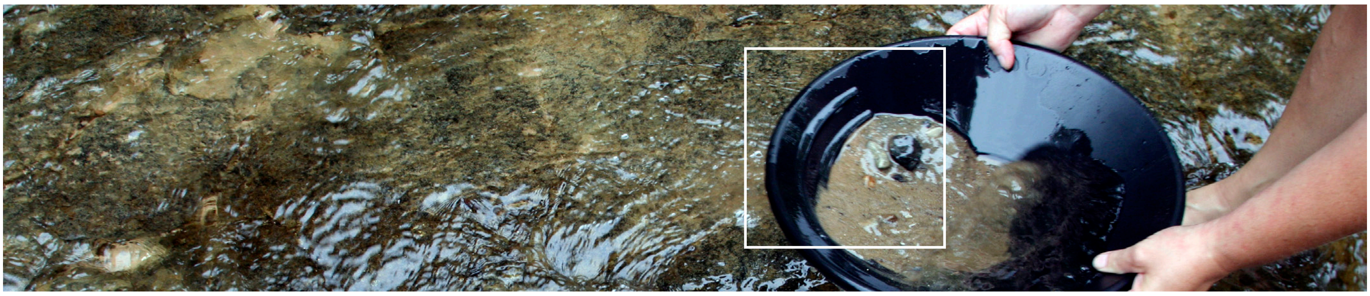
Arthur D Little

Making Value Management Work, at Last

How Telecom Operators Can Extract More Value from Their Customer Goldmine



The telecoms industry has reached a turning point and is shifting from a period of exponential growth towards optimization. While many operators have implemented some form of Value Management, they have focused too closely on short-term results to capture the full benefits of these programs. Operators now need to implement new techniques and transform their business models around customer value. By doing so, they can generate two to five points of incremental margin and create long-term competitive advantage.

Remember the California Gold Rush

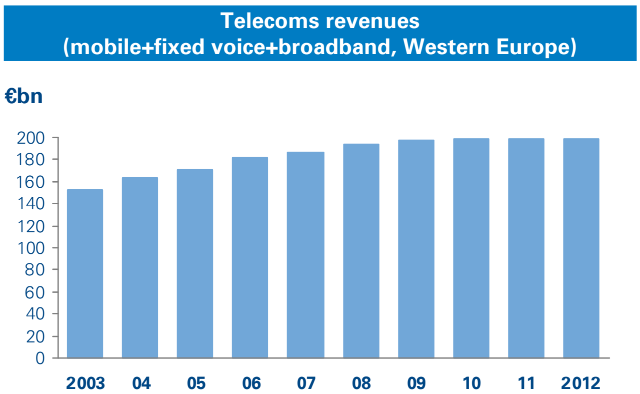
The Gold Rush began in 1848, after James Marshall discovered gold at Sutter's Mill, California. News spread like wild fire and half a million people from around the world migrated to California in search of instant wealth.

By 1855, the big rush was over, yet it had generated substantial changes. San Francisco became a boom town, and other towns and infrastructures were built in California. The Gold Rush also stimulated economies around the world as the gold influx drove value creation, encouraged new investment and accelerated job creation.

The Gold Rush illustrates how, after the initial boom, more challenging conditions drove mining organizations to develop and implement new ways to extract gold in places that were less easily reached. Initially, individual miners had retrieved gold from rivers with simple manual techniques, such as panning. However, once the readily accessible precious metal had been exploited, more sophisticated methods were developed that allowed larger mining organizations to extract gold worth billions of dollars.

To some extent we believe that the telecoms industry is in the same situation today. Telecoms is rapidly becoming a mature industry with mobile reaching saturation, broadband hardly compensating for wireline decline and adjacent services generating real but limited gains to operators' overall cash flows (see figure 1).

Figure 1. Telecoms becomes a no-growth industry



Source: Yankee Group, BofA ML, Arthur D. Little, ESS Analysis

The challenge for operators: extract more value from the gold mine

The industry's current focus is largely on generating cash flow, with operators engaged in cost-cutting programs and capex management (acquisition costs, network sharing, outsourcing, etc). As customer needs shift more rapidly and new technologies emerge, this strategy is unlikely to be sustainable in an intensely competitive marketplace.

In fact telecom players are faced with multiple and often competing business decisions – they need to keep investing in new technology and upgrading their infrastructure to compete while top-line revenue is being cannibalized as a result of aggressive bundling and pricing.

Other industries, such as retail, consumer goods, and consumer credit, have reached similar turning points and have made major strides in using Value Management to strengthen their customer marketing, loyalty and relationship management programs.

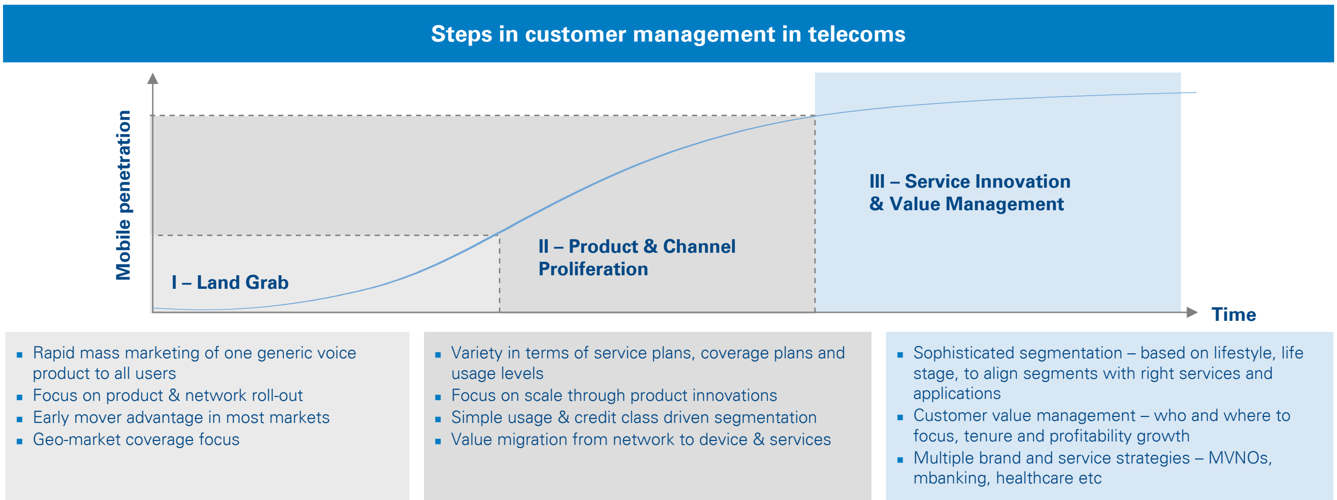
Similarly, it is now imperative that telecom operators adopt a new mindset and implement highly proactive and sophisticated Value Management techniques. Telecom operators need to embrace the inevitable transition fully and move rapidly to the next phase of the telecom rush by extracting the full value inherent in their most valuable asset – their customer base (see figure 2).

1. De-average, de-average, de-average

Our experience shows that operators have significant amounts of information at their disposal but need to differentiate between what are customer characteristics, what can drive customer behaviour and what is within the operator's influence.

To do that, operators need to build a fact base of customer behaviours that will allow levers for value improvement to be identified, tested and validated. This fact base must be constructed at a de-averaged level i.e. by customer segment, by value, by offer etc.

Figure 2. Entering the era of Value Management



Source: Arthur D. Little, ESS Analysis

Making Value Management work

While numerous operators have already implemented Value Management techniques in some form, only a few have maintained the management and operational discipline required to achieve profound and sustainable results.

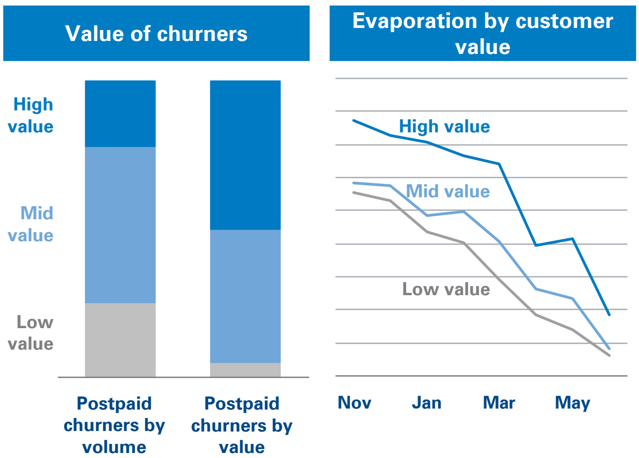
Our experience shows that Value Management projects, when applied systematically, deliver highly tangible and transparent benefits. Our case studies show that such projects can easily generate two to five percentage points of incremental EBITDA margin.

The trouble is that many players have either rushed to achieve short-term objectives ("I need to reduce churn in the next quarter by x%", "I need to cut my bad debt by y% urgently" etc) or have tried to achieve too much too fast.

In order to realise the full benefits of Value Management we advise operators to focus on five key success factors.

Even though this might sound obvious, we continue to observe numerous cases where operators do not have a true 'de-averaged view' of their business. Only by addressing the individual levels will operators succeed in influencing consumption and creating incremental value (see figure 3).

Figure 3. De-averaging churn patterns



Source: Arthur D. Little case experience, ESS Analysis

2. Address underlying causal drivers

One of the common mistakes made is that instead of analyzing the strategic issues, operators frame issues in terms of average past measures such as churn rates, subscriber acquisition and retention costs, or bad debt.

There will always be a distribution of values (from low to high) on all these performance metrics and just looking at the observed average value without understanding the underlying causal events will not provide the roadmap for successful transformational improvements.

One key success factor is to move away from static observed performance metrics to causal performance drivers. For example instead of just measuring churn rate (a historical metric) it is more helpful for operators to also design and adopt a churn propensity index score (forward-looking metric) that can be managed to anticipate churn effectively.

3. Anticipate and exploit dynamic change

Another common pitfall in operator marketing analytics is the ongoing reliance on traditional, static analytical methodologies even when customers are demonstrating significant changes in behaviour.

For example, we continue to see many operators clinging to traditional cluster-based segmentation schemes (e.g. "technophiles", "family talkers" or "value minders") that do not allow them to market new value-creation opportunities generated by dynamic changes across the customer base.

To stimulate new sources of value creation we recommend adopting advanced analytical techniques that anticipate and predict changes in customer behaviour. Such techniques also make it easier to evaluate marketing strategies that impact the "convergence" of multiple customer decision points – device selection, voice/data usage dynamics, coverage requirements and value-added services.

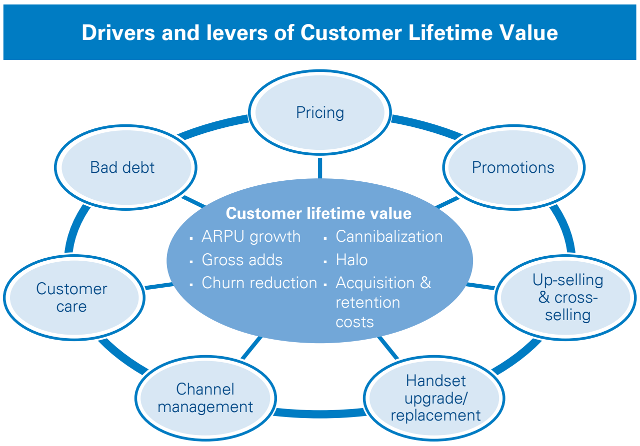
4. Look broadly at customer lifetime value

We have seen many operators addressing one "symptom" at a time, hence over-simplifying the actual dynamics of customer behaviour.

Consider the case of an operator who cuts prices for certain offers to reduce churn and only considers the existing price-elastic segments. Analysis may have shown benefits from churn reduction at constant ARPU, but the operator may have overlooked the negative re-pricing effect from customers from other segments who would drop their current offer to benefit from the new one.

It is therefore critical to recognize the interplay of available customer levers i.e. from a customer lifetime value perspective, as halo effects may be generated (see figure 4).

Figure 4. Main levers to increase customer value



Source: Arthur D. Little, ESS Analysis

Case study A

Situation: With the onset of the recent economic recession this large mobile operator was experiencing a dramatic increase in churn. Multiple internal initiatives had been initiated but had failed to address this growing problem.

How we helped: By using Value Management techniques, we helped our client modify the existing process of focusing on past metrics and focus instead on forward-looking propensities. We identified the key drivers of churn, isolated the subgroups with higher churn propensity (top 10% of the customers with highest churn propensity scores represented approximately 70% of churn cases) and re-designed products and services accordingly.

Results: Our client managed to decrease churn by 20% and reduced bad debt and credit adjustments, hence generating over €180m incremental annual benefits.

Case study B

Situation: A large telecom operator was experiencing higher customer acquisition costs than its peers. This problem was further compounded by the fact that the higher customer acquisition cost did not correlate with higher customer value.

How we helped: By using Value Management techniques, we helped our client to identify the impact of devices on customers' usage, service adoption and satisfaction. We re-aligned the handset portfolio and procurement strategy accordingly and identified other opportutunities for generating incremental revenue as well.

Results: Our client managed to reduce device obsolescence and customer acquisition costs by a total of €100m while at the same time increasing ARPU by nearly 3.5% at constant acquisition costs for selected subgroups of customers.

5. Transform the organization and business model around customer value

Not only does Value Management require shifting to new techniques; it also demands changes to the organization, metrics and processes to produce an effective response to the dynamics of value segmentation. All functions should feel the impact: marketing, distribution, finance and network/IT.

Importantly operators need to avoid the temptation of accepting short-term outcomes as their objective. Instead management teams must establish Value Management as a core tenet of their business and operating model.

This is by no means an easy or quick transformation but we believe the key is to follow a phased and disciplined transformation approach guided by proven Value Management metrics.

Conclusion

Now that strong market growth has vanished, only those operators that focus more on extracting additional value from their customer bases and less on acquiring new customers will achieve continuous improvements in the bottom-line of their core business.

This change in focus will not only generate quick and tangible bottom-line benefits (i.e. two to five percentage points of incremental EBITDA margin) but it will also create the foundation for sustainable competitive differentiation over the longer term.

Old habits of a young industry, where most managers have been raised in a climate of double-digit growth, must be replaced by new habits of managing in a slow-growth environment. This is neither an easy task nor a quick transformation but other industries have succeeded in making this transition. Consider credit cards, airlines, hotel chains, consumer goods… and of course… the gold mining industry!

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Arthur D. Little

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