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Exploiting the Core
*Returning Telecom
Operators to
Profitability Growth*



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EXECUTIVE SUMMARY

Most large telecom operators in developed markets are in a bind: On the one hand, their revenues are flat or in decline, and on the other, their ongoing efforts to cut costs are yielding less and less in the way of returns. The result: Their profitability growth has stalled, and in most cases turned negative.

In order to reverse this trend, operators must look within. Their core businesses still harbor numerous opportunities to trim expenses and boost growth. But to take advantage of these opportunities, they must pursue a balanced, holistic program for restoring profitability that is designed to make gains on both the revenue and the cost sides of the equation.

Booz & Company's cash flow improvement framework, outlined here, is just such a program. It consists of four dimensions—two on the revenue side, and two on the cost side:

- *Leveraging underdeveloped segments to boost revenue*
- *Generating more revenue from the existing customer base*
- *Focusing and simplifying the product portfolio, technology, and business processes*
- *Realigning costs in light of customer needs*

In applying this framework, it is best to make sure that top management, including the CEO, is fully supportive of the effort. Moreover, all four dimensions of the framework should commence simultaneously, since progress in any one will benefit the others. And the best time to start is now.

THE GROWTH DILEMMA

Over the past several years, in developed markets around the world, telecom operators have struggled with ever-declining revenues. In Europe, for example, revenue growth for integrated operators has been anemic at best, and negative at worst. Even mobile telephony, which has been the primary growth driver over the past decade, is no longer generating consistently higher revenues. As differentiation among telecom offerings disappears, operators are resorting to more and more aggressively priced—and less profitable—packages in hopes of defending their market share.

Meanwhile, despite multiple rounds of cost cutting, primarily driven by the

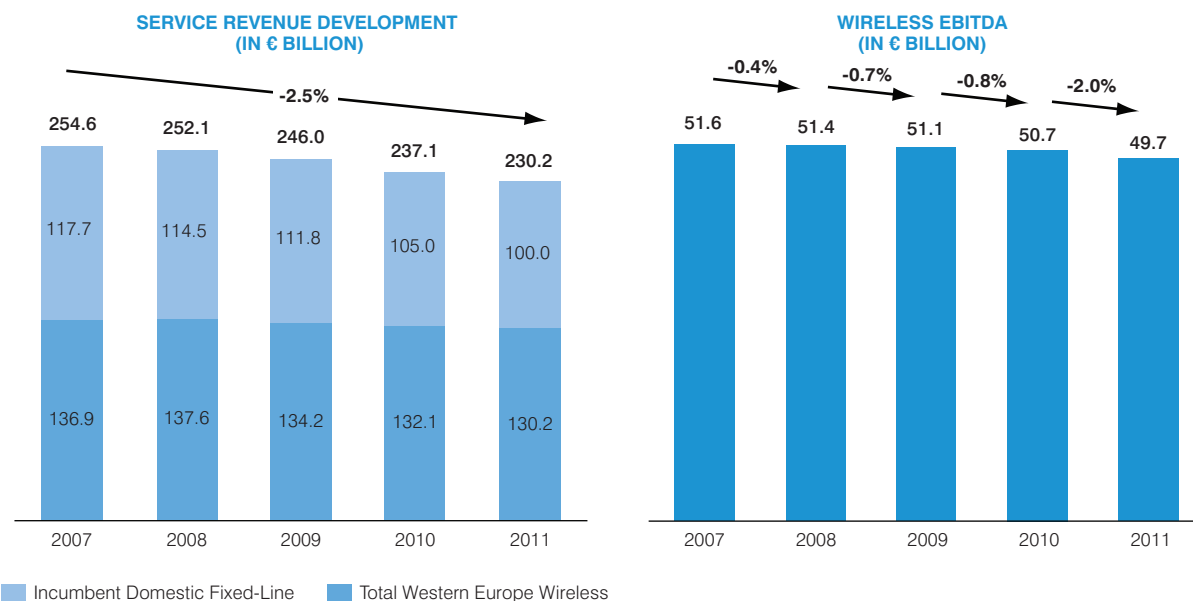
demands of securities analysts, operators' ongoing efforts at cost restructuring are delivering less and less in the way of profits to the bottom line (see Exhibit 1). While some operators have succeeded in remaining very profitable in recent years, even they are under great pressure from investors and industry analysts to continue to show profitability growth and to make further cuts. Can operators reverse this downward spiral and restart their growth engines?

We believe they can. But to do so, they must design new, differentiated growth models and stop relying solely on the strategies they have depended on in the past. Many operators have long viewed expansion into other countries and emerging markets as a silver bullet. Now, however, operators ripe for acquisition in most of these target markets have already changed ownership in recent years, and the few promising opportunities remaining come with a hefty price tag. Emerging markets, too, are quickly becoming saturated, reducing what used to be

their huge potential for growth to a level similar to that of the developed markets. And finally, operators have found little success so far in trying to extend their operations into adjacent activities such as mobile apps and other products and services. New markets and new businesses will likely bring real gains in the future, but neither strategy will earn the added profits that operators need in the short term.

Instead, operators eager to boost profitability should look no further than their own core businesses for unexploited opportunities to drive growth more holistically—an approach far too many operators continue to neglect. This approach to optimizing current operations involves not just more cuts or extensions to the business, but rather a balanced strategy of top- and bottom-line gains. Just as important, the capabilities required to generate new growth from core operations will serve operators well as the industry as a whole becomes increasingly consumer-oriented.

Exhibit 1
Telecom Revenues and Profits in Western Europe Have Been Dropping for Several Years



Source: Bank of America Merrill Lynch European Telecoms Matrix Q3 2011; Booz & Company analysis

A FRAMEWORK FOR GROWTH

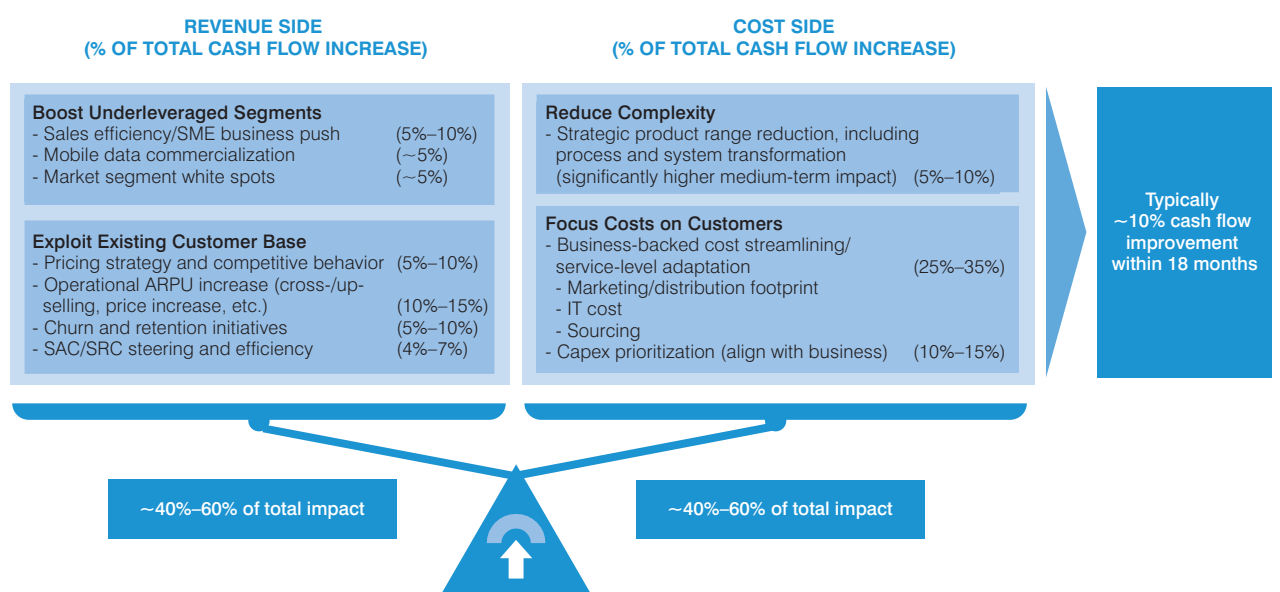
In creating a holistic plan to ensure growth in profitability, our goal has been to balance short-term tactical gains with longer-term strategies—and revenue enhancements with cost

reductions. By covering all dimensions—revenues as well as costs, in both the short and long terms—our cash flow improvement framework will ensure rapid and sustainable results: 10 percent improvement in free cash flow, on average, in our experience. The framework covers the key steps that operators typically can take to leverage the value hidden in current operations (*see Exhibit 2*). Each step offers real gains in free cash

flow, through either incremental revenues or savings, above and beyond the current baseline.

Operators should concentrate on analyzing these steps, on both sides of the equation, in parallel to ensure a rapid return to profitability growth. And they should avoid hunting around for low-impact levers that will likely take much more management time than they're worth.

Exhibit 2
The Cash Flow Improvement Framework



Source: Booz & Company analysis

REVENUE ENHANCEMENTS

A close look at current operations reveals two areas in which to concentrate to begin building revenues: underleveraged customer segments and the existing customer base.

Boost Underleveraged Segments

If they examine their operations closely, virtually all operators will find customer segments that they have underserved, and thus which have the potential to release more value. The small and medium enterprise (SME) segment is a case in point. Too often, it ends up caught between business units devoted to large enterprise customers and those handling residential customers, with the result that the SME segment is often significantly underserved. To reverse this phenomenon, operators should consider four key success factors:

- *Service offerings* need to be designed specifically for the SME market in terms of both product mix and pricing, and promotions and campaigns should be focused on the segment.

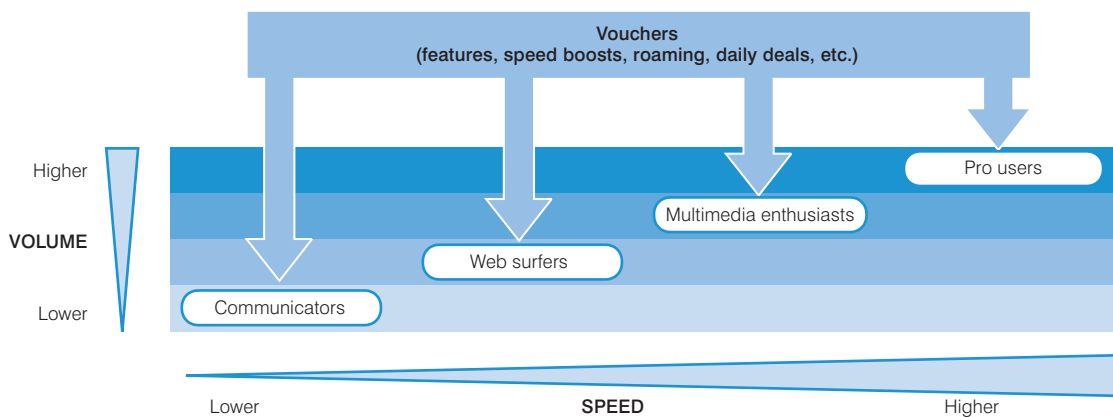
- *The mix of sales channels* needs to be optimized for the market. It should include both direct channels—such as outside sales, dedicated stores and call centers, and an SME-specific website—and indirect channels like outside dealers and franchises. SME customers should be prequalified to shop in any channel.
- *Commission plans* need to be developed specifically for the direct sales force dedicated to the SME market, while the incentives for indirect dealers need to be aligned with the overall objectives for the market.
- *Channel support* should include marketing tools and materials and customer service specifically tailored to the SME markets.

In addition to reexamining the SME segment, operators must rethink how they position and market their mobile broadband services. In many markets, mobile broadband has already become a commodity service that most customers expect to receive at very low cost—a situation brought on by a competitive downward spiral with new operators aggressively pricing “all you can eat” mobile broadband offerings and incumbents moving to undercut them. Today, most operators offer

low-cost, fixed-price, one-size-fits-all mobile broadband products, without differentiating through innovative price plans that could stimulate data usage and extract significantly more value from customers.

Operators should be making a greater effort to understand their different mobile broadband customer segments—sporadic use, e-mail and messaging only, multimedia and Web use, heavy media usage—and then to devise plans tailored to those different segments. Depending on the segment, such plans might include specific prepaid data offers such as a day pass or a temporary speed boost, and individualized product bundles at different data speeds and download volumes, perhaps including primarily text communication and light browsing for a low fee and much heavier use for a much higher fee. Any such offering should communicate the value proposition to the customer clearly and simply by highlighting the key features rather than just speed and volume, which most users don’t really understand. Thus, operators could offer “€5 per month for unlimited e-mail and chat and 50 photo or document attachments,” or “€35 per month for unlimited e-mail, Web browsing, video streaming, and gaming” (see Exhibit 3).

Exhibit 3
Behavior-Based Mobile Broadband Customer Segmentation Scheme



Source: Booz & Company analysis

Exploit the Existing Customer Base

A critical difficulty faced by most telecom operators is the ongoing decline they face in revenue generated from each of their customers. Increasing the average revenues generated from existing customers by even a small amount is without question the most powerful lever that operators can pull to turn around their overall profitability. But this is likely to be an uphill struggle for many. Even as the costs of most goods, including food, gasoline, and energy, have risen significantly over time, telecom services are among the very few that have kept declining. Few operators have managed to develop attractive customer offerings that don't include lower prices and larger bundles of services.

Unfortunately, most of the obvious alternatives, such as simply raising prices, are unlikely to succeed in the long run. If operators are to reverse the downward revenue spiral, they need to develop a variety of more sophisticated pricing and customer base optimization levers, in both their mobile and fixed-line businesses. A value-based management approach, which requires a deep understanding of customer needs and usage patterns at the individual user level, can significantly improve revenues per customer—and consequently profitability.

Once operators learn to generate and analyze this vast amount of data, they can begin to create any number of different tactics for optimizing pricing,

improving revenues per customer, and reducing churn (see Exhibit 4). Examples of such tactics might include improved offers for the high-value segments; design of more competitive tariffs; reduction of marketing costs for low-value segments; churn and retention initiatives specifically focused on high-value, high-margin segments; and more focused and rebalanced acquisition and retention spend based on the expected value contribution.

As rich an opportunity as value-based management can be, the typical telecom operator is far behind many companies in industries such as retail, where advanced customer analytics is already a core capability. Still, it is an area well worth pursuing.

Exhibit 4
Value-Based Management Program Options

COST STREAMLINING

		Mobile		Fixed	
		Prepaid	Postpaid		
Pricing & Customer Base Management	Pricing	Price reduction on high-commitment plans	✓	✓	✓
		Overall plan alignment	✓	✓	✓
		Creation of new plans/add-ons for specific usage customers	✓	✓	
		Up-selling and migration to hybrid plans	✓		
		Increase consumption of low-ARPU clients	✓	✓	
	ARPU	Increase the low to medium customer value frontier	✓	✓	
		Data cross-sell	✓	✓	✓
		Promotional campaigns	✓	✓	✓
		Top up nominal value adjustment	✓		
	Churn	Term contract expiration		✓	✓
		Legacy plan abandonment	✓	✓	✓
		Focus on high-churn groups	✓	✓	✓

Source: Booz & Company analysis

COST RESTRUCTURING

Extracting the most value out of existing segments and customers is a must to ensure sustainable profitability growth in an increasingly saturated market. But that is only half the equation. If operators are to return to growth, and to sustain that growth, they must also continue to take into account the cost side. Most operators are finding that continued cost cutting no longer provides much in the way of real savings. Instead, they must turn to two techniques in particular—reducing complexity and realigning for growth. Most operators have not yet made gains in either of these areas, as important as they are, primarily because much of the gains to be made come in the medium to long term. Yet they remain essential for operators looking to remain healthy going forward.

Reduce Complexity

The average telecom operator is a highly complex organization, with millions of customers being offered a wide variety of different products

and services—not to mention the spectacular technology and process complexity of even the smallest telecom network, which is compounded by legacy environments. Yet operators have long avoided looking for cost savings through complexity reduction. Traditionally, operators have simply added new products and services on top of their existing portfolio, neglecting to phase out legacy products as they become less viable. As a result, operators are now challenged with thousands of products spread across multiple systems, making the process of introducing new services and changing current systems and processes much slower and more difficult, if not impossible.

When a leading European telecom operator conducted a comprehensive assessment of its tariff and product portfolio, it discovered that as few as 15 percent of the tariffs at one of its operating companies were generating more than 80 percent of total revenues. Simply cutting off the “long tail” tariffs, this analysis suggests, would have an outsized impact on the portfolio’s overall complexity. Indeed, rigorously phasing out legacy products is required if operators hope to create a step-change in terms of process efficiency, simplification, and time-to-market.

A successful complexity reduction program should be conducted in three stages:

1. *Products*: The entire portfolio of products and services should be assessed to better understand their contribution to revenues, profitability, and differentiation potential, and then segmented by these criteria. Ultimately, the long-tail outliers should be removed from the system.
2. *Technology*: The various technology platforms—provisioning and billing, business support, customer care—should also be segmented using the same criteria. Unprofitable legacy platforms should be decommissioned, and alternatives substituted for them as needed, through a careful migration plan closely aligned with the product portfolio reduction program.
3. *Processes*: As a consequence of steps 1 and 2, processes such as provisioning of new customers and introduction of new products should be dramatically improved. This will result not only in significantly lower costs but in a superior customer experience as well.

The cost benefits of this effort, if carefully executed, will be significant. Savings in operating expenditures will come as the groups managing unprofitable products are phased out and the sales and marketing functions are rationalized and become more focused. A simpler product catalog and database will lead to fewer costly errors in fulfillment and order management. Simplifying the product portfolio and order processes will also mean fewer customer service requests. And over time, reducing technological complexity and the sheer number of different platforms will lead to lower capital expenditures as well.

Reducing complexity is by nature a cross-functional effort, so the successful simplification program will require full dedication on the part of top executives throughout the company. The benefits of such a program can be very difficult to calculate in the beginning, and a multitude of operational concerns will inevitably surface in the course of the program. So unless the CEO is setting the targets and keeping a close eye on progress, these programs are likely to fall short of their goals, if not to fail entirely. Reducing the total residential product portfolio by as much as 50 to 60 percent would be an ambitious but reasonable target.

Operators might also consider a more radical approach to reducing

complexity—setting up a cross-functional team whose sole purpose is to reduce the number of tariffs and projects and to migrate customers of old products. This team must operate independently of the line organizations running the day-to-day business to ensure that it concentrates completely on reducing complexity. Remaining independent will enable the team to build the lean processes and systems that all operators will need to operate profitably in the long term.

Focus Costs on Customers

The typical cost-cutting exercise focuses on simply comparing different cost centers with various benchmarks. A more sophisticated approach is needed if operators are to continue to make gains in profitability and ultimately meet the demands of analysts for faster growth. Rather than just squeezing out a little here and a little there, operators should consider the value of all their various activities from the customer's point of view. Only by looking at costs from a customer's perspective can operators identify the activities that don't really provide value and thus could be cut, as well as those that should be strengthened to increase their value to the customer. Just by asking simple questions—"Would customers notice the absence of new activation checkup calls?" "Would customers be willing to pay more for paper statements?"

"What is the benefit of having a specific internal support function for the customer?"—operators will gain a much more focused understanding of where the value lies in their operations, and where to trim back.

Of course, all operators conduct activities that customers have no involvement in at all. Therefore, we suggest a three-step approach to aligning for value:

1. *Value to the customer:* In this first stage, all activities are assessed for their value as perceived by customers. Those of lower value or visibility are targeted for streamlining.
2. *Value to the line organization:* Each activity is then assessed in terms of its value to operations. Again, lower-value activities should be considered for streamlining.
3. *Legal/regulatory importance:* Finally, each activity must be screened to determine if it is required by law or regulation.

Once the screening process is complete and each activity is assigned an appropriate level of value, decisions can be made about whether to strengthen it, streamline it, or cut it entirely.

MAKING IT WORK

If carried out successfully, the program described here can have a significant impact on both revenues and profitability. Based on our project experience, we would expect gains of at least 10 percent in free cash flow within 18 months of the program's inception, half through cost cutting and half through revenue gains.

Such a program, however, will inevitably have a widespread impact on virtually every aspect of operations. In light of the program's holistic nature, success will depend on five guiding principles:

1. *Top-level support:* The most important factor of all is an

absolute commitment to the program on the part of top management. That support must be gained at the very beginning and communicated throughout the company through alignment workshops and interviews with senior management. Effective governance programs must be put in place at this stage as well.

2. *Program targets:* All stakeholders must agree on ambitious but achievable targets for the program and clarify responsibility for each target. In setting the targets, it is critical to determine whether they are fair and reasonable, given the capabilities and market circumstances of each stakeholder.

3. *Key initiatives:* Once the initial list of targets is settled on, through interviews, surveys, and data analysis, top management and the program leads must choose a limited set of the most important

initiatives. Here, the goal is to ensure that the program can make early gains and be sustainable, by striking a balance between short-term tactical initiatives and medium-term strategic changes.

4. *Business unit buy-in:* Once top management alignment has been achieved, a commitment to the program on the part of all divisions and subsidiaries must be gained. Ensuring that all units understand the nature and purpose of the program is critical, as is giving them the flexibility to tailor the program to their own needs.

5. *Measuring success:* A project management office must be established to monitor progress. This must include the development and communication of key performance metrics, for both individual business units and the company as a whole.

Within 18 months of inception, the cash flow improvement framework can deliver gains of at least 10 percent in free cash flow.

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CONCLUSION

Considered separately, the four dimensions of our cash flow improvement framework for boosting the profitability of telecom operators may not seem particularly new or different. The challenge lies in combining all four into a complete, holistic, and, most important, focused program. The journey to increased profitability will likely be complex and sometimes painful, but it is necessary if operators are to reach the ultimate goal: to return to sustainable profitability growth quickly.

Indeed, these four dimensions ultimately embody the key capabilities required to ensure success in this increasingly consumer-oriented business environment:

- *Boosting underleveraged segments:* the capability to address each customer individually and fairly, while extracting optimal value
- *Exploiting the existing customer base:* the capability to address specific market and customer segments for optimal value
- *Reducing complexity:* the capability to effectively and continuously cull value-destroying products and processes
- *Focusing costs on customers:* the capability to spend only where it matters to the customer

Operators that succeed in integrating all four capabilities into a coherent capabilities system will be able to deliver true operational excellence and thus deliver the level of sustainable profitability growth needed to outperform the competition in an increasingly customer-oriented business environment.

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