

Telecoms & Media executive breakfast event

Launch of annual Arthur D. Little flagship Telecom & Media study in London



On March 31, 2017, Arthur D. Little held in London the first of a series of launch events of the latest edition of its annual Telecoms & Media flagship report with an unprecedented attendance of global senior industry executives and key investors, including more than ten leading UK operators, multiple web-majors and OTTs, infrastructure companies, banks, several private equity firms and representatives of the vendor community and UK government advisory bodies.

The report focuses on the industry's most pressing topic, *"How digitalization will impact telecommunication operators' configuration"*, and addresses some critical questions: Is there volume-driven growth in the core segments of the European telecom market? How to successfully execute a B2B2x strategy? What are new production models that begin to emerge?

The importance of this topic for operators, broadcasters, as well as hardware and content providers was highlighted by the large number of top UK based executives attending the event.

Held at the Royal Institution, the event commenced with a welcome speech by Ignacio Garcia-Alves, Global CEO of Arthur D. Little, and Richard Swinford, Head of the Telecoms & Media team of Arthur D. Little UK. Subsequently, Bela Virag, Partner in ADL's Vienna office and lead author of this year's edition of the report, presented the main findings. This was followed by a lively Q&A session where questions from the audience and attending journalists were addressed.

Key conclusions from the report

1. We expect that Telcos will master the "ARPU x volume" battle moving forward, which will amount to ~1% CAGR (in Europe) over the next five years, stabilizing top line growth
2. 'B2B2x' is gaining importance – it represents a new segment and an untapped opportunity for Telcos, that can be captured by leveraging core assets and capabilities, and understanding what is needed to help companies digitize
3. New production models begin to emerge – a tailored transformational journey will be key to drive an improved customer journey, lower production costs and more innovative/faster time to market
4. Operators will need to review how they manage their diverse portfolio of assets with potentially significant impact on balance sheets due to a shift from depreciation to opex
5. 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 different abilities to scale

Volume-driven growth in core European Telcos 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 should offset declining segments such as fixed telephony. This is part of a transition of the voice segments being the main revenue driver for telecom companies 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 become 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 modelling). Seeking further growth, some operators are expected to focus on new market opportunities outside their core segments and to 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 of 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 it does include 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-growth fields for Telcos to focus on. By leveraging their assets, telecom operators can carve out a space in it 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 the facts that the company is not ready yet, the opportunity is too small, or that the IT providers are better positioned, deterring Telco's entry. Industrial digitization is already in motion, and there is a material opportunity in providing and operating digital services for B2B clients. Telco's can, as well 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. Telco's need to take action in amending the design, sale and operation of offerings, as well as in increasing the agility and openness of their internal systems and processes in order to be able to 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, or at least at a feasible price and as a consequence Telco's 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 optimize asset structure
- Operators must make production models more accessible and programmable to enable swift and efficient innovation, beating competitors to market a whole differentiating offering



A new art: managing assets – why owning everything may not lead to an overall optimal situation

Diverse asset groupings, such as data centres, 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 fibre and small cells, will likely work in asset-sharing models. As many copper-network owners embark on fibre-upgrade journeys, they will need to balance the need for fibre sharing with their legacy roadmaps. This is in stark contrast to cable network operators, which, given their technical nature, can follow an “upgrade with demand” strategy. 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 a rigorous cost-cutting approach while operating on a simple, customer-centric model. Beyond that, we will see international operators expanding their footprints on the basis of 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 very different abilities to scale. Operators can differentiate their plays by: becoming truly global players; partnering capable players fully embracing the new segments and customer needs; remaining strong and highly efficient in their domestic markets; becoming asset-heavy or light operators; or 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.

Conclusion

The Q&A session following the presentation of the study results reflected the main themes of the report and the breadth of the audience, representing key stakeholders from across the industry.

- Several participants sought views on the extent of new internal capabilities being required in order to successfully develop customer platforms for B2B2x and move from an asset based set-up to a more software oriented set-up
- In addition, representatives of some of the biggest telecom operators wanted to understand whether there is room for multiple successful B2B2x players in a geographical market or vertical industry, or whether a single player would be able to achieve a dominant position
- A lively discussion was had around whether Telcos should focus on engaging with customers to better understand potential opportunities for a B2B2x play, or whether Telcos should provide an open API platform that these customers (including developers) could use as they see fit
- Some members of the audience questioned whether a new approach to asset management, such as engaging in asset-sharing models, would not also require Telcos to change their mindset – a journey that might prove to be significantly more difficult than merely adjusting their approach to asset management
- The opportunity for Telcos to differentiate themselves from other IT players by providing edge computing at the base stations was of keen interest to some of the participants
- The Q&A session was concluded with a final thought by Arthur D. Little’s CEO Ignacio Garcia-Alves, that for a successful B2B2x play, Telcos should focus their efforts on verticals and applications that are close to the Telcos’ ‘heart’ and which directly leverage their core capabilities



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About the Arthur D. Little annual report

We are honoured to release our annual Arthur D. Little Telecom & Media flagship report in 2017, available to our global clients. Every year since 2002, Arthur D. Little has conducted an in-depth examination of the telecom market with a focus on global operators.

To conduct these studies, Arthur D. Little's international consultants meet with a variety of stakeholders within the sector, including operators, hardware manufacturers, media and regulators. The 2017 report is the result of over 100 interviews with telecom operators, telecom and device vendors, regulators, utilities and local authorities across the world, many of whom attended this event.

Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. Arthur D. Little is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

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