

# Creating Value in a No-Growth Industry: A New Approach to Value Management in Telecom

By  
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Despite growth in certain services like mobile broadband, most large telecom companies operating in mature markets are in a no-growth business. Even more than the economic downturn, this reality is having a profound effect on how executives run their businesses, on two key fronts: operational efficiency, and management of the value generated by their large customer bases.

This report focuses on the latter priority, and offers a novel approach to next-generation value management based on our work with some large operators. When applied systematically across the business, this approach can drive up EBITDA margins by 2 to 5 percentage points.

## Two Questions for CEO Nolan

Anna Nolan hung up the phone and turned around to face the large glass window. She realized she was worried for the first time since she got the top job at TelCo, the major telecom operator in the country, two years earlier.

Of course, she knew it was going to be a tough job when she accepted it. TelCo's fixed-line revenues had already started to decline despite broadband growth; and while the mobile business was still growing, its profitability had started to shrink due to regulatory pressure and increasingly endogamic subscriber rotation among rival operators. Fortunately, there were still plenty of things to do: cutting costs aggressively across businesses, integrating back-end operations between fixed and mobile, launching exciting new IPTV, mobile broadband, and Internet services. She had been enthusiastically doing all that.

But now it was over, or at least she felt it was. For the first time in many years, the business was out of growth. No more fuel. And with all the easy efficiency gains already realized, further cost-cutting would yield meager bottom-line improvements.

Compared to other companies (and certainly to other industries), TelCo was not doing that badly considering the downturn. Nonetheless, Nolan somehow had a 'perfect storm' feeling that morning, particularly after hanging up the phone.

Two astonishingly simple questions, posed by the chairman of the board, rattled in her mind. In their next meeting, he wanted Anna to explain why TelCo's P&L was losing steam, and what could be done about it—not counting further cost reductions, as he seemed OK with their plans there. Simple enough questions. Or were they?

It dawned on her that there was nothing really new on the table. TelCo was the largest telecom in the country, had a healthy mass of fixed-line, broadband, and mobile customers, and was doing all it could to develop and retain them; she knew few companies with such a dynamic pace of new commercial offers, promotions, and initiatives. And, for years now, TelCo had collected exhaustive tracking data, scoreboards, and reports to follow all that activity.

And yet, she realized, TelCo had been so focused on launching new offers, signing new customers, stealing customers from competitors (by the way, at a cost increasingly difficult to justify for large segments like mobile prepaid), that they had not really put their large customer base in the spotlight of their management decisions. TelCo did not have a readily available understanding of how much each of those customers was worth and how each behaved; how their value and behavior influenced the P&L; or what management priorities should be not per product type, or per business line—but per customer.

As a consequence, Anna felt, for the first time, that she and her team had a less-than-compelling answer to the chairman's two deceptively simple questions.



## Value Management

Our introductory story, based on a recent, real case, is illustrative of the pressures faced by many large telecom operators in developed markets, who have been experiencing declining growth since 2002 (see Exhibit 1, “The End of Growth”). The lack of overall growth at major players, however, has been offset by strong growth of certain services such as fixed and mobile broadband, which has contributed to keeping the focus on “acquiring customers to capture market growth” despite the stagnant aggregate revenue picture.

Going forward, subscriber acquisition for new services will certainly remain a value driver, but a less important one given that there will simply be less market growth to be captured. The focus, then, in our view, turns toward two key areas:

- Achieving a leaner operating model to protect profitability as business economics get (structurally) tougher.
- Extracting more value out of the operator’s customer base by going one step further than current efforts—which is the

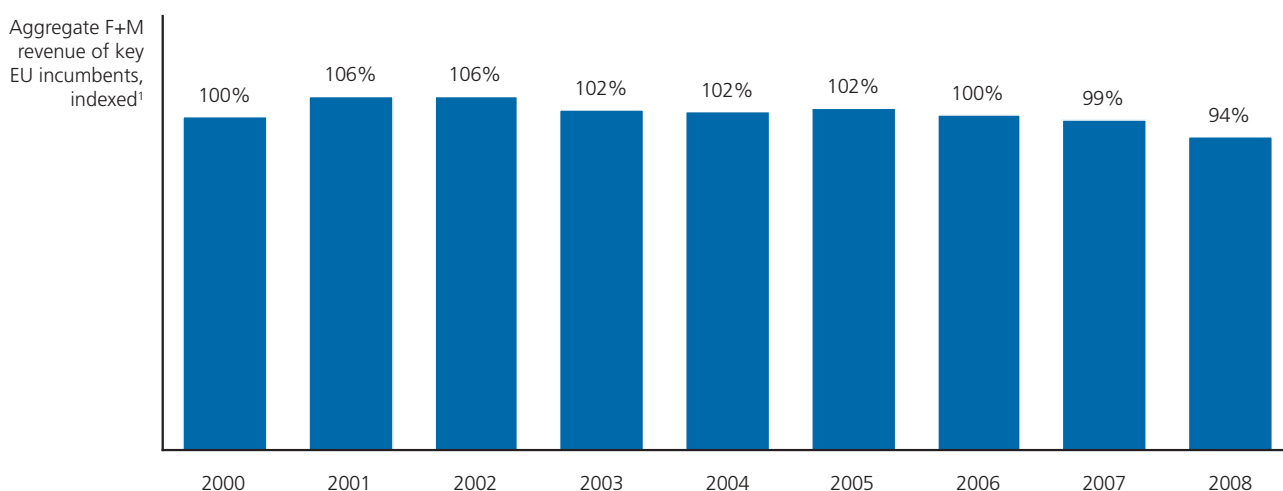
focus of this report. We call this “value management.”

What do we mean by “extracting more value out of the customer base”? Basically, four things:

- Sustaining **ARPU** (or improving it, or decelerating its fall) and **per-customer contribution margin** levels;
- **Profitably containing the economic impact of churn**—which is not the same as just reducing the operator’s “numerical” churn rates;
- Engineering a **better return on customer spend**, both on subscriber acquisition costs (SAC) and retention costs (SRC);
- In some (not all) operations, **limiting the value impact of bad debt**—which does not necessarily equate with lowering the incidence of bad debt.

To be sure, these priorities are not at all new. Much work has been or is being done in these areas at most large operators in developed markets. Yet an increasing num-

Exhibit 1 The end of growth



<sup>1</sup> Includes TEF (ES), FT (FR), PT (PT), DTAG (DE), TI (IT), TDC (DK), Swisscom (CH), BT (UK), Telia (SE)  
Source: published operator results.

ber of telecom leaders feel like our anecdotal Anna—that the current customer-base value performance could and should be taken further.

Indeed, as our work with operators is demonstrating, it is possible to go further and squeeze anywhere from 2 to 5 incremental EBITDA percentage points from a new approach.

### Managing the Telecom Customer Base: The Current Approach

Before advocating our approach, let's examine what we believe are some of the key characteristics of the current approach to value management at most operators, which are also at the root of its main limitations:

**1. Offer-centric.** A legacy from the days of capturing subscriber growth, most operators think first about what products, services, rate plans, promotions, and initiatives they need to launch (based on strategic priorities or accumulated learnings about the customer base, the competition, etc.). Then they look for the best targets in their customer bases to sell these offers or initiatives to. The examples are varied, ranging from SMS usage promotions to fixed-to-mobile bundles to broadband value-added services to packs of VoD movies.

This sales mentality poses at least two practical challenges. One, it makes the company focus often on the same customers (e.g., the most active users, or the most elastic) while leaving large parts of the customer base under-managed. Two, it overlooks many opportunities which stem from intrinsic customer behavior, reactions, and needs, which are less visible *a priori* from an offer perspective.

**2. Driver-centric, and lever-centric.** Much improvement activity consists of initia-

tives or projects that focus on specific value drivers or business levers, as management deems necessary. For example, where there's a churn problem, "let's do a churn reduction project" to address it. Or, if pricing is outdated, "let's do a pricing project." These are just two of many possible examples.

The problem, of course, is not with making such fixes; they might well be fully necessary for the business. In our view, the problem is that these initiatives are typically formulated at the outset, as a problem statement and a management goal based on (usually good) management intuition. Rather, they should be a *consequence* of what the company actually wants to do with the customer base as a strategy.

**3. Top-down segmentation.** Consistent with an offer-centric approach, segmentation is normally based on socio-demographic or attitudinal traits as a basis for determining what to sell to whom; as such, it is rather "top-down" as a segmentation approach.

Whereas this is logical from a marketing and communications standpoint, it is also true that this type of segmentation offers few insights to directly derive a value-enhancement strategy for each part of the base. For example, age and income as segmentation axes do not make it easy to formulate what to do with "young rich people," say, in terms of developing their value as customers.

The lack of a bottom-up, behavior-based segmentation approach imposes an even more serious limitation. By working with the customer base at a higher, aggregate level, operators encounter the usual trade-offs between value drivers—e.g., reducing churn might hurt ARPU, or decreasing commercial spend might affect acquisition effectiveness. The limits of these trade-offs

are more or less known, but very hard to tailor at a macro level. It is at a more micro level, thinking about and acting upon specific customer clusters, that new trade-offs can be found which aggregate up to a better efficiency frontier overall. For example, increasing real effective prices for inelastic customers, or proactively eroding ARPU in high-churn, high-response groups, can be profitable ways to arrive at better overall performance than is possible acting at a macro level.

**4. KPI-based business information.** Most decision making is, of course, based on a wealth of information, with most operators having implemented robust scoreboards and powerful data-mining systems and procedures capable of solving sophisticated queries useful for specific analyses.

However, richness of information does not necessarily allow tracing business results back to their root causes, or spotting the most salient value-creation opportunities hidden in the customer base. For example, some operators routinely track detailed churn parameters per product and even segment, but not the churn (and remaining migration flows) for each behavioral customer cluster, or the possible halo effects a high-churn product can have on other offers taken up by the same customers. This lack of knowledge makes it difficult to understand whether some products traditionally justified by churn-reduction promises are really fulfilling their role, or whether churn-reduction efforts should be targeted toward the customers offering better return on each effort, and so on.

**5. Management knowledge of the business.** In many operators we know, most front-end decisions affecting the value extracted from the customer base are based on two types of knowledge. First, the management team, which typically has mastered the trade-offs

between the key value drivers, has developed a good sense of what works and what does not. Second, myriad *ad hoc* analyses provide useful insights about how and why customers behave (in terms of choosing services, churning, etc.)

While fully necessary, relying on these sources of knowledge alone limits how far operators can go in managing the value of their customer bases. In order to formulate a value strategy that optimizes operator actions on the customer base for maximum value, a third type of knowledge is necessary.

We call this causal knowledge, which means actually understanding how each customer cluster would react to possible operator actions—in a segmented, quantitatively robust way and systematically enough to incorporate this knowledge into the day-to-day management of the business.

## **Managing the Telecom Customer Base: A New Approach**

In the light of the aforementioned characteristics of the prevailing approach at most operators, and taking into account their limitations, we advocate a new approach to value management, which could be summarized by the following five points (see Exhibit 2, “Advocating a New Management Approach,” for a comparison of both approaches):

### **1. Customer-centric (as opposed to offer-centric, driver-centric, lever-centric)**

All telecom operators make sustained efforts to understand and develop customers. At the same time, very few have adopted a true customer-centric philosophy to understand and manage the base (see “How Customer-Centric is Your Base Management” for a self-test about your company’s true approach).

## How customer-centric is your base management? A manager's audit

1. What are the main value/growth opportunities within your customer base?
2. For what % of customers in your base do you have a strategy (i.e., do you know what to do with them)?
3. What % of customers have you *not* contacted or otherwise "managed" within the last 12 months?
4. How different are your management priorities across different groups of customers?
5. How does your company decide which initiatives to launch to the base?
  - Based on an overall strategy, initiatives are designed and then addressed to the best targets
  - Based on a strategy for each customer group, initiatives are designed for and addressed to each
6. How do you approach customers who will just not "buy the new products," e.g., broadband, IPTV, 3G? What about "vanilla" customers who seem to have no salient traits?
7. How are the business KPIs (e.g., churn), tracked in your management reports?
  - By product (e.g., IPTV churn, 3G datacard churn, broadband churn)?
  - Or also by client (e.g., access churn for heavy voice, light data users vs. churn for light voice, heavy data users)?
8. How readily available is customer-level data, e.g., usage, ARPU, churn, and direct margin behavior of customers with a certain profile in the last 12 months?
9. How many variables about a customer's behavior and value do you routinely integrate into your management of the base?

Exhibit 2 **Advocating a new management approach**

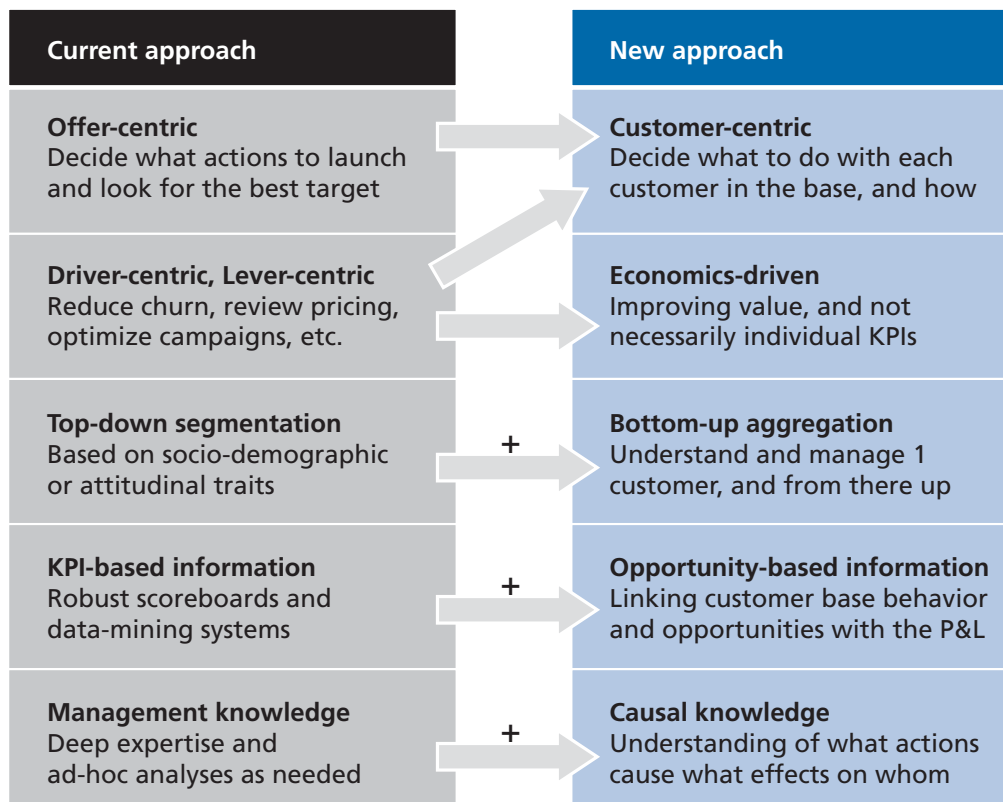
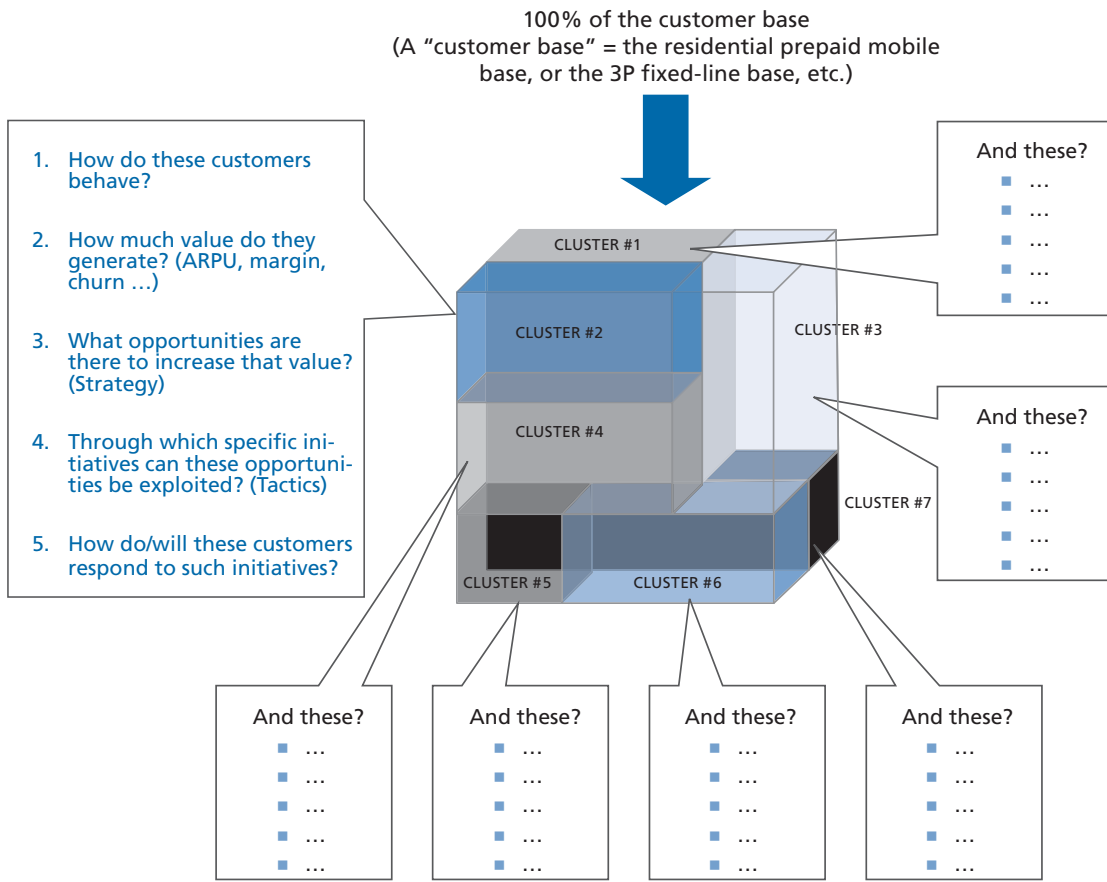


Exhibit 3 Customer-centric management approach



A true customer-centric management philosophy (see Exhibit 3, “Customer-Centric Management Approach”) is based on three pillars:

- Understanding which customer clusters with different behavior (and value, and response to stimuli) exist and must be managed.
- Understanding how customers in each of those clusters (and sub-clusters, etc.) behave (what services they use, how they respond to operator actions, what they spend and how they pay, for how long they stay in the base (and why), and how much they are worth). That knowledge must be systematically organized to provide executives with actionable knowledge.

- Identifying the opportunities to create more value in each of the clusters, designing specific initiatives to exploit them—and setting management priorities to execute them.

This approach yields a permanently updated opportunity map that directly translates to a strategy for each customer group. Some recent examples of specific opportunities stemming from this map in recent value management projects include:

- A mobile operator in a very competitive market with highly aggressive offers found that lower subscriber retention costs (SRC) were required to keep the least SRC-elastic customers, and improved the equation between loyalty

spend and life extension in order to get equal results with less SRC.

- A large broadband operator found that part of its ADSL customer churn was due to structural mismatch between its offer bundles and customer usage patterns in one important customer cluster, and thus was hardly manageable under a traditional churn management approach. A tailored modification of the offer for these customers reduced this structural churn with minimal ARPU downside.

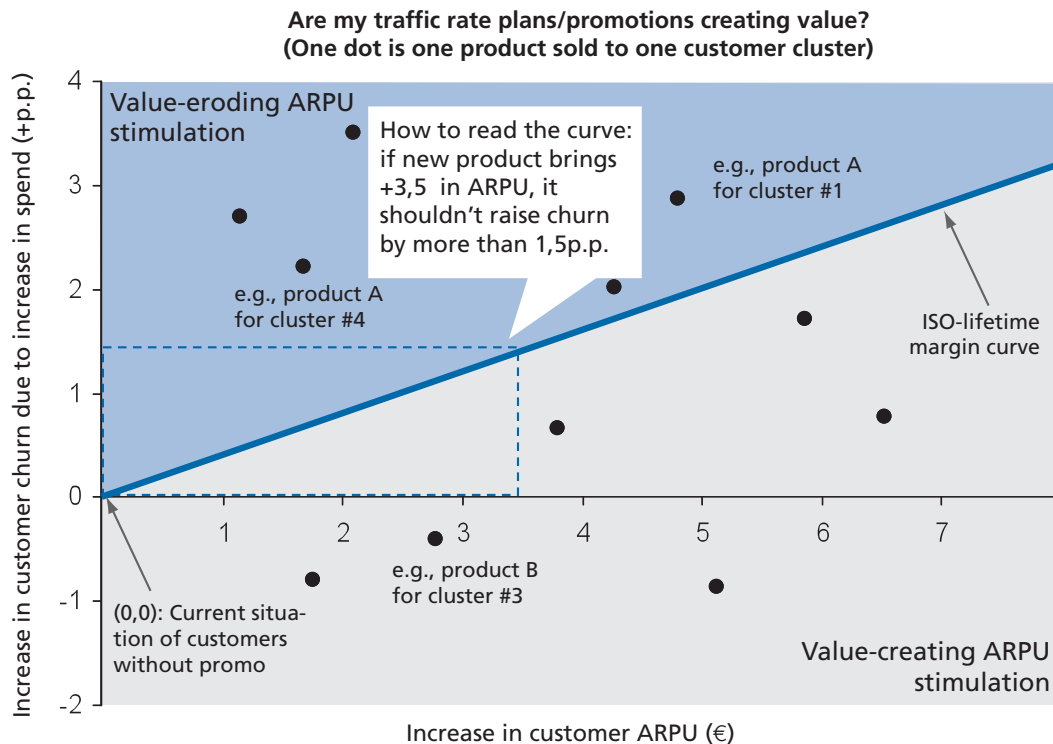
## 2. Economics-driven (vs. the current KPI-improvement focus)

All telecom operators have economics in mind when managing their customer base. For example, it is common practice to calibrate potential benefits of a telemarketing campaign against the cost of the campaign itself, and to build profitability models before launching a new product, service, or promotion.

However, the “driver-centric” nature of customer-base management at many operators also means that a lot of effort is put into managing ARPU without necessarily understanding churn, and thus lifetime revenue (or understanding margin, and thus lifetime margin); or in reducing numerical churn without fully understanding the implications on revenue and margin; or in reducing bad debt ratios without first calibrating the trade-off between bad debt incidence and the opportunity cost of bad debt prevention. Linking back to customer focus, these economic trade-offs must not just be understood at a macro level, which rarely has any real value—but understood at a customer cluster level.

Exhibit 4 (“Managing the ARPU-Churn Tradeoff”) provides a simplified, sanitized illustration, taken from a real case. This operator was trying to stimulate voice ARPU for a certain customer base. The effects of taking up variations of a given product (certain combinations of minute bundles for

Exhibit 4 **Managing the ARPU-churn trade-off**



Increase in customer's ARPU due to promotion take-up (+EUR)  
(% margin varies as a function of promotion design and ARPU delta)

a given fixed amount per month) on customer ARPU (and underlying margin) as well as churn (due to higher spend) have been quantified and put in the context of the calculated ARPU-churn trade-off in the chart.

As the chart's gray area shows, when certain products are taken up by certain customers, they generate incremental margin per customer but no incremental churn (some can even *decrease* churn). But, as the blue area shows, in other cases the incremental ARPU would actually generate so much incremental churn as to make the move value-destructive. What's more, these two extremes can happen with one single offer—when applied to two different customers. In our view, this dynamic relationship illustrates why both a value (vs. a driver) view and a customer-centric (vs. a product-centric) view are so important.

By emphasizing customer economics, we also advocate a product-agnostic approach to value opportunities. As long as there is incremental value to be generated from the customer base (as well as positive return in the specific actions needed to extract it), all opportunities are in principle worth pursuing, subject only to budget or workload limitations, even if they might not be the focus of the company product-wise.

### **3. Bottom-up aggregation of customers based on behavior (as opposed to top-down segmentation)**

In order to support this customer-centric, economic view of the business, it's critical to understand customers at a very granular level, down to the individual customer.

Why is this so important? If operators understand customer behavior at such a granular level, they can group customers into clusters of similar behavior.

With wildly different customer behavior, needs and response functions (e.g., price elasticities or churn elasticities) from one cluster to the next, the operator faces different challenges and opportunities to create value in each of them. Therefore, management priorities and potential business levers are different for each cluster.

For example, one customer cluster at a large mobile operator talked many days per month but mainly on-net and always by taking advantage of discount modules. Thus, this cluster was paying average real prices per minute way below more valuable customers, as well as way below competitor customers with the same profile, hinting at a clear opportunity to raise effective (not necessarily facial) prices *for that cluster*.

By aggregating similar customers into clusters and acting on the base differently cluster by cluster, it is possible to launch a series of targeted, profitable actions that would not necessarily be economical for the whole base.

### **4. Information to enable opportunity-spotting (on top of KPI-rich management information, which remains necessary)**

Adopting a customer-centric, economic, bottom-up approach often calls for additional types of information beyond those readily tracked by most operators' management scoreboards, including:

- Information per customer (on top of per product). Example: What is the monthly churn rate of triple-play vs. VoIP double-play vs. PSTN double-play customers? What is thus the churn effect of bundling?
- Information per *cluster* of customers. Example: How does the combination “product take-up vs. usage vs. ARPU vs.

churn” work out for each cluster? How competitive is the company’s pricing for each cluster, given its usage profiles and real prices?

- Bottom-up reconstruction of the operator’s economic performance (e.g., the P&L top line, or contribution margin, or even operating margin) as a function of customers.

Exhibit 5 (“Tracing P&L Evolution Back to Customer Behavior”) provides a real-life illustration of the need for new types of information. The question is: When P&L magnitudes move (as is the case with the revenue example shown), what are the underlying causes? By focusing on how customers arrive (and how much value they bring when they do), churn, upgrade,

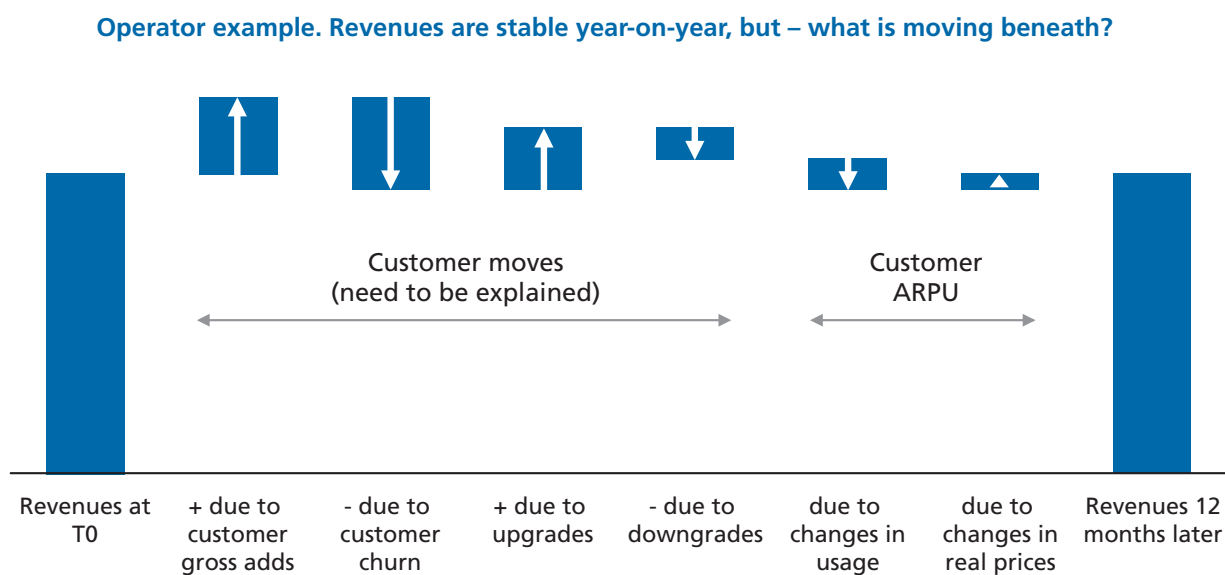
downgrade, and evolve their usage (and the average prices they end up paying), a rich explanation of P&L root causes is possible. Ultimately, what we advocate is nothing short of matching individual customers to the company’s P&L evolution for improved visibility and manageability.

### 5. Multivariable causal understanding of customer response (on top of management expertise and ad-hoc analyses)

A last piece of the value-management puzzle remains: Achieving and maintaining a *causal* understanding of customer reactions; that is, of how customers respond to operator actions.

For example, if an operator sells to the base an off-net minute bundle, or a video-on-

Exhibit 5 **Tracing P&L evolution back to individual customer behavior**



- How does this look by customer cluster?
- How does this look as a function of competition? (e.g., picture in cable-passed households vs low-competitive-intensity households)
- How do these revenue flows translate into margin?

demand movie package, or a premium IPTV channel, or a churn-reducing promotion, it is not only important to understand how many customers will take up those offers, but also:

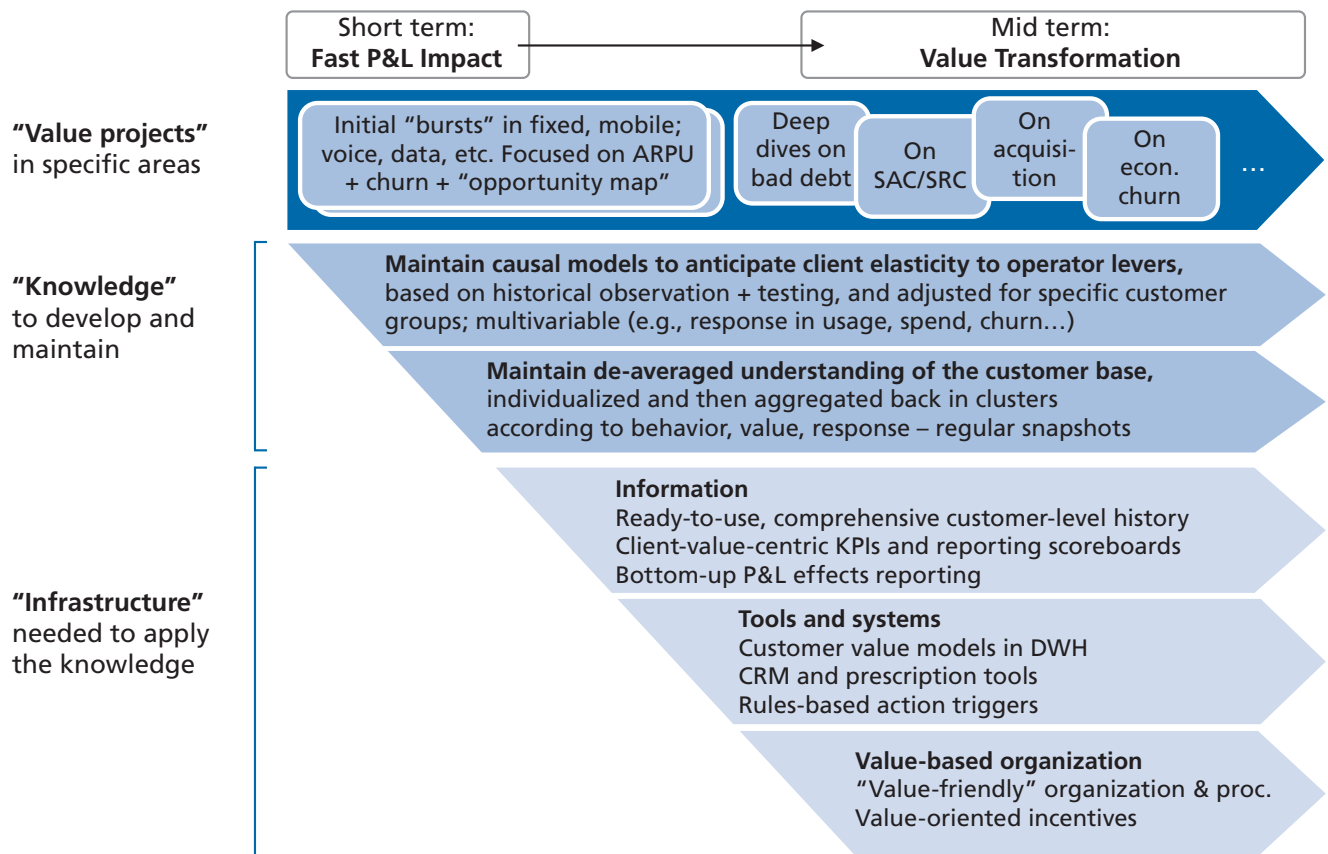
- How customers' service usage will change as a result. How many more minutes will he talk, how many more movies will he watch?
- How customers will change their usage of other services that might be connected through cannibalization or halo effects. For example, how will premium IPTV channel take-up influence VoD consumption of active users?
- How will customers change their ARPU,

for the specific service and for others?

- How will customers change their contribution margin?
- How will customers change their churn behavior?

The ultimate goal of understanding causality is to be able to compare the effects of doing something to doing nothing. Obviously, as customer responses vary widely across the base, it is precisely this knowledge that allows operators to customize their actions for specific clusters, for a single action might be very value accretive when applied to some customers and value destroying when applied to others.

Exhibit 6 From value management artisans to industrialists



## Implementing the New Approach: From Artisans to Industrialists

A key characteristic of this new approach is the degree of systematization, across three layers (see Exhibit 6, “From Value Management Artisans to Industrialists”):

- **Projects.** Initial burst of advanced value management, typically followed by specific initiatives to improve value (e.g., drive up IPTV net revenues, or how to save on mobile SAC through value-oriented scoring).
- **Knowledge.** Both a systematically updated, bottom-up understanding of the base, as well as the set of causal relationships between operator actions and customer responses. The latter is not easy to build, calibrate, and update, but is at the core of a next-generation value-management approach.
- **Infrastructure.** In order to really industrialize the approach, most companies will require decisive adaptation of their management information; better customer-information extraction capabilities; updated tools and systems to enable both customer analysis and the subsequent selective application of actions to specific parts of the base; and adjustments to how their commercial teams and processes are organized.

This is by no means an easy or quick transformation. In our view, fully adopting the approach can take a large, established operator between two and five years.

## Benefits for Operators

What’s in it for telecom managers? Three key benefits:

- **Improved performance.** This approach can help operators improve revenue, margin, SAC, SRC, churn, and bad debt value performance. When applied systematically across all client-facing activity, 2 to 5 p.p. gains in EBITDA are possible, depending on the operator’s status and competitive environment.
- **A clear way to manage the customer base.** Operators gain an exhaustive management map for 100% of their customer base and a thorough, quantitative understanding of opportunities and risks.
- **Competitive advantage.** Better SAC/SRC return can free up resources for further competitive action, and more varied and customized actions on the base make it harder for competitors to understand what the operator is doing and to respond or replicate.

In summary, telecom operators in developed markets have so far focused more on acquiring and retaining new mobile and broadband customers, rather than on getting more from their large, existing bases. However, as the most recent sources of revenue growth dry up, getting better at value management will become a key factor separating the good and the bad performers in the industry. ❖

## About Oliver Wyman

Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm works with clients to deliver sustained shareholder value growth. We help managers to anticipate changes in customer priorities and the competitive environment, and then design their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities.

We have more than 35 years experience serving Global 1000 clients. Our staff of 2,900 operates from offices in more than 40 cities in 16 countries.

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