TELECOM
STRATEGY PARTNERS

Practical experience, market knowledge, and insight assisting customers on the path to greater profitability

Date: August 15, 2008

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It is time for operators to take more responsibility for the profitability of the telecom industry.

The biggest threat to the telecom sector right now is not the economy. It is what will happen if service operators admit defeat before fighting the battle, and *choose* to proactively commoditize 3G and 4G mobile data, and fixed line Ethernet services rather than differentiating them.

One of the fundamental problems of telecom being an industry with its roots in regulated monopolies and oligopolies is that many service operators may never have developed the strength in marketing expertise that they really need to succeed in a competitive marketplace.

In a regulated environment, having a core competence in marketing was not all that critical. And the people that filled the marketing roles in those regulated organizations typically formed the pool of people that were later tapped to kick off the marketing activities of today's competitive operators.

These marketing personnel not only stayed on as the marketing execs of many incumbent operators' marketing groups after telecom was opened up to competition. They also became the mentors that influenced the thinking of new marketing personnel...and were hired away to lend their expertise to alternative operators.

The result, in our opinion, is that many service operators have a very hard time figuring out how to effectively differentiate on much more than price. Worse yet, many of the operators seem to have a near-religious belief that it is not possible to do so. And they seem to win converts in the Sales groups of some vendors as well.

A recent visit to the web sites of several operators reinforced our perception of the shortfall in operators' marketing expertise. For one major operator in North America, we found that 3 of the first 22 words of text on the wireless page of their web site happened to be the word "free," and that there were 3 mentions of "free" or of "special" pricing within the first 38 words of their residential page. So 10% of the words in this operators' *opening* marketing pitch currently revolve around price! After checking a major competitors' web site, we found its focus on "free" to be similar

The problem with assuming the inevitability of "all-you-can-eat" fixed and mobile services, free or heavily discounted camera phones with service contracts, free shipping on those camera phones, free first month recurring fees, and compelling discounts for bundled service packages is that these tactics have become the rule for operators and almost a fixed part of the landscape rather than being actual promotions - and they typically coexist at the very same time in the same operator.

We do not argue that operators are finding themselves having to compete on price, or that transport has historical always tended towards commoditization. What we are arguing is that it is the operators themselves that created this situation, and that no one but they can potentially fix it. And while it may be difficult or impossible to reverse this situation for existing services, it does not have to be extended to new services that subscribers have no history with.

True, transport has always tended toward commoditization. But perhaps this in part is due to the way it has always been marketed. You have to remember that the same residential subscribers that buy fixed line broadband and mobile services are the very same people that are frequently willing to pay a wide range of prices for salt. Why? Because with salt, some of these subscribers in their role as consumers have been convinced by effective marketing that sea salt is different than salt that came from the sea, but which has been mined from underground deposits after sitting there virtually unchanged. Others have been convinced that salt is the way to get your iodine supplement. And still others have been convinced that different granularities of salt might provide a different dining experience and be worth a premium.

Are these attributes of salt really more substantive forms of differentiation than is clear, accurate, and easy to read billing accessible with records accessible on the web? Do subscribers really not care about how customer service objectives have suffered at some operators in their quest to become more competitive on price? Do subscribers not care what kind of throughput that they get on their oversubscribed broadband access? Are they happy when the network goes down, and not at all concerned about the availability of the network? Or have operators had a difficult time communicating this to subscribers in a way that they can understand, or worse yet not made a substantive and skillful effort to do so?

The most frequent way to deal with self-commoditized services in the past, rather than good marketing, has seemed to be for operators to turn to vendors to explain that they could sell more services and buy more infrastructure if only they had lower infrastructure costs that supported lower pricing. The problem, of course, is that vendors and their suppliers also need to take a profit. Ultimately, there is only so much consolidation that is good for the operators. And the degree to which they lean on low service pricing as a primary means of differentiation not only directly impacts the financial health of their suppliers, it ultimately impacts the viability of their own supply chain. So while operators can and should try to negotiate competitive supply of infrastructure, there is a limit to how aggressive they can really afford to be in the long-run.

Another real challenge the telecom market has to overcome is the short-term focus of the **financial community**. Unfortunately, long-term thinking in operators and vendors alike tends to get overridden by the need to satisfy the ridiculously short-term focus of the financial community. The problem is that if you are in a highly complex industry, making changes to the business model is a gradual process that requires forward planning and takes a lot of time to implement - more time than the financial community is willing to wait. So they exert short-term pressures on operators and vendors, looking for more short-term results than are practical.

Since real change in operating practices and resulting performance are not going to be achieved in a single financial period, instead of making the business profitable and profitably engaging personnel, the one thing that CEOs can find to do to appease the financial community is downsize - creating "improved results" on paper by shedding people and product lines...often reducing their ability to generate revenues in the future at the very same time.

The financial community taking such a short-term focus and punishing those companies that do not take radical short-term measures to try and address their concerns about past and current performance is ineffective. Forward planning is important, and companies have to have the patience to wait a reasonable amount of time for results. If the Captain of the Titanic had ordered the helmsman to spin the wheel to avoid a more distant iceberg, all would have been well. But trying to make that kind of decision at the last minute is unlikely to yield positive results.

Signs of Hope

In the past few years, operators have been increasingly looking at streamlining their own OpEx as part of this equation - which is at least part of the answer. And there are a crop of new, **high value mobile data and video services** on the way, not to mention **unified messaging** and a host of **innovative services**. And there has been a proliferation of some really good, innovative new service deployments at service operators recently, as they look to maintain and grow profitability.

That is all encouraging in some respects. But consider this:

Although some operators are offering very unique services and sometimes gain high initial margins, successes before long are going to be copied, and seem to get bundled into the commoditized category before long. If operators continue in the present mode of marketing, the result will be the roll out of attractive new ubiquitously available multimedia services that could change our personal and work lifestyles, but do not result in a profit. And if that happens, there will necessarily be far more consolidation among vendors than is necessary.

Economic downturns and upswings are cyclical. Self-commoditization of services, left unchecked, can be a never-ending downward spiral. Consider the airline industry, for instance, which as a whole has for the last three quarters consistently managed to be an unprofitable business despite offering services that businesses and people need and find compelling.

But with such a long precedent on commoditization of transport having been set, this is going to be a very difficult situation to turn around for existing services. Subscribers have been conditioned by the operators to buy transport based on price. No problem, right? After all, the future of the industry lies in professional services, managed services and applications - and all we really need is to find ways to recover the cost of transport and gain overall acceptable margins.

Hopefully, it *will be* no problem. But ensuring that it does may require that operators get together with hosted service providers, broadcasters, and content providers to find ways to cooperatively commercialize new applications and equitably share in new revenue streams that rely on underlying transport. Without a strong profit motive, service operators are simply not going to scale the transport network dramatically so that someone else can make money off of it.

Remember a few years ago when it was predicted by a major industry expert that transport would one day be given away for free? Transport will never be cost free, but it might be bundled with other services and have a $0 charge next to it on the monthly statement. But for that to happen, there have to be high-margin services being delivered over that transport.

It might sound popular in board rooms to merge applications providers, content providers and service operators to resolve the problem. But taking on that much complexity is not the answer even if regulators were willing to let it happen. Streamlining the organization, gaining unified strategic objectives, merging cultures, and achieving the theoretical synergies of existing mega-mergers that merely span formerly disparate infrastructure vendors has proven difficult enough for many vendors as it is.

In the short-term, internal growth of professional services and managed services have been low hanging fruit in terms of increasing profitability for operators and vendors.

But other types of services are definitely going to play a bigger role in a number of operators' futures - a variety of content and hosted services, including software as a service, will have to be a bigger part of the future. BT for example has very publically related its strategy of becoming a software-driven service company.

But we think a mix of internal growth within moderation, supplemented by a lot of good partnerships, will be an important path for service providers to take.

For any operator, an infusion of marketing personnel from more highly profitable industries might be a welcome addition. Former airline marketing executives need not apply. And maybe the best way to gain marketing savvy to avoid commoditization of new services in future will be for service operators to partner for it. We need to take care not to spread the marketing culture borne out of a regulated environment to the industry's greatest future opportunities.

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