector's role as an enabler of innovation for applications and content. "We're service providers in the end. There is a lot of innovation that happens in the background; we're effectively paying someone to do it for us indirectly." Another participant noted that the telecom industry makes bold moves every few decades, paving the way for others to innovate: "Every 20 or 30 years, this industry makes a major move, enabling further innovation. Facebook would not have evolved at the speed it did had there not been about 700-plus operators around the world delivering the connectivity."

Operators can team up with outside application companies to position themselves to take advantage of future innovation in applications. "The model of partnership is going to be critical, because we all cannot be the Google or the Apple of the world—but we can collaborate," said one attendee. Another participant said that partnerships already are the norm for his company: "We partner with everybody. We don't need to invent it ourselves. We don't have that syndrome in our company."

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Dr. Nasser Marafih, QTel Group; Ghassan Hasbani, Saudi Telecom; Karim Sabbagh, Booz & Company

Roman Friedrich, Booz & Company; Peter Weichsel, Booz & Company; Boris Nemsic, VimpelCom Group

EMERGING BUSINESS MODELS AND CONSOLIDATION

Another major theme in the discussion focused on the business models that will allow operators to remain successful in a rapidly changing industry. Four business models dominate the telecom sector, though these four are not necessarily exclusive and some operators have adopted models that blend two or more approaches. Network guarantors provide access; they typically are infrastructure providers, focused on efficiency, quality, and scalability. Business enablers, the model used today by most service-based operators, act as intermediaries with consumers to provide them with their ICT needs, forging partnerships with applications and service providers. Experience creators have a deep understanding of customer needs and transcend traditional communications services by offering targeted services such as gaming, social network services, or healthcare offerings. And finally, some operators are global marketers that can operate in multiple markets and leverage their brand and efficiencies by sharing basic services.

The global multimarketer approach will become increasingly critical for operators to deliver results and provide returns to demanding shareholders, as traditional services no longer provide the same robust revenue growth that they once did. “We are not loved by the financial markets anymore, as we had been for a long time,” said one attendee. “So it is really up to us as top executives in this industry to impress our shareholders and the markets.”

The need to operate in multiple markets will be a strong driver for consolidation; it will continue and likely accelerate in the GCC after a lull of several years. “We have not seen aggressive consolidation the last couple of years because of the economic and financial situation,” said one participant. “But this has created opportunities for some players that cannot survive and cannot sustain the business for long.”

Participants expect to see activity on several fronts: in-market consolidation, especially markets with more than three competitors; cross-market consolidation; and consolidation between telecom operators and other businesses.

The benefits boil down to scalability: gaining perspective from other markets to wring out cost synergies as well as the ability to introduce services and products. “Instead of inventing or reinventing the same product, six, seven, eight different times, a product can be launched in one market and then quickly rolled out across other markets,” an attendee said. “At some point in time, regional scale might not be enough. We may want to expand globally as well and get experiences from other parts of the world.”

One attendee used Europe as an exemplar for consolidation, stating that he could not think of many, if any, single-market operators that are not part of a bigger group or have not formed a group at either a regional level or a global level. “In the Middle East we’re still not there, but we are getting there, for the simple reason that our business is a scale business. So you’re either part of a group or you form a group.”

The Middle East, however, is unlikely to achieve the same scale of market consolidation that Europe has because of the national sovereignty of incumbent operators. One attendee noted, “I don’t see us reaching the levels that we have seen in Europe, where consolidation has happened at much larger scale; possibly not until incumbent operators get further privatized in their local markets and open up to potential share-swapping or mergers at large scale.”

Single-market operators at the discussion were candid about the challenges they face in having to sit out the consolidation wave. “We are now faced with a pie that’s not growing as fast as it was 10 years ago,” one single-market operator said, adding that shareholder expectations have increased. “Therefore, we need to focus our investments where the demand and return are. So we may be cherry-picking.”

Another single-market operator stated that it is possible for such operators to prosper. “An operator can be successful in just one market,” he said. “I just think it’s tougher.” Single-market operators can integrate into other, larger networks, though not necessarily through ownership. “It could be through partnership or collaboration or by creating their own larger networks themselves,” a participant said. Another option is to accept their high cost structure and seek government support in capital-intensive areas that will allow them to flourish as national champions.

Dr. Amer Al Rawas, Omantel; Nasser Bin Obood, Etisalat Group

"The incumbents will strive for end-to-end cost optimization. The challengers will aim to innovate even more. So we expect greater competitive intensity in the region."

2011 OUTLOOK

Discussion about the outlook for the year ahead kicked off with a provocative question: “Are the best years of our industry behind us?” As attendees engaged each other in response, some operators concurred, expressing concern that regulatory involvement and a difficult macro environment could curb growth. Others, though, were optimistic, looking to strong consumer demand for data and services, as well as sustained investment from GCC governments, as key growth drivers. Nonetheless, the middle ground of cautious optimism captured most of the overall sentiment in the room.

Some operators agreed with the perspective that the sector has entered a new phase. “If you think back to what happened in the sector between 2005 and 2010, now it’s much more competitive,” one attendee said. Another operator noted the challenges in capturing traditional revenue streams. “We are facing the possibility of revenue erosion in the voice business,” he said. And another attendee said that operators might struggle to sustain high levels of profitability: “The incumbents will strive for end-to-end cost optimization, given the current macro environment, so EBITDA margins will come under more pressure. The challengers will aim to innovate even more. So we expect greater competitive intensity in the region.”

Regulatory concerns also persist. “The biggest wild card is the regulatory regime and the underlying sector policy,” one attendee said, referring to the liberalization that has opened the doors for multiple competitors to enter into his market, driving down prices and profits. Another noted that regulatory pressures stem from diverging motivations. “The regulators’ agenda is different from the shareholders’ agenda,” he said. “They need to promote competition at reduced prices.” As a result, opera-

Dr. Nasser Marafih, Qtel Group

tors feel pressured by regulators, and believe that the foundations of their business are being challenged, with long-term detrimental effects, in the absence of a clear sector policy.

On the other side of the spectrum, some operators were very optimistic. In select emerging markets, such as India, Internet and personal computer penetration are in single digits. "It's just going to boom," said one attendee. "The sky is the limit." There's even room to grow in the GCC, said another participant. "In the Middle East and in Asia, the broadband penetration is very low," he said.

Consumer demand for data also continues to be strong. "Data and broadband are going to be the next areas of growth," said one attendee. And operators also see enormous opportunity in providing ICT solutions to businesses. "The nature of the conversations has changed from just selling pipes to actually delivering solutions," one operator said, adding that such business could fuel growth in 2011. Another participant noted that several governments have announced large-scale infrastructure projects that are very likely to fuel strong economic growth beginning in 2011. "We believe the next 11 months will be just as positive because of the predicted economic growth and the economic activity that is going to be fueled by a number of announced mega-projects, some of which have started," he said.

Many participants fell in the middle, expressing cautious optimism that could turn based on incremental uncertainty. "In 2011, we're still coming out of recessionary thinking, globally," one participant said. "The investment thinking is still pretty much post-recession investment thinking, where any small uncertainties would move it into hold position until further notice."

Operators must also take into account the fact that recent circumstances have put several countries in the region in flux, which could affect telecom growth. "This may impact the policymakers and the regulators," one participant said. "It may slow down the growth of the business." Added another attendee, "The current geopolitical scene is going to make 2011 the year of uncertainties."

Beyond the cautious optimism regarding near-term growth, most participants expressed unbridled optimism for long-term sector prospects. "I am extremely optimistic for 2012 and 2013 onward, where we will see the launch of a mega-cycle in global economies, where we will see the real impact of the current Asian markets' growth hitting investors in that part of the world. And we'll probably see the impact of the geopolitical situation today turning into a positive outcome in this part of the world that will encourage the investor mentality into infrastructure and into acquisitions and mergers."

Peter Weichsel, Booz & Company; Cheenu Seshadri, MTS India

Dr. Fahad Almubarak, Mobily; Ahmad Abdulkarim Julfar, Etisalat Group; Nasser Bin Obood, Etisalat Group; Dr. Amer Al Rawas, Omantel; Dr. Nasser Marafih, Qtel Group

Kadir Boysan, Avea

Ahmad Abdulkarim Julfar, Etisalat Group; Nasser Bin Obood, Etisalat Group

CONCLUSION

Discussion at the conference flowed from one critical topic to another: innovation, consolidation, and industry forecasts. Throughout the session, though, telecom sector executives focused on the underlying theme of how they will position their companies and which business models they will need to adopt to ensure growth.

With consolidation likely to resume in 2011 and accelerate in years ahead, according to the group, operators recognize the need to focus more on the model of a global marketer. Even single-market operators acknowledged the challenges and opportunities that lie ahead in a consolidating sector and highlighted the necessity of preparing to either join the trend or innovate faster and further to keep up.

Accordingly, operators will need to develop new capabilities to support changing business models. Most operators noted that their core capabilities remain in providing connectivity and service. This will continue to be an important part of their business going forward, and it is ripe for innovation in both products and services—but for most operators, that will not be enough.

Similarly, the group collectively recognized its role as business enabler, linking with partners to provide services and applications. The advent of MVNOs and MNOs throughout the region underscores this emerging model. Finally, the operators realized the great opportunity in adopting the model of an experience creator, either teaming up with others or creating the in-house expertise to alter the traditional company–customer relationship and offer customized solutions. All of these approaches, however, are more likely to be successful for operators that can leverage these assets across multiple geographies. The future of telecom, for most operators, will lie beyond their own borders.

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