FIXED–MOBILE CONVERGENCE AS A COMPETITIVE WEAPON
THERE WILL BE WINNERS AND LOSERS
Fixed–mobile convergence (FMC) has long been a hot topic in telecommunications but is becoming a reality in some European markets. We think it will spread across the globe in all markets in which the right conditions exist. While FMC can generate significant value, it can also harm some players, so the challenge will be to find the best strategy to benefit from future market turmoil.

FMC has finally become a reality in some European markets. In France, Belgium, and Spain, operators have been able to consolidate their customer bases by moving clients from fixed bundles and mobile contracts to FMC packages, and have done so in very short time frames. Germany is also moving in this direction. We think that the natural position of most markets is to become convergent if certain conditions are present, namely the existence of integrated fixed–mobile operators and market shares with asymmetries.

The concept of FMC isn’t new, and has been analysed from many perspectives. Three of the more relevant are as follows:

1. Convergence as a competitive weapon – operators try to maximise the share of their customer bases made up of converged clients, increase their share of each household’s or company’s spending, reduce churn, and use convergence to gain market share.
2. Convergence of client-related operations – operators unify all customer-related processes (marketing, sales, activation and provisioning, and customer care).
3. Convergence of back-end services – operators look for integration in, for example, networks, systems, platforms, and content rights.

This paper considers the first perspective, convergence as a competitive weapon, which has proven to be a driving force in shaping the industry. It has triggered a new wave of consolidation that has already altered market structure in Germany, the UK, Belgium, France, and Spain. We review the routes to convergence so far, and their outcomes; the opportunities and risks faced by operators in a convergent market; strategies for decision-making; and possible actions to take. We plan to issue a further paper on FMC, looking at convergence in client-related operations and back-end services, in the coming months.
BEWARE: THERE WILL BE WINNERS AND LOSERS

For more than a decade, FMC has been a buzz term in the telecoms industry. High-speed internet, voice services, and video soon became integrated in the fixed-line world into a single line of product, enabled by a common access network; dual and triple play became the norm for most telecoms and cable companies across the globe. Fixed-line operators used this strategy to reduce customer churn; justify higher Average Revenue Per User (ARPU) through more product penetration; and differentiate themselves from, or repel, “pure players”, like video or Voice over Internet Protocol (VoIP) providers.

Although the logical next step was for mobile telecoms to join the movement towards convergence, end users saw little change. Existing mobile operators integrated (fully or at least partially) their back-end systems, platforms and processes, and some elements of their networks. But for years, convergence was not used as a competitive weapon.

This situation started to change around 2012. Very aggressive FMC market strategies were launched in France, Spain, and Belgium, disrupting the markets and triggering a consolidation process in these three countries as well as in Germany and the UK.

So why are operators now starting to use FMC as a competitive weapon? Perhaps it’s because, as markets become more mature and competition increases, FMC is very effective in acquiring and retaining customers. On one hand, converged customers show a much lower churn rate (of up to 50% or less) compared with non-converged customers. On the other hand, there is great asymmetry between fixed and mobile users when becoming convergent: evidence shows that mobile users are three to five times more likely than fixed-line users to transfer to converged services. Hence, FMC is a powerful tool to capture mobile customers from competitors and introduce them to an FMC package.
THE STATUS OF CONVERGENCE IN THE MAIN MARKETS

SPAIN
LLU ADSL company Jazztel was the first mover in Spain in 2012, but the launch of Movistar Fusión (with a discount of about 30% over standalone products) was the real trigger. Convergence was sustained initially by price cuts and mobile multi-line plans. This situation has unleashed a consolidation process with Vodafone and Orange acquiring the main broadband challengers, which has concentrated the market. Despite being a first mover, the benefit for Movistar of such a process is uncertain.

FRANCE
The move to FMC started with the launch of Free Mobile. Competition was met by mimicking fixed–mobile bundling offers with aggressive discounts and the launch of low-cost brands like Sosh offering FMC packages. Convergence has driven significant value destruction and consolidation moves. After years of FMC, the main players achieved a high mobile penetration (over 60%) within the fixed broadband base, reducing the likelihood of upselling but also the risk of churn.

BELGIUM
Proximus was a pioneer in selling convergent packages. However, the convergence battle started in 2012 with the Telenet launch of mobile services at significantly discounted prices. Since 2012, the market has identified convergence with “internet (and TV) access everywhere”, using Wi-Fi hotspot infrastructure. Proximus had to continuously defend its mobile-only base and cross-sell mobile to its fixed-line base, but existing mobile operators (Mobistar and Base) were the most negatively affected. More recently, FMC has triggered consolidation with Telenet’s acquisition of Base.

GERMANY
Convergence is expected to be one of the main market growth drivers, together with the evolution of highspeed services. Most exposed players have led M&A deals (Vodafone–Kabel Deutschland, O2–E-Plus) to avoid missing out and, in the case of Vodafone, to get a better cost position than the one provided by ADSL, but none of these moves has created a strong fixed broadband base. Deutsche Telekom (DT) is the most secure player (despite being threatened by cable technological advantage); about 70% of its mobile base has DT broadband, and it has significant upselling potential. Vodafone has little overlap of its mobile and broadband bases, which leaves room for cross-selling but also creates the risk of mobile churn. O2–E-Plus is the most at risk as most of its mobile base has broadband as a competitor.

UK
Convergence today is at an incipient stage after previous attempts. Virgin Media launched quad play in Q2 of 2014 with limited success. Preparations for FMC are under way, with the merger of BT and EE. Today, Vodafone is the most at-risk operator with about 40% of its mobile base with BT’s fixed broadband. O2 and Three would be the next ones to get a serious hit. Virgin Media may have an important convergent growth opportunity through mobile cross-selling if its FMC solution is well executed.

US
Several attempts at convergence have been launched with limited success, including: Cable initiatives to enter the mobile arena have failed due to poor execution and lack of regulation. Verizon and AT&T launched offers in 2010 with mobile discounts but did not promote them aggressively. The only true convergent solution in the market is the combined Comcast–Verizon proposition, but the only benefit is a discount voucher and access to Verizon hotspots for “TV on the go”. Wi-Fi solutions or wise moves by cable companies could be the trigger to get FMC moving.
There have been two main routes to convergence so far, and a third is emerging:

Firstly, as a new entrant – with a good position in Fixed Broadband (FBB, comprising internet, voice, and video) and a Mobile Virtual Network Operator (MVNO) agreement, launching very aggressive FMC bundles, and rapidly transforming its fixed broadband customer base into a converged one. Examples of this are Free in France, Telenet in Belgium, and Jazztel and Ono in Spain.

Secondly, as an incumbent – faced with a high churn rate, very likely with a high price premium compared to the market, launching highly discounted bundles to the customer base and the market, heavily supported by Above-The-Line (ATL) advertising. The best example of this is Telefónica in Spain.

Thirdly, also as an incumbent but executed in a much more subtle way – realising it has a clear strategic advantage in the market, launching a convergent but not greatly discounted offer, and very much leveraging the go-to-market execution in telesales platforms, targeting first its own customer base and then that of competitors. DT seems to be following this approach.

Exhibit 1: Convergence as a competitive weapon

What have been the results of these different routes to convergence? In general terms, the main winners of FMC have been consumers. A massive transfer of surplus from operators to users, with steep price reductions, has damaged the industry as a whole.

But there have also been some winners among operators. Challengers such as Free in France, Telenet in Belgium, or Jazztel and Ono in Spain have very successfully played the FMC card to increase their market shares and their market value. For example, in the consolidation process in the Spanish market, Vodafone paid €7.2 BN for Ono while Orange paid €3.3 BN for Jazztel, which was 10.5 and 18.1 times their Earnings Before Interest, Tax, Depreciation, and Amortisation (EBITDA) respectively.

What about incumbents? Here the balance is not that clear. Up to now, the incumbent most boldly taking the lead in FMC strategy has been Telefónica in Spain. While Telefónica registered a significant decrease in churn, ARPU dilution has been very high, mainly due to a massive migration of clients within the base. In Germany, DT is playing a more subtle game with MagentaEINS, targeting the customer base firstly to manage the effects of price changes and secondly to upsell and cross.sell. The German operator is reporting close to a million converged customers, but this time with a much lighter ARPU dilution when compared to Telefónica in Spain.
Exhibit 2: Mobile portability in the Spanish market

**EVOLUTION OF MOBILE SUBSCRIBERS AND PENETRATION OF CONVERGENCE**

THOUSANDS OF SUBSCRIBERS. Q3, 2012–Q3, 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>236</td>
<td>314</td>
<td>341</td>
<td>417</td>
<td>553</td>
<td>557</td>
<td>798</td>
<td>756</td>
</tr>
<tr>
<td>2013</td>
<td>1,687</td>
<td>1,543</td>
<td>1,351</td>
<td>1,166</td>
<td>993</td>
<td>798</td>
<td>1,085</td>
<td>902</td>
</tr>
<tr>
<td>2014</td>
<td>798</td>
<td>1,548</td>
<td>1,461</td>
<td>1,315</td>
<td>1,085</td>
<td>902</td>
<td>1,687</td>
<td>1,548</td>
</tr>
</tbody>
</table>

1. Customer penetration – excludes additional mobile lines.

Exhibit 3: Churn and ARPU evolution in the Spanish market

**POSTPAID ANNUALISED CHURN RATE**

Q1, 2013–Q3, 2014 (% AOP)

<table>
<thead>
<tr>
<th>Operator</th>
<th>Q1 2013</th>
<th>Q2 2013</th>
<th>Q3 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yoigo</td>
<td>-8.3</td>
<td>-10.7</td>
<td>-8.3</td>
</tr>
<tr>
<td>Movistar</td>
<td>-3.6</td>
<td>-3.6</td>
<td>-4.2</td>
</tr>
<tr>
<td>Orange</td>
<td>-1.2</td>
<td>-2.1</td>
<td>-2.1</td>
</tr>
<tr>
<td>Vodafone</td>
<td>-3.1</td>
<td>-3.1</td>
<td>-3.1</td>
</tr>
</tbody>
</table>

**POSTPAID ARPU**

Q3, 2014–Q1, 2013 (%)

<table>
<thead>
<tr>
<th>Operator</th>
<th>Q1 2013</th>
<th>Q2 2013</th>
<th>Q3 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orange</td>
<td>-29.8</td>
<td>-29.8</td>
<td>-29.8</td>
</tr>
<tr>
<td>Movistar</td>
<td>-17.9</td>
<td>-17.9</td>
<td>-17.9</td>
</tr>
<tr>
<td>Yoigo</td>
<td>-8.1</td>
<td>-8.1</td>
<td>-8.1</td>
</tr>
</tbody>
</table>

- Convergence has positively impacted churn figures of all MNOs since it generates higher customer stickiness.
- Movistar states that “Fusión” has increased customer value by extending lifetime (2.2x FBB standalone and 2.6x mobile contract standalone).
- All operators have suffered a notable regulatory impact in 2013 (-60% drop in termination rates on July 1st).
- ARPU decline is stronger for Orange and Movistar who exhibit the highest convergent penetration:
  - Orange: 77% of FBB (better market share performance at a cost of higher ARPU dilution)
  - Movistar: 61% of FBB

Source: Operator quarterly report, Oliver Wyman analysis.

1. From €2.76/min to €1.09/min
Exhibit 4: Deutsche Telekom’s MagentaEINS results

MAGENTAEINS CUSTOMER BASE
THOUSANDS OF SIM CARDS; ~2 SIMS PER HOUSEHOLD

<table>
<thead>
<tr>
<th></th>
<th>OCT 2014</th>
<th>NOV 2014</th>
<th>DEC 2014</th>
<th>Q1 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add on SIM</td>
<td>222</td>
<td>257</td>
<td>256</td>
<td>256</td>
</tr>
<tr>
<td>Had mobile or FBB with DT</td>
<td>51%</td>
<td>50%</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Had mobile &amp; FBB with DT</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>New customers</td>
<td>37%</td>
<td>37%</td>
<td>37%</td>
<td>37%</td>
</tr>
</tbody>
</table>

- MagentaEINS ended 2014 with ~250k convergent customers (households), and already had ~450k in Mar’15 (approx. 2 SIM cards per household)
- The current MagentaEINS base has been achieved through Cross/Up-selling among existing DT subs. (99% of MagentaEINS subs. in Q4, 2014)

KEY TAKEAWAYS SEVEN MONTHS AFTER LAUNCH (SEP 2014)

1. **Quad Play Share (Fix + Broadband + Mobile + TV)**
   - Around 50% of MagentaEINS subscribers in Q4, 2014 and 40% in Q1, 2015 chose MagentaEINS with TV.

2. **Growth in SIM Cards Penetration**
   - Households in MagentaEINS demand ~2 SIM cards (1 additional mobile line is added to the pack).

3. **Improvement in Customer Loyalty**
   - 75 loyalty index\(^1\) points per convergent customer (+25% vs. avg. in 2014 for all products).

4. **ARPU impact per Household**
   - €10 ARPU erosion vs. no convergent pricing, of which two thirds (Q1, 2015) are compensated through add-ons\(^2\) upsell.

---

Source: Deutsche Telekom, Deutsche Telekom Capital Markets Day 2015; Deutsche Telekom Q1/15 Results.

1. TRI*M index: Customer retention model between 0 and 100 points.
IS CONVERGENCE HERE TO STAY?

Despite convergence not having been a clear value-generation lever for the industry as a whole so far, we are convinced that it is here to stay and most markets will follow the convergence path. We base this conviction on our analysis of the strategies of the different telecoms markets. Specifically, we think that most markets show marked asymmetries among players, and these asymmetries generate enough incentives for some of the players to begin convergence. There are three main asymmetries:

1. An integrated incumbent, with a strategic advantage in the fixed broadband network (coverage or speed, or both). This type of incumbent can try to use its superiority to (a) consolidate its customer base and (b) capture mobile lines from its competitors. BT (plus EE) in the UK or DT in Germany enjoy this position.

2. A fixed broadband player with an MVNO agreement, and with very little to lose in the mobile space. Such a player will try to capture as many mobile lines as possible in its household footprint.

3. A mobile-only player, or an integrated player with little overlap in its fixed-line and mobile customer bases. This mobile player is vulnerable in its mobile base, which generates an incentive for its competitors to capture as many of its mobile customers as possible.

We think that at least one of these asymmetries exists in most markets. In the USA, Wi-Fi is likely to play a material role but, from a client perspective, we can expect to see a dynamic similar to the one witnessed in Europe.

Other factors will help to catalyse these three main asymmetries, such as:

- Cost reduction and efficiency improvements. While cost cutting was not high on the convergence agenda of most groups, and there were plenty of improvements to be found in other areas of the business, cost cutting through convergence is the natural next step.

- Technology development. The evolution of technology is making convergence a reality, which is putting pressure on all telecoms operators and lowering the barriers to market entry. For example, Wi-Fi penetration could enable cable operators to disrupt the mobile arena, and the advent of 5G could open up opportunities for mobile players to enter the video business.

Clearly, convergence will materialise in most markets. What is less clear is how convergence will disrupt each market, as this will depend on several factors.

Firstly, available technology, such as 4G and fibre, will help to boost convergence but the Wi-Fi hotspot network could also be used as a disrupting asset by telecoms operators and technology players. In the USA, for instance, Wi-Free could easily be used by different players to disrupt the mobile market. Secondly, the regulatory framework may enable real competition in both mobile and fixed services. Finally, the operator that makes the first move will influence the outcome; how other operators react, or overreact, could define market profitability in the long term.
THE FMC STRATEGIC CHESSBOARD

Many telecoms and cable operators are discussing their convergence strategies. Beyond corporate strategies, when confronted with convergence in the competitive arena, the two main questions are “Should I attack, or wait and see?” and “How aggressive should I be?” To answer these questions, each operator needs to consider the following:

What is my mobile churn risk? In the market context of convergence, how many of my mobile customers have their broadband with a competitor that could offer them a convergent solution?

What is my mobile cross-sell potential? How many mobile lines are in households that also have my fixed broadband, which could be brought to my convergent solution?

What is my customer base repricing risk? If I launch a convergent offer, what would be the dilution effect caused by my clients migrating to it?

Mobile churn risk and mobile cross-sell potential are relevant in deciding whether to take the initiative or wait. In decisions about the degree of price aggressiveness for a converged proposition, repricing risk is more important.

Exhibit 5 shows some opportunities and risks in decision making about convergence. Based on these and our experience in convergent markets, we can identify five types of players. When addressing convergence, each type faces a different reality with different optimal actions.

Exhibit 5: Decision making: attack or defend?

Given my market situation, and my position in it, is FMC an opportunity or a threat? Should I take the initiative or react if other take it?

On one side, there are operators with high cross-selling potential and low churn risk; these should be the first to go on the attack and heavily push for convergence. On the opposite side, we see operators with significant churn risk and limited or no cross-selling potential; these will need to focus their efforts on defending their customer base and should postpone their emergence in the convergent market.
### Exhibit 6: Strategies associated with five types of operators

<table>
<thead>
<tr>
<th>Type of operator</th>
<th>Decision</th>
<th>Risk or opportunity</th>
</tr>
</thead>
</table>
| **Mobile-only**  | DEFEND: All of their mobile base will have broadband competitors | • High mobile churn risk, needs to be managed  
• Significant repricing risk to enable them to compete in the market; much-needed retention campaigns increase the risk |
| **Mobile share greater than broadband share** | DEFEND: Most mobile-only operators have broadband competitors, and most of their broadband subscribers are already mobile (low cross-sell potential) | • High mobile churn risk, needs to be managed  
• Significant repricing risk to enable them to compete in the market; much-needed retention campaigns increase the risk  
• Reduced opportunity for mobile cross-sell given the reduced fixed broadband footprint |
| **Balanced shares (fixed broadband and mobile); non-overlapping customer base** | STEALTH EXECUTE: High stakes because, while there is significant room for cross-selling, there is also a significant mobile base at risk; SRC and SAC budgets will be high | • High mobile churn risk, needs to be managed  
• Repricing risk in the customer base will emerge rapidly, and will be very difficult to manage even if using BTL campaigns  
• Major mobile cross-sell opportunity, but with an acquisition cost |
| **Balanced shares (fixed broadband and mobile); overlapping customer base** | INDIFFERENT/ATTACK: A significant share of mobile customers are already fixed broadband customers but, given the fixed broadband footprint, there is room for cross-selling. | • Repricing risk is the name of the game but, if properly managed, these operators could increase their market share (through mobile cross-selling) and accelerate market consolidation |
| **Fixed broadband share significantly larger than mobile share** | ATTACK: A large fixed broadband customer base, which can be used to cross-sell mobile  
Maintaining credibility as a mobile operator is important, and value for money is key | • Limited or marginal mobile churn and repricing risk  
• Significant mobile cross-sell opportunity, if operator retains a credible mobile service  
• Opportunity to weaken a mobile incumbent’s competitive and financial position |

### SO WHAT SHOULD I DO?

We think all operators should plan for a convergent market environment, and begin by defining their strategy for convergence as discussed above. The following checklist may help in this process:

- **Assess the situation.** What incentives do the industry players have to trigger convergence in the market?
- **Assess your own position in the context of convergence.** What are the opportunities? What is at risk?
- **Decide whether to attack or defend.**
- **Decide on your specific course of action.** Will your convergence be based on:
  - bundling and pricing;
  - cost;
  - product innovation; or
  - customer experience?
- **Decide the level of aggressiveness of the convergent approach.**
- **Design a plan to manage internal migrations within the customer base.**
- **Plan your operations.**
To quote the famous architect Mies van der Rohe, “God is in the details”. His famous statement can easily be applied to convergence. Operators should not only define a sound strategy but also take care of operational details. And a good way to start is by understanding that executing a convergence strategy is extremely complex. The main elements of the process are as follows:

• Development of a household (or enterprise) view of the market. The atoms of the convergent dynamics are households. Without looking at the market with convergent glasses and designing the value propositions and the go-to-market with them, execution will be a failure.

• Good and careful management of the customer life cycle. Knowing when to launch a converged offer to the customer base, and ensuring an excellent customer experience, will be the key to successful convergence. It is also important to appreciate that customers often become convergent in more than one step.

• Value preservation. Operators need to consolidate the customer base while minimising ARPU and margin dilution. This calls for the careful planning and implementation of one-to-one customer targeting, relying on private prices.

• Preparation of processes and systems for a converged operation. Careful implementation is needed especially in commercial channels and customer care platforms.

CONCLUSION

Operators need to define their convergence strategy now, and be ready to anticipate FMC disruption in the market. To succeed, it is essential for operators to secure their mobile-only customer bases and ensure sufficient overlap of their mobile and fixed broadband capabilities. Those that do not plan sufficiently in advance, or which underestimate the impact of failure, will face an uphill struggle – and risk being too late.
ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across 26 countries, Oliver Wyman combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation. The firm’s 3,700 professionals help clients optimise their business, improve their operations and risk profile, and accelerate their organisational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC].

For more information, visit www.oliverwyman.com.

AUTHORS

RAFA ASENSIO
Partner
rafael.asensio@oliverwyman.com
+34 91 212 6343

LAURENT BENSOUSSAN
Partner
laurent.bensoussan@oliverwyman.com
+1 212 345 3528

MATTHIAS LORENZ
Partner
matthias.lorenz@oliverwyman.com
+49 40 376 92 583

LORENZO MILANS DEL BOSCH
Partner
lorenzo.milansdelbosch@oliverwyman.com
+34 91 212 6342

IVAN PALENCEA
Principal
ivan.palencia@oliverwyman.com
+34 93 507 9008

CONTACT
CMT.practice@oliverwyman.com

Copyright © 2015 Oliver Wyman. All rights reserved.