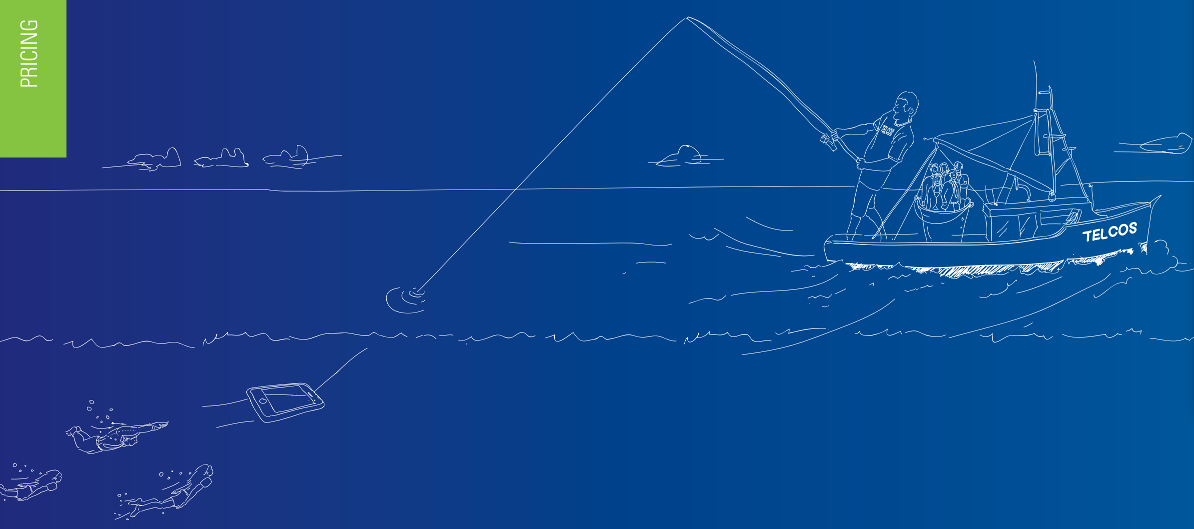

▲ **Robert Browne,** Partner, Pricing expert

THE PRICE ISN'T RIGHT

by **SIMONE DA COSTA**

Associate Director, Telecommunications

Price offers aimed at motivating instinctive responses from customers – such as 'free phone for £30 per month – have become prevalent amongst telecoms operators. These tactics are common in markets where growth requires winning customers from the competition and companies should focus on reducing costs to offer the lowest prices, as Robert Browne explains in the video.

In reality, if this approach becomes dominant in an industry, price wars are inevitable and revenue and margin will be surrendered, and permanently. This happens because, in the eyes of the customer, the value equation (the relationship of benefits to price) is re-set when prices are lowered and in order for prices to rise again in the future, additional benefit (value) must be added so the equation makes sense to the buyer again.

Getting the value equation right is even more important in the telecoms industry, where network operators' earning potential is being squeezed by capital investment requirements, regulatory obligations and over-the-top service providers eroding revenue.

We believe telecom operators need to move away from tactical pricing and take a much more strategic approach to pricing based on a thorough understanding of customer value. This will require a significant improvement in pricing capabilities for most operators from where they are today.

Understanding the customer lifecycle

The customer lifecycle in the telecoms market is much longer than in the general retail trade, particularly for contracted customers. As a result, pricing is more complex and needs to be considered very differently. The question is not simply what price will the market bear for this product or offer today, but how profitable will this customer be during the contract period and beyond. The focus of most operators today is on acquiring new customers and this typically takes the form of offering discounted handsets, special offer tariffs and other inducements. We believe, however, this focus is too narrow: pricing needs to be considered through the lens of acquiring new customers, and maximising revenue per customer throughout their contract period and extending the contract as long as possible.

Creating demand profiles

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Clearly, different customers and different groups of customers have different preferences and a lesser or greater responsiveness to changes in price. For example, having the very latest device or a contract with a low initial set-up cost are the examples of requirements that indicate a customer will be less price sensitive over the lifecycle. Once the customer segmentation has been identified, there is significant value in building a demand profile for each which can then be used to inform the company strategy of how best to price for each of these segments. These segments need to be granular enough to ensure they are distinct but at the same time operational and big enough to be worth pursuing.

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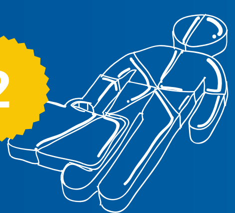

Once it is understood what customers value, bundles or a la carte offers, for example, can be tailored more effectively and it is possible to identify where prices can be maintained or increased – where demand is less price elastic. Similarly, revenue can be increased by reducing prices and driving volume for products and services where demand is more price elastic.

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However, it is important to recognise there are limitations in one's own data. It's therefore important to conduct customer insight work to understand what customers would be prepared to buy which are not currently being offered. It is also important to gather insights on why customers choose the products and services of competitors.

Pricing analytics

Telecoms operators can benefit from using modelling and statistical techniques to help shape a detailed understanding of how value is currently being created and by which customers, in order to answer forward-looking questions such as "which new customers are more likely to be highly sensitive to future price increases, which are likely to purchase add-on products and services during the lifetime of the contract and which are likely to extend their contract?" In addition, regression analysis can be used to get an insight into how profitable a customer is likely to be based on how closely their characteristics are aligned to customer profiles created using data from existing customers, and this can help inform decisions about how aggressively they should compete to acquire and retain customers with a certain profile. This approach is similar to how the insurance industry works. In simple terms, a potential new car insurance customer will be profiled to assess how likely it is that they will make a claim and the likely cost of such a claim. The insurance premium is then set at a point at which the customer will deliver positive value to the insurer over their lifecycle.

Meaningful sample groups can also be, and have been, created by operators using 'live' samples of existing customers. Proposed pricing changes can be applied and tested in real-time to a small sample of customers, and responses, for example in terms of price elasticity, can be analysed before they are offered to the market as a whole.

PRICING

Effective pricing capabilities

Taking a more strategic approach to pricing will only be possible if there are appropriate capabilities in the organisation and disciplined and consistent pricing execution. Many telecoms companies have hundreds, if not thousands, of legacy tariffs that exist and need to be reviewed and controlled on a regular basis. For this to happen and to benefit from the pricing analytics discussed above, telecom companies need to get smarter on how they use their data. Transaction and usage data, customer insight, and understanding competitor benchmarks are some of the data points that need to be readily available to inform better pricing decisions.

Clear pricing goals that emphasise customer value and de-emphasize costs, underpinned by senior management commitment, are key. A dedicated pricing team that "owns" pricing and works hand-in-hand with the sales, products, marketing, and finance teams can increase the effectiveness of this process. If the sales organisation is aligned to the organisation's pricing policy and can negotiate based on value then profitable growth is possible. Given the availability of data in the industry, making pricing decisions based on intuition or 'gut feel' is simply not good enough. Over time, pricing capabilities will become a clear competitive standard among telecom operators as it has for retailers and airlines.

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The benefits

Once a telecoms operator has gained a comprehensive understanding of the pricing environment it operates in, and developed a clear and practical pricing strategy, the benefits can reach across the whole business. First, more targeted products and services can be offered, with a far greater confidence that customers will respond favourably. Second, revenue growth will also be more sustainable - it may be possible to outsmart customers once to pay more than what they need, but in the longer term, loyalty and customers will be lost. However, finally, telecoms operators must exercise caution and avoid the temptation to use pricing analytics to capitalise on the inertia of the proportion of customers who will tolerate excessive pricing rather than switch to a competitor. Not only is this likely to incur the annoyance of regulators and cause reputational damage to the sector, as it has done in the financial services and utilities sectors, but customers will only pay for value relative to competitors and so higher prices must be accompanied with additional benefits.

Simone Da Costa
Associate Director, Telecommunications
Tel:+44 (0) 20 73114495
simone.dacosta@kpmg.co.uk

in connect with Simone on **Linkedin**