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Beyond cost cutting: How to make money in the data world

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Beyond cost cutting: How to make money in the data world

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Facing pressure from all sides, fixed and mobile operators need to look beyond cost cutting to safeguard and improve their top-line performance.

Fixed and mobile players have one thing in common: both face growing economic pressure from a variety of sources. Trends in consumer behavior, market activity, and governmental regulation could cost them over 15 percent of their revenue by 2015. There was a time when an operator's primary profit preservation strategy could be rooted in customer acquisition or cost reduction. With such heavy penetration and bare-bones costs, operators might benefit by looking beyond merely controlling costs. When exploring opportunities to bolster the top line, it is important that the underlying revenue-eroding trends are fully understood.

Revenue-eroding trends in telecoms

Increasingly savvy customers, growing competitive pressure, faltering new product revenues, and resurgent price-focused regulators have the potential to destroy significant amounts of value for fixed and mobile players alike.

Customer creativity. Telecoms customers are changing their behaviors, replacing high-margin products such as voice with cheaper alternatives like SMS or social network messaging. Some markets are experiencing a major shift away from extended voice conversations to shorter calls augmented by an increased reliance on messaging, which is perceived as less intrusive. Tech-savvy consumers have learned, for example, how to replace making ten calls to organize an outing with either ten text messages or one Facebook status update. As a result, their cost of spreading the news falls from ten calls at 60 US cents each to ten messages at 15 US cents apiece to about 0.01 US cents respectively.

Consumers have learned to trade ten calls at 60 US cents apiece for one Facebook status update that probably costs 0.01 US cents

Competitive pressure. Fixed and mobile pricing continues to decline, since operators are feeling the impact of new entrants that keep pushing the price floor downwards. At the same time, efforts focused on fixed/mobile substitution and integration are leading to more competition as mobile players use their 4G long-term evolution (LTE) networks to attack low-end fixed broadband. Fixed operators with Wi-Fi clouds meanwhile pose a threat to mobile player efforts to raise data prices. Beyond this, both private and business fixed-line customers are replacing legacy data products with lower-cost alternatives in both voice and data.

Popular but less lucrative new products. While data use continues to explode, operators are seeing only limited additional monetization opportunities. Mobile video use, for example, is booming, but operators fail to benefit since most traffic flows over the top (OTT). Even if they share in the associated mobile ads, income remains limited.

Operators are also mostly left out of the mobile apps party. The most popular stores are run by Apple, Google, and Amazon – not by the operators. Sometimes, operators are involved as billing providers – as with ads, this is an attractive business in its own right – but this stream is very small compared with traditional telco revenues. Revenue streams generated in data are associated with substantial infrastructure costs, making the gross margin of data as much as ten times lower than that of traditional voice. As a consequence, operators need to start moving away from ARPU and

subscribers as the main commercial KPIs, since these do not reflect profitability differences.

Regulatory impact on prices. Regulators continue to drive prices down – especially in Europe, where mobile revenues and profit pools are affected by low mobile termination rates and by new international roaming regulations. Based on the "local breakout" structural proposal for roaming put forward in Europe, for instance, customers would be able to use any roaming provider they choose when outside their respective home countries, while keeping their local phone numbers. Additionally, it is expected that Europe will start capping retail data roaming charges over the next few years, reducing revenues from this service.

These trends are driving an overall reduction in fixed and mobile industry profit pools. What's more, several of them are actually causing the overall market pie to shrink. WhatsApp, for example, is rapidly commoditizing the multibillion euro SMS market while generating very small returns of its own. In the most optimistic case, estimates put WhatsApp's annual per-user revenues at EUR 2, compared with traditional SMS subscribers who often spend over EUR 10 a month. This dynamic results in an interesting paradox: while users deeply value their mobile devices and spend ever greater amounts of time every day focused on them, the industry providing this breakthrough value remains unable to capitalize on or monetize it.

Paradoxically, mobile operators don't make much money from the tremendous value they're providing to consumers

Three ways to optimize economics

Fixed and mobile leaders seeking options to turn this situation around have a number of choices. They could, for example, optimize their costs by aggressively pursuing network sharing or integrating their core fixed/mobile elements. While an excellent and often necessary approach, three other ideas go beyond a strict cost focus to protect and enhance an operator's top-line performance.

Rebalance the product and service portfolio. Operators would benefit from making their current product and service portfolios more robust against OTT attacks while securing their legacy revenue streams. A key strategy involves moving away from "metered" products to data bundles and controlled flat-rate voice and SMS plans.

Since flat-rate data plans are largely unfeasible as long-term solutions, operators should explore smarter ways to package offerings, such as bundling data with SMS and even voice. They can also design clear data upselling paths, offering customers attractive ways to move up to larger bundles to circumvent data usage throttling. For SMS and voice plans, operators could create controlled commoditization paths that include flat-rate plans.

Finally, companies can explore new service models, such as allowing multiple subscriber identification modules on one subscription. Operators should also work to increase the perceived value of their data offers. In a number of proprietary surveys, consumers have expressed a strong willingness to pay for data, but monetizing this willingness will require marketers to tailor their data offers more effectively so that they target real customer needs. This tailoring should be done in ways that subscribers understand. For example, while 20 to 30 percent of consumers have indicated a willingness to pay EUR 5 to 10 for a higher quality of service (QoS), operators have struggled to develop products to capture this demand, explicitly communicating the value customers will receive. On the upside, the emergence of LTE will create a disruption that operators can use to reset their pricing structures. LTE offers a far richer set of QoS options, allowing operators to align their portfolios more fully with customer needs. Early signs suggest this approach could become a real pricing game changer.

Value is in the eye of the beholder

After seeing unacceptably low margins from services its customers clearly valued, one mobile operator developed four pricing-related guidelines. The operator was able to close the gap between what customers paid for its services and what these were worth – effectively compelling its customers to rethink value.

Recalibrate the value of data vis-à-vis voice. Recognizing that VoIP was diminishing the perceived value of traditional voice, the operator decided to stop discounting data. As data enables an increasing amount of services, its price should more closely match its value.

Increase the value of low-ARPU customers. The declining value of high-ARPU customers may be inevitable, so why not raise the value of low-ARPU customers? To maintain average value, the operator introduced a connection fee. It also designed bundles specifically for its low-ARPU customers that created and encouraged a subsequent upsell path.

Raise the commitment level of customers. The operator foresaw that its out-of-bundle services (e.g., VoIP, IP messaging, and Wi-Fi) were on a trajectory of declining revenue. Their answer was to move these services into committed bundles. It campaigned to move its high-value customers who used a significant amount of out-of-bundle services to a higher commitment level and introduced regressive pricing for services that remained unbundled.

Capture the value of applications. Believing that a substantial part of the mobile industry might move to applications, the operator decided to stake its claim in this arena. It explored its options to establish its own app store as well as develop country-specific data services and applications.

Under these principles, the operator was able not only to charge what its customers were willing to pay but also to extract greater value from its least lucrative customers.

These routes should be explored on a situation-by-situation basis. Also, given the fast pace of competitive and technology change, they need to be revisited regularly (see text box).

Chase new revenue streams. Operators need to determine the role they want to play in value-added services (VAS). In the last ten years, most operators outside of Korea and Japan have struggled to monetize these types of applications and advanced services. Since companies are now being attacked on their own turf – namely voice and messaging – many are, however, reconsidering their stances on the need to play in the VAS space.

The first VAS strategy, access-only services, is attractive to attackers. This strategy enables users to gain the maximum freedom to use their connections as they please. It means there are no restrictions on, for example, the type of use, speed, or technical setup. Investments are low for this option, which typically appeals to advanced users who generate high ARPU levels and make up a very small share of an attacker's consumer base. Some of these attackers have also started leveraging data access to increase the appeal of smartphones, which are offered with "data inside," similar to a Kindle device. This can be a key differentiator for smartphone OEMs, whose devices are

With telcos being attacked on voice and messaging, many are pursuing value-added services

becoming increasingly commoditized beyond the flagship phones of the leading manufacturers.

A second VAS activity has operators developing their own apps and running their own app stores. In the current multiplatform world, consumers may be reluctant to invest heavily in apps that will be useless if they switch to another phone. By introducing rental models for apps, operators can play an attractive value-adding role for customers. Furthermore, the latest HTML5 advancements make it possible to develop device-independent apps. Key industry players like Facebook are increasingly embracing this concept. The social network has launched its own HTML5 environment, which is giving the entire realm a strong boost. While never meant to be a full replacement for native apps, this can be an interesting route for operators that want to combat the power of the apps ecosystems. In fact, Facebook just added operator billing in the US and selected Asian countries for their HTML5 store, which is generating more momentum for the HTML5 ecosystem.

The third strategy focuses on monetizing the network access control point. One way is based on peering agreements – the voluntary link between different Internet service providers (ISPs) that facilitates traffic exchange between the customers of each network. Such agreements are being challenged due to traffic imbalances from content-heavy applications such as video – a hurdle that will likely arise in the mobile space as well. Similar recent confrontations increase the probability that more ISPs will charge distribution networks premium prices for access to their "last mile." Also, regulators in some markets appear willing to give operators room to monetize this privileged access to their customers, while others do not.

Explore partnerships with OTT players. Typically, operators can generate value for OTT players by providing them with a go-to-market channel, billing capabilities, and the ability to bundle data with their service. Two service categories show especially compelling reasons for operators to partner with OTT players.

Voice- and address-book-related apps make up the first category. A number of operators are investing in applications that add value to voice service, such as high-quality voice and Rich Communication Suite (RCS), which offers the ability to personalize voicemails and route calls. This is a natural fit for operators because these platforms make use of the subscriber's address book to launch new OTT services. Controlling the address book is the key to monetizing certain services. Apple's iMessage, for example, enables users to send unlimited text messages via Wi-Fi or mobile networks to other iPad, iPhone, or iPod Touch devices without this being transparent to users.

The second category is data-hungry services such as music streaming and video. Operators can bundle the service with high QoS data to provide a superior customer experience. They do, however, need to ensure that such bundling does not conflict with the emerging "net neutrality" regulations. While the European Commission is still shaping the rules, some regulators (e.g., in the Netherlands) are already passing "net neutrality" regulations that limit operator flexibility in these areas.

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Fixed and mobile players face challenges that are unlike anything most have ever experienced. To do more than just survive in this environment, operators need to look beyond cost-cutting opportunities and seek out new revenue-boosting ideas.

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