Exclusive Telco CEO & Private Equity Event

On May 15th, 2017, Arthur D. Little hosted its seventh annual exclusive Telco CEO & Private Equity Event, with an impressive attendance of CEOs and shareholders from telecom operators, investors and leading banks.

The topic of this year’s event was “the strategic choices operators face and how they can leverage the impact of digitization”. Arthur D. Little presented how operators can best configure for value in their commercial approaches, production models and asset compositions.

The importance of these topics for players in telecommunications, information technology and media attracted over 60 top executives and shareholders of leading mobile, integrated and infrastructure operators; software and equipment vendors; banks; and private equity and venture funds, spanning 18 countries from across the world.

The event began with a welcome by Karim Taga, Global TIME Practice Leader and Managing Partner of Arthur D. Little Austria. Following was a presentation on the key observations and future strategic choices by Bela Virag, Partner at Arthur D. Little Austria and lead author of this year’s flagship report. The event finished with a Q&A session, during which the topics raised a lively discussion about the implications of the findings on the future development of telecom operators.

Key insights shared

- We expect that telcos will master the “ARPU x volume” battle moving forward, which will amount to approximately +1% CAGR (in Europe) over the next five years, stabilizing top-line growth.

- B2B2x is gaining importance – it represents a new segment and an untapped opportunity for telcos, which can be captured by leveraging core assets and capabilities and understanding what is needed to help companies digitize.

- New production models begin to emerge – a tailored transformational journey will be key to drive improved customer experience, lower production costs and more innovative/faster time to market.

- Operators will need to review how they manage their diverse portfolios of assets to deal with a potentially significant impact on balance sheets due to a shift from depreciation to opex.

- We expect the markets to recognize that, given a change from the traditional approach of asset management, vastly different types of operators will offer different risk profiles and abilities to scale.

Volume-driven growth in core European telcos is on the horizon

The “ARPU x volume” equation remains a key characteristic of the telecom services market. Declines in ARPU are anticipated across nearly all market segments, coupled with volume increases. We forecast that telcos will win the “price x volume” battle. Mobile and fixed broadband services will act as key growth drivers and offset declining segments such as fixed telephony. This is part of a transition from having voice segments as the main revenue driver to becoming a complementary service in converged bundles. Voice markets will become less relevant as the revenue share of converged services grows stand-alone segments and revenue becomes too complex to be attributed to the voice market.
The volume-driven growth is, however, limited, with an estimated 1% CAGR over the next five years (in the geographic perimeter considered in the report modeling). Seeking further growth, some operators are expected to focus on new market opportunities outside their core segments and reconfigure their businesses in order to address the increased pressure on various financial margins.

B2B2x: Will operators finally take advantage of the digitization of the industry?

B2B2x is a new segment seen as an extension in new markets, in parallel with the existing segments of B2B, B2C and wholesale. It is developing to capture the business opportunity of operating customers' digital solutions. B2B2x differs from the other segments in that services become part of the client’s value chain. It differs from the Internet of Things (IoT) in that it does not include B2C, but does involve services delivered by people.

We expect this segment to reach USD 276bn in size – or 8% of global ICT spending – by 2020 and, as such, it should be one of the fastest-growing fields for telcos to focus on. By leveraging their assets, telecom operators can carve out a space in the segment and address a much larger share of the “digitization of the industry” mega-trend than they have historically.

Doing this requires a thorough understanding of what is needed to help companies digitize. We expect that some operators will actively address this new segment in an attempt to become part of their customers’ value chains, while others may choose not to participate. The main perceived drawbacks are around possibilities that the company is not ready yet, the opportunity is too small, or IT providers are better positioned, deterring the telco’s entry. Industrial digitization is already in motion, and there is a material opportunity in providing and operating digital services for B2B clients. Telcos can, as well as or better than IT companies, operate technical assets on a reliable, low-cost basis.

In order to capture this new opportunity, telecom operators need to work towards proactively engineering and jointly operating business models for their customers, adopting a perspective of value co-creation. Telcos need to amend the design, sale and operation of offerings, as well as increase the agility and openness of their internal systems and processes so they can produce repeatable and scalable results from the B2B2x segment.

Changing production models: Why and how?

Three factors are driving new production models:

- An improved customer experience,
- Lower production costs, and
- More innovation/faster time to market

Eventually network resources will become elastic, transparent and accessible – moving far away from today’s often slow, cumbersome and inefficient architectures. We will see web-like collaboration between companies emerge – even in the network and Operations Support System / Business Support System (OSS/BSS) domain. We will also see web-like competition emerge. Cross-border service competition will arise and international expansion will be accelerated. We expect groups with multinational footprints to be able to leverage group-wide scale effects and eventually achieve lower costs. Beyond this, we expect some of them to become suppliers to off-footprint operators.

Transformation programs must be tailored to achieve the strategic goal of the operator initiating the move. Four key take-aways emerge from our analysis:

- There is no “one-size-fits-all” transformation program available, at least at a feasible price. As a consequence, telcos need to evaluate and set their goals and prioritize their choices.
- Customer experience strategies are geared towards enabling delivery of the demanded solutions, which still may lack the technology or an attractive business case.
Cost optimization from business-model abstraction is enabled as hardware, software and related processes are automated and centralized, while divestment optimizes asset structure.

Operators must make production models more accessible and programmable to enable swift and efficient innovation, beating competitors to market with a differentiating offering. Operators have struggled to monetize the growth of data traffic. More importantly, though, many operators have recognized that they need to redesign their production models to meet the continued demand for bandwidth, agility, accessibility and efficiency increases.

A new art – managing assets: Why owning everything may not be optimal

Traditionally, telcos owned and operated their infrastructure for both fixed and mobile telecommunication services. They obtained a unique strategic advantage by owning infrastructure that was wider in geographical reach and better in technology than that of competitors. The strategic advantage of owning infrastructure needs recalibration in importance compared to the past.

Diverse asset groupings, such as data centers, towers and legacy networks, among others, require differing managerial approaches and strategic objectives. Operators will need to consider establishing dedicated approaches that suit each asset class. Certain assets, such as fiber and small cells, will likely work in asset-sharing models. As many copper-network owners embark on fiber-upgrade journeys, they will have to balance the need for fiber sharing with their legacy roadmaps. This is in stark contrast to cable network operators, which, given their technical nature, can follow “upgrade with demand” strategies. Clearly, this will have a significant impact on balance sheets: a shift from depreciation to opex makes EBITDA levels less comparable.

However, the most dramatic impact will stem from the vastly different types of operators that spring into existence: we will have traditional players competing with asset-light players following rigorous cost-cutting approaches while operating on simple, customer-centric models. Beyond that, we will see international operators expanding their footprints based on equally available infrastructure assets.

Quantifying the impact

We expect the markets to recognize that these vastly different types of operators offer very different risk profiles and abilities to scale. Operators can differentiate their plays by: becoming truly global players; partnering with capable players that fully embrace the new segments and customer needs; remaining strong and highly efficient in their domestic markets; becoming asset-heavy or -light operators; or becoming pure asset-holding and operating players. All of these possible paths have one thing in common: they anticipate the arrival of the next wave of efficiency increases – this time on a much more global scale.

We expect to see an increase in the importance of non-tangible assets in the sense of capabilities: e.g., the “degree of openness” of an operator to third parties, the “market-oriented approach to assets” and the ability to “take design responsibility for the software that runs their factories” will gain weight when assessing operators.

Focus areas during the Q&A discussion

The presentation sparked a lively discussion, as guests were eager to elaborate the strategic choices available and the implications for value creation within the industry.

Many of the points raised revolved around the role telecom operators will play, with the many angles of that question:
Should operators be as they are today, or transform into asset-light and asset-heavy parts? What role will the production platform play? It became clear that changing the current set-up will raise a number of subsequent questions, e.g. how to manage the transition, what ownership and governance models to adopt and how differentiation from competitors can be achieved.

The B2B2x opportunity also raised interest. The main issues discussed were related to telcos’ ability to build up capabilities to partner and to open their production platforms. Overall, there seemed to be a consensus on the need for clearer evaluation of the necessary steps in terms of investments, acquisitions, and other means of capability building to engage in the B2B2x opportunity.

One of the final topics discussed related to the management of such diverse operators. Will EBITDA or EBITDA margins still be as relevant? It seems that management and investors alike will need to refocus on EBIT and FCF as the leading KPIs by which operators will be managed. As some operators will own infrastructure while others share or buy access to it, the EBITDA performance may vary greatly.

Contacts

Ines Matzelle
Austria
matzelle.ines@adlittle.com

Arthur D. Little

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