



# The future of telco

## Adapt to thrive

January 2016



## The digital clock is ticking for the traditional telco.

Alex Holt explores how the traditional telco will struggle to survive beyond the next decade ... unless it embraces the opportunity presented by digital.

To do that it must first take note of the 'Unicorns': the private – often digital – businesses valued at more than \$1 billion, who are known for their agility, customer focus, great value and being cool. Traditional telcos cannot simply duplicate the DNA of the Unicorn and transplant it into their own businesses. But by mimicking the best of the Unicorns while still playing to their established strengths, they can yet become the digital telco of the future.

In one sense, the traditional telco's position has never been more secure, despite upheaval across the industry. Our society and economy demands ever faster, more reliable networks, meaning the telco's infrastructure arm is more important than ever. Recent KPMG analysis estimates that planned ultrafast broadband investments could add up to £30 billion to UK GDP over the next ten years<sup>(1)</sup>. For those willing to write big cheques, there is a significant long-term investment opportunity to build speed and capacity into the network.

But it is in retail markets where the traditional telco is more fragile, and undoubtedly this is where the next battle for the market will be fought. If a successful traditional telco is to become a successful digital telco, it must make changes to its retail operations... and quickly.

Their first challenge must be to shift the prevailing business mindset from one focused on engineering to one focused on the customer. There remains a legacy culture in some telcos in which the customer is a secondary consideration to engineering.

The Unicorns play by different rules. They identify a real customer need, quickly build a product, create a significant user base and then figure out how best to monetise it.

Although reports of the telco's death have been greatly exaggerated, they are seeing a gradual erosion in performance. Cost-cutting programmes have masked the decline for a while, but the stark reality is that growth in many of these businesses is stagnant. Perhaps this hard truth will serve a purpose: some of these organisations need to wake up to and realise they require a fundamental shift in culture.

This urgent need to focus on customers should lead to other important changes that will help them transition from the Old World to a New Digital World.

A successful digital telco will use data and analytics to inform business decisions. Data will provide greater insight into what the customer wants, allowing the telco to service the customer the way they want and offer products and services they

(1) DELIVERING BRITAIN'S DIGITAL FUTURE: An Economic Impact Study

actually need. By improving service and being relevant to the customer, a telco will increase the number of services it sells, which in turn will increase retention. The digital telco will also be a ruthless commercial operator, adopting an approach akin to that of a Private Equity house: relentless at taking out unnecessary cost and making shrewd investments in areas of growth.

## Telco CEOs must demand and conquer the engineering mentality.

By digitising the customer journey from end to end, the cost to serve is vastly reduced by automating much of it in a way that delights, rather than infuriates. Telco customers often have relatively simple requirements. In these instances, the digital telco would see the need for human intervention as a failure of process design.

The contrasting sizes of the old and new telco is where the differences in model are most striking. An outfit like WhatsApp – with c.500 million users, instant messaging and video customers – was run by less than 100 employees when acquired by Facebook.

A traditional telco has many multiples of that workforce in its finance department alone. Some might say that it's an unfair comparison, but it was sold for some US\$22 billion – more than EE, the largest mobile carrier in the UK.

There is a lot of hype around the battle between the Unicorns and the 'Dinosaurs'. It is high time that the traditional telcos started to realise the benefits of becoming a digital telco. If they can become truly customer-led, properly deploy data and analytics and adopt a commercial philosophy that a PE house would be proud of, the results will be clear:

- Top line growth
- Reduced cost base
- Higher retention
- Increased number of services sold

Investors are clearly keen to pour money into this sector, but increasingly they are asking questions about who the winners and losers will be. It is time for traditional telcos to demonstrate they are moving towards the digital future by adopting a more customer-centric approach. There is still time, but the digital clock is ticking...

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## Tomorrow's telcos will build new businesses out of their data.

Against a backdrop of falling prices, increased competition and tough regulation, unearthing new revenue streams is critical to the survival of today's telco. **Ian West** explores how one of the most successful ways to do this will be using their data to build new businesses, particularly targeting the enterprise market.

To date, traditional broadband and mobile providers have used roughly the same strategies to gain customers: cut prices and offer innovative technology devices and more latterly, quad-play and premium content bundles.

As profit margins inevitably shrink, I imagine the defining characteristic of a successful telco will be the ability to do something fundamentally different to the existing core business. In all likelihood this will involve leveraging the data held by telcos.

Today's telcos collect enormous volumes of consumer data: from the location of the individual, where they are travelling and how fast, content they are consuming, who they are interacting with, to what they are buying.

Although this thinking isn't new, mining data for new consumer revenue streams has not yielded much success yet. This is partly due to increased regulatory pressure (such as the Data Retention and Investigatory Powers Act 2014), consumer privacy concerns and other market competitors. Indeed, recently we heard Apple's Tim Cook criticise Google and Facebook – both modern telcos in their own right – for 'tricking' people into giving up their data<sup>1</sup>.

This is why the enterprise market represents much more fertile ground. I foresee successful telcos bundling together location or movement data and selling this to governments who want to predict infrastructure demand on a subscription basis.

For major rail or road infrastructure projects, business cases have historically been made through 'armies of people' capturing passenger journey information on clipboards. Mobile data can build a far more accurate picture of a customer's movements for a fraction of the cost. The commercial opportunity for telcos is even greater in emerging markets, where infrastructure is less developed.

In more mature markets, infrastructure planners can use mobile data for more everyday tasks such as managing motorway traffic and optimising public transport networks. By identifying patterns in the data, transport companies and services can start to pre-empt demand or potential issues and price in real time.



Although we have already seen car insurers tracking where customers are going and how fast they are driving to determine risk, the possibilities are endless for telcos. They could also bundle holiday, car and house insurance together to provide a 'pay as you go' option or lifestyle insurance on the basis of your exact location. For example, if you are on holiday then you may require not only travel insurance but also a higher level of house insurance, and potentially less car insurance.

## The commercial opportunity for telcos is even greater in emerging markets

Telcos may opt for the safety of partnering with an insurer rather than trying to build an infrastructure division from scratch.

However, the broader lesson is that telcos have an incredible opportunity – one they are only just starting to exploit.

Please contact your lead partner from KPMG to discuss further. Alternatively speak to our UK Head of Telecoms, Alex Holt:

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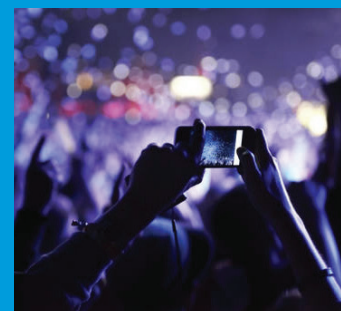
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## Incumbent telcos must go through their next mutation.

Alex Holt explores how the telecommunications industry has witnessed the rapid rise of new digital players and the decline of digital incumbents at an unprecedented rate in the last ten years. The whole market must keep changing, and for incumbent telcos the time to do that is now.

Today, we spend more time using third-party services such as Twitter, Instagram and WhatsApp than we do on the branded services provided by telcos. However, these multi-billion dollar businesses would not exist were it not for the likes of BT, Vodafone or Telefonica. Their infrastructure sits behind every tweet, photo and internet call. Yet their relevance – in the eyes of the consumer at least – seems to have declined as they focus more on apps and devices, rather than the service provider.

So how can traditional telcos remain relevant? Innovation has lowered barriers to entry, allowing disruptors to destroy old business models. For instance, about a third of all international phone-call traffic is now reported to go through Skype<sup>1</sup>, but Skype hasn't taken anywhere near a similar proportion of global revenues. New entrants are shrinking the total pool while still turning a profit.

So incumbent telcos have a fundamental choice to make: either redefine themselves as digital communications companies and take on digital disruptors, or specialise as pure infrastructure providers.

The first option would see incumbent telcos redefining themselves as truly digital telcos – combining their traditional network services while also delivering over-the-top (OTT) services across the internet. Some are trying to do this but without a huge impact thus far.

The challenge is that they typically lack the young, entrepreneurial, fast-paced culture of a Facebook, Twitter or Google. As a result, operators are looking to team up with newer entrants to remain relevant.

Given the threat, it would be easy to forget that the traditional telco is actually more important than ever to our society and economy. The infrastructure they provide underpins more and more of our working and personal lives. So the second route is to become a pure infrastructure provider, concluding that others are better placed to develop OTT services and chase retail consumers. This is the ultimate doomsday scenario – the 'dumb pipe' prophecy coming true.

But the truth is that this is a real possibility: if telcos don't eliminate the engineering-led culture and adopt a customer-led approach, they will struggle to be relevant to a new digital society.

Source: 1) <http://italphaville.ft.com/2015/03/17/2121994/>

The much-hyped Internet of Everything (IoE) represents a great opportunity for telcos to get on the front foot and collaborate with manufacturers who don't understand the power of data communications. We are starting to see this in some devices such as a TIMEX watch that has in-built global connectivity provided by a large US carrier. Collaboration with automotive manufacturers promises further opportunities as the development of connected and autonomous cars continues apace.

## Embrace change and harness the unstoppable force that is digital

Telcos are already proving that infrastructure no longer has to be the defining characteristic of a successful telco, with many successful telco businesses choosing different routes to market. Regardless of their choice, they will need to find new ways to create value for themselves as digital innovations increasingly circumvent the traditional routes to market.

The digital revolution has unleashed six disruptive forces that are reshaping the telecoms sector: mobile, analytics, cyber security, social, gamification and the Cloud. Telcos with a 'glass half full' mentality will embrace change and harness these unstoppable forces for the benefit of customers. Those who see their glass as half empty because of the digital 'threat' are in danger of allowing the 'dumb pipe' prophecy to come true.

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## Old and new: When telco cultures collide.

All telcos are striving to innovate in the digital world, but many of the sector's more traditional players are struggling to make the leap.

**Alex Holt** explores how new market entrants innovate quickly, using new business models to provide global services that traditional companies can scarcely comprehend.

If traditional players are to compete with new entrants, they will have to overhaul not only their technology but also their culture.

One that injects agility and innovation with new talent while putting many sacred cows to pasture.

Traditional telcos have developed over decades – employing tens if not hundreds of thousands of people who are responsible for capital-intensive infrastructure projects and have been shaped by widely differing national regulations.

Conversely, the new digitally focused entrants such as Twitter, Snapchat and WhatsApp operate on a significantly leaner basis, despite having much larger customer bases. Benefiting from less regulation and cultures based on innovation and agility, they have quickly taken hold of consumer trends and muscled in on the communications industry.

Traditional telcos will have to shake up their culture to remain relevant to consumers. They must create an environment where innovation drives strategy, not the demands of regulators and the time-frames of large engineering projects. There are several things they could do:

1. Bring in new talent at all levels to drive a different culture that is willing to innovate and work in new ways. The speed of change in this industry also means it is not practicable to develop the necessary skills in-house.
2. The board need to drive and support cultural change with an emphasis on innovation.
3. Many companies have created offices in the heart of tech areas such as Silicon Valley or Shoreditch, in an effort to show that they are serious, but precious few have actually moved any core business functions to those offices. Change cannot be a temporary project – there needs to be visible commitment.
4. An acceptance of failure is contrary to the very DNA of so many organisations but without failure, how can we innovate? For every Twitter, there have been 1,000 failures. The key is to identify failing projects and kill them quickly.
5. Put sacred cows out to pasture. Many new businesses have been created around new business models growing on a global scale, with few, if any, barriers to entry. New services may need to be offered to anyone, not just their own 'traditional' customers. To ignore the shared economy would be short-sighted.

Of course there will be things that will always make this an uneven playing field; with lighter regulation enjoyed by non-traditional telcos and their vastly smaller cost base, they may always have the edge where innovation and agility are concerned. However, the traditional telcos' ownership of core infrastructure will always give them an advantage. They need to understand how to use it.

## I believe many telcos will increasingly require a cultural shake-up to adapt to sector change

Teaming up with these new entrants is the most likely way to succeed, at least in the short term. It is not without its pitfalls of course. Aligning disparate cultures and ability to execute change are not challenges for the faint-hearted. However, the opportunity to build the best services and to access new markets should be enough to make the journey to becoming a Digital Telco worthwhile. The alternative is not at all palatable.

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