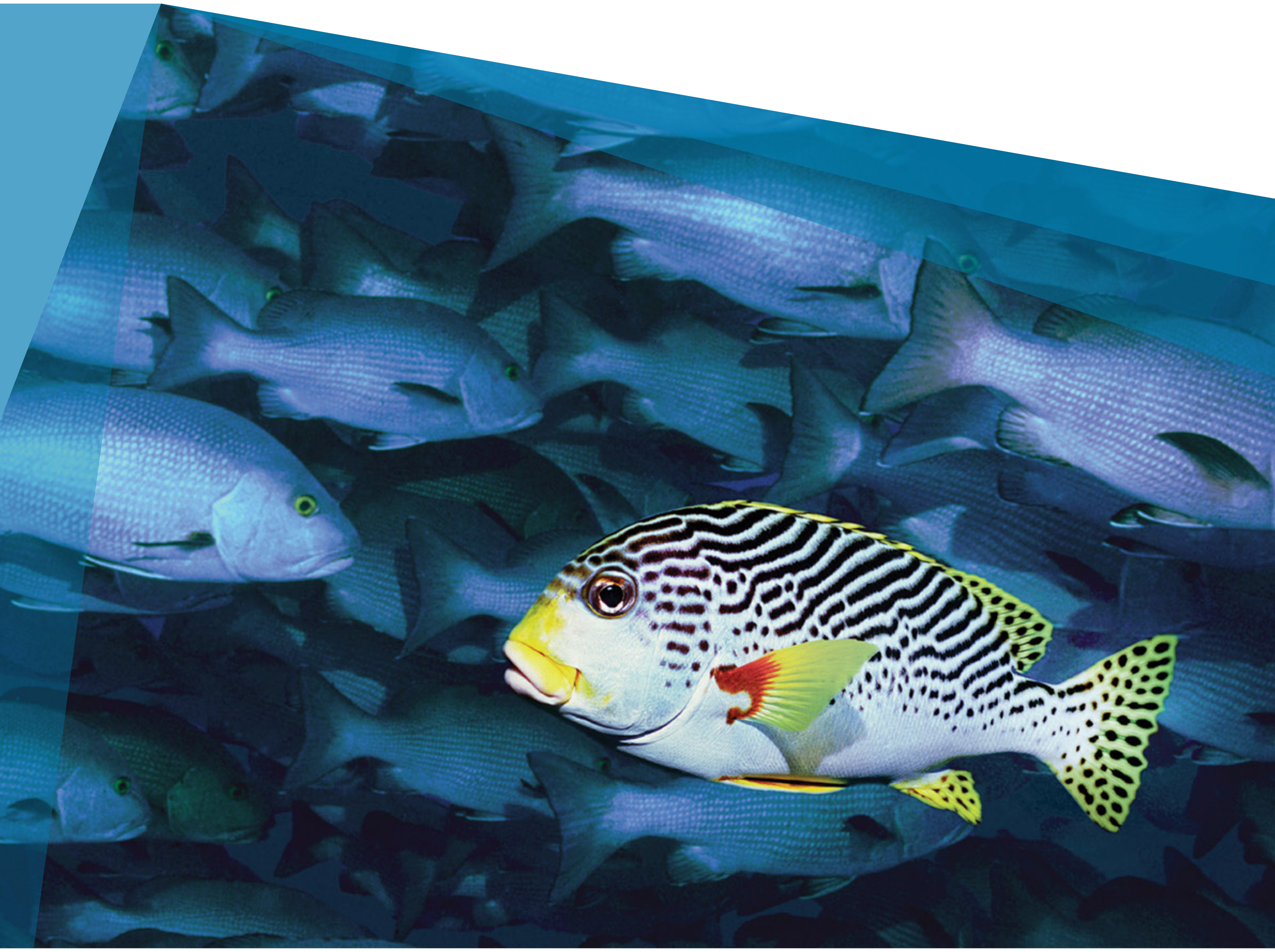
WIRELESS VALUE PROPOSITION

MAINTAINING DIFFERENTIATION IN A COMMODITISING WORLD



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WIRELESS VALUE PROPOSITION

The wireless industry was well known for the many innovations it brought to pricing – and the complexity that resulted for customers. Over the past few years, operators have considerably streamlined their portfolios of offers but, by the same token, oversimplified the way the industry is selling (think unlimited or large data caps and handset decoupling). This has left little room for differentiation in a commoditising world. The pendulum may have swung too far and it's now time for carriers to innovate again with the pricing of their core products, potentially looking at other industries for inspiration.

THE EARLY YEARS: MARKETING INNOVATION SPURRED GROWTH BUT ALSO A LOT OF COMPLEXITY FOR CUSTOMERS

Who did not hear complaints about the complexity of wireless pricing in the early years of the industry? As the appetite for mobile services grew around the world – and as new operators kept emerging – carriers used a myriad of pricing options to appeal to different segments and grow consumption (of, at that time, voice services and texting).

In the early 2000s and until recently, the typical arsenal of a carrier included:

1. Different counters and triggers – peak/off-peak, in/out of network, Friends & Family and other closed user groups, and spend-triggered bonuses and perks
2. Handset subsidies (flat or tied to offer tiers) with different contract terms, lengths, and early cancellation policies
3. "Walled gardens" where different carriers would offer their own data experiences (including access to differentiated content)
4. Aggressive "marketing programmes" to differentiate the company from its competition: loyalty schemes and special benefits (such as Orange offering 2-for-1 movie tickets on certain weekdays, or O2 providing special access to events with its rewards programme)
5. Discounting for bundling wireless with other products (typically fixed internet or TV)

Part of this creativity was prompted by need. In a world of heavy capital investments (deploying 3G then 4G networks), operators had to come up with pricing differentiation that allowed them to make the best of their cost structure (including off-peak, in-network calling, and so on) and assets (such as scale or wireline). But this creativity also resulted from the need to keep stimulating additional penetration and consumption, that is to say the necessity to convince ever more people to use ever more services. Marketing innovation resulted in richer options being available to consumers – and ensured new profit streams for carriers.

Orange, for instance, created its Optima product to reassure customers who might be worried about overpaying due to usage overage. For three euros a month, customers were guaranteed to be placed on the best possible tariff plan for that month. This gave customers peace of mind and ensured additional profits for the operator: for most subscribers, whose usage varied only mildly in reality, the three euros more than compensated for the reprice resulting from adjusting plans in months where their usage varied drastically.

Similarly, O2 introduced O2 Refresh to capture the benefits (in customer awareness of the handset's value, and delayed upgrades) of handset decoupling, while keeping the marketing power of subsidies (taxing customers for their willingness to pay a little upfront, steering acquisition and retention volumes more finely, and so on). It started differentiating subsidy levels depending on the upfront amount a customer was willing to put down for their handset and the tariff plan chosen. In doing so, O2 was able to use its subsidies more efficiently, de facto subsidising the less cash-constrained and less price-sensitive customers, while communicating better rates in its tariff plans.

Finally, many carriers across the globe also offered zero-rated in-network calls, using their scale to create resilient network effects within their base. Some, such as Orange UK, even went as far as offering tenure-based, zero-rated Friends & Family numbers to create further loyalty.

WHERE WE ARE TODAY: SIMPLE DATA METERING COEXISTS WITH HANDSET FINANCING SCHEMES

The pricing innovation of these early days has come to an end in the past five years. Firstly, customers started complaining about the complexity of options offered to them, and often felt confused by the non-transparency and intricacy of mobile pricing and terms. A study by the United States Government Accountability Office in 2009 found that 86 percent of US wireless users were dissatisfied with their mobile service: billing, terms of the service contract, and carriers' explanation of their service were cited as top reasons for frustration. Nothing exemplifies this better than the much-derided non-concomitant expiries on wireless pricing contracts for a family: as long as one phone on the account was on a contract, the entire family was de facto locked into a contractual relationship with their operator. Attackers such as T-Mobile in the US or Free in France seized this opportunity to launch offers with very simple terms that incumbents also eventually had to adopt.

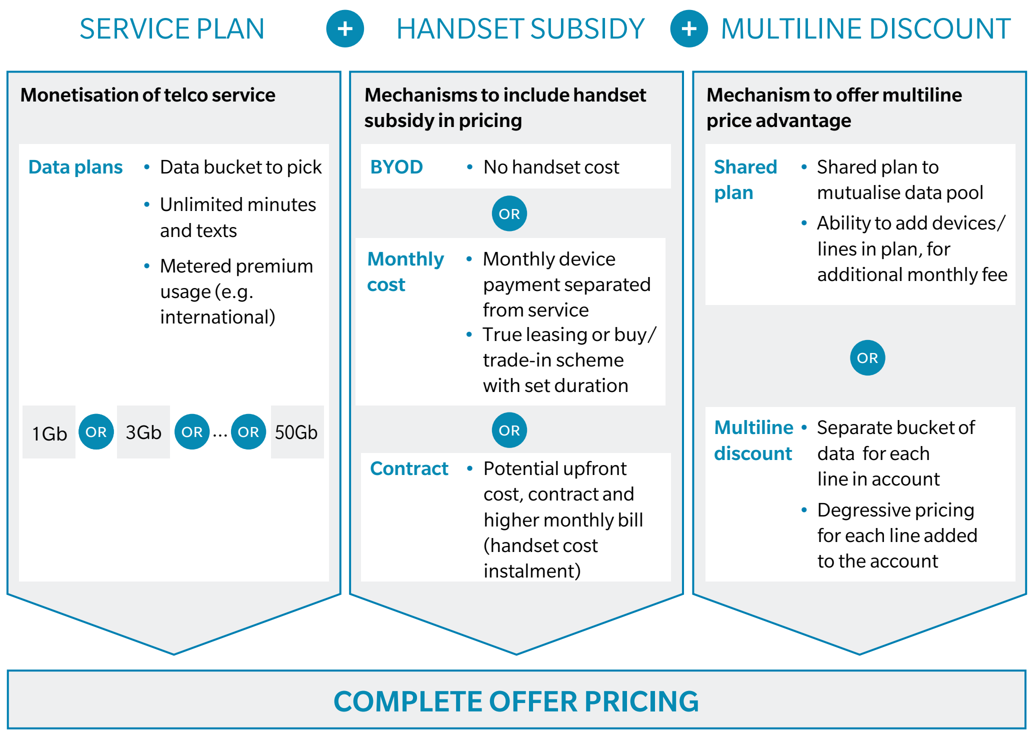
Secondly, a surprisingly relevant portion of carrier profits started to be derived from "bad revenue": overages, phone upgrade charges, plan change fees, and so on. That is, revenues were created by tricking customers rather than by engaging them in a sustainable, loyalty-building relationship. In some countries, regulators stepped in to force carriers to abandon some of these practices. In most places, they didn't, yet many operators started to end these practices because of the customer backlash.

Thirdly, the pressure from over-the-top content (OTT), for example from Skype, WhatsApp, and iMessage, and the willingness of operators to get a fast return on their 3G and 4G network investments, encouraged them to pivot their rate card structure. This included unlimited calls and texts for all customers who would be ready to pay for the new currency (namely data).

Fourthly, handset prices increased dramatically with the rise of smartphones. Operators used to charge high bills to their customers, with a hefty portion going to Apple or Samsung through handset subsidies. Many operators chose "handset decoupling" and made the cost of the handset more transparent on the total monthly bill.

As a result of all these factors, many operators now have very similar tariff structures, as illustrated in Exhibit 1.

Exhibit 1: Typical pricing structure today



Source: Oliver Wyman.

This simpler, flatter model has often benefited price value attackers (typically the number three or four operators in a particular country), which can position themselves around value and simplicity or straightforwardness.

For instance, in the USA, T-Mobile US regained momentum with its "Uncarrier" strategy (based on no contracts, no overage, handset financing or leasing, accelerated upgrades, and so on, and a good dose of buzz marketing) growing from 42 million (after its merger with Metro PCS) to 59 million subscribers in less than three years – in a market with no overall growth.

In France, Iliad's Free entered the wireless market as the number four operator with a radically simple offering and an evident value proposition around cheap unlimited text messages, calls, and a large data allowance. By launching at a 60–70 percent discount below previously prevailing prices, Free rapidly gained momentum (reaching 16 percent market share in just three years after its launch).

However, this trend towards simpler industry pricing does not leave much space for premium carriers (typically incumbents) to maintain differentiation and continue justifying a price premium over competitors. The recent struggle of Verizon Wireless to differentiate its premium pricing from attackers highlights the difficulty that incumbents have in marketing anything beyond "small to super-sized" data options. Simply put, the lack of differentiation drives margin pressure for many incumbents.

WHAT OTHERS HAVE DONE: WHAT MOBILE OPERATORS COULD LEARN FROM OTHER INDUSTRIES

The wireless industry has often been looked at for its pricing and the inventiveness of its marketers. It may now be time to look at other industries for inspiration, however. Across a broad spectrum of industries (ranging from consumer finance to travel, energy utilities, and others), companies are rethinking and expanding the definition of what it is that they are actually selling, and how they are selling it, in an effort to thwart commoditisation.

Consider consumer finance, for instance, and how payment and credit cards have evolved over time. Initially, credit cards were merely defined as a combination of interest rates (APRs), payment terms, and various kinds of fees. Industry leaders – like Capital One – were able to win share by offering the most attractive combinations of those terms that would still address the underlying risk of particular customers.

Following the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009, though, the industry found itself restricted as to what types of fees could be charged and how interest rates could change on existing balances. Pricing creativity was affected, particularly for subprime customers, traditionally targeted with fee-based products. As a result, the credit card business model became more commoditised, with interest rate as the main adjustment variable remaining. In turn, the industry put more focus on boosting transaction volume (and making money from transaction fees), the model historically favoured for prime customers and used in payment cards, such as American Express' Gold and Platinum cards.

Today, most card issuers therefore offer a broader portfolio of options covering very different customer segments with unique value propositions (like points, cash back, charge cards, or perks) beyond APR and payment terms. Some, and in particular the private networks American Express and Discover, are redefining themselves as offering broader experiential benefits. These include:

1. Exclusivity and prestige, with access to differentiated experiences (such as reserved seating at sports or entertainment venues, and access to high-end hotel perks)
2. Peace of mind, with features like 24-hour card replacement, extended purchase insurance, theft protection, and ID security

In doing so, not only do card issuers encourage a higher volume of transactions but they also increasingly monetise some of their customers' underlying needs, such as the willingness to pay a premium not to have to worry about losing their card.

Let's now think about how Disney has evolved the way it markets its parks, from ticket sales to building an entire customer experience around parks as destinations. That experience is based on four premises:

1. Expanded offering. Different theme parks have been juxtaposed, creating local destinations for week-long trips vs one-day or two-day visits. To accommodate longer visits, significant hotel and food capacity has been created, often under the Disney brand itself.
2. Customisation. Disney can cater to different levels of budgets and experience expectation within the same park. With a range of hotels spanning from economy lodges to luxury five-star properties, and additional enhancers (such as Disney character meals and fast passes) that can be purchased a la carte, each customer can build a unique experience based on their own preferences and budget.
3. End-to-end experience. The Disney park experience starts at home, with a website allowing families to plan their vacation remotely day by day (My Disney Experience) and to link travel, hotel, restaurant, and park reservations seamlessly. And it ends by checking all pictures taken at the park when back at home, and ordering prints and merchandise based on them.
4. Customer-friendly technology. Examples include FastPass, a system that smooths demand for the most popular rides while enhancing the customer's experience by avoiding long queues; MagicBands, which customers use to enter parks, unlock hotel rooms, and pay for services; and smartphone apps giving real-time information about the parks, the shows, and the waiting times at different venues. Disney technology is perceived to enhance the customer experience; for the company, it also optimises the parks' economics.

Finally, consider the airline industry. For the most part, consumers buy airline tickets today the way they were buying them ten years ago: on price and convenience of route. If anything, the explosion of comparison websites has made these factors ever more relevant to tourist travellers. The reality, though, is that for many airlines, profits are generated not from these casual, one-off customers but rather from the repeat business of professional travellers paying high fares. In redefining its offering over the past five years, Delta Airlines deliberately focused on providing much better service to those high-margin clients (while improving its overall value proposition). This came through:

1. Superior perks and benefits for very frequent travellers – from premium economy seating and first-class upgrades, to more gimmicky offerings such as Porsche Cayenne rides from gate to gate at busy airports
2. Improved transparency on processes – allowing travellers to understand where they stand in the pecking order and why, and reinforcing their desire to move to the next tier
3. Consistent, easy experience – from rejuvenated planes to seamless reservation handling (including a redesigned, easy-to-use app)

What do those examples have in common? Each case has been about reinvention, by embedding the core offering (payments, parks, flights) into a set of valuable segmented experiences. This in turn allowed players to better monetise these core assets through rejuvenated and easier-to-understand value propositions for customers.

SO, WHAT NEXT FOR WIRELESS?

There is no shortage of possibilities for wireless operators (and, more broadly, converged operators) to move away from the current and undifferentiated positioning as providers of buckets of data. For instance, the American Express example could be followed by wireless carriers, focusing more on peace of mind, restructuring their value proposition around a promise of hassle-free communications. This might include features like:

- Guaranteed handset availability – systematically bundling in handset insurance, saving all handset data on the operator's cloud, and leveraging their retail footprint to propose pick-up locations for loaned handsets
- Network and handset-based cyber threat monitoring – systematically adding anti-virus and anti-phishing software, and monitoring (and protecting against) all threats targeting mobile phones
- Premium technical support – provided for the whole connected life of customers (from which connected devices to use, to how to connect them and how to manage them)

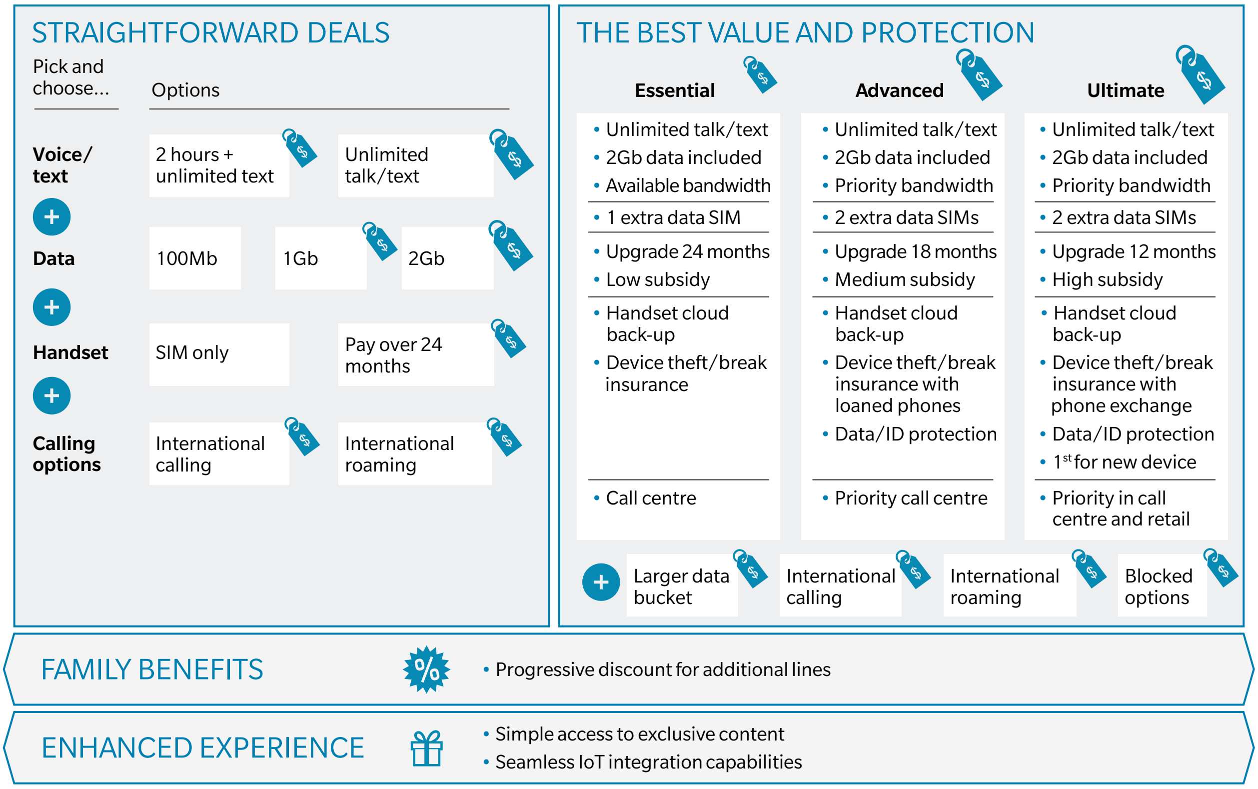
The Delta Airlines experience could also be followed, with operators more clearly segmenting core services, with a focus on the most demanding customers (and those willing to pay). This could mean:

- Network access prioritisation – operators could propose different priorities (and guaranteed levels of service) for access to the network; the highest plans would grant priority access to the fastest network available, while the lower plans would only provide access to older-generation networks at times when capacity is constrained
- Care segmentation – the highest-value customers could access all channels (retail, care, and so on) as a priority, while the lower-value segments would be directed to lower-cost self-care or community-based care options

Finally, should they want to follow Disney's full experience, operators could develop broader value propositions, providing a set of unique integrated experiences. Focusing on what is typically consumed over wireless (such as video) or connected through wireless (like wearable or household devices), wireless operators could develop value propositions that would:

- Simplify access to the best content – whether by using their size and negotiating power to give customers access to more à la carte content (rather than the packaged variety often offered by pay-TV) or providing customers with solutions to cheaply access the best content (caching the content most likely to be viewed or appreciated on their customers' handsets when they are connected to wi-fi or at off-peak times)
- Orchestrate the mobile ecosystem – whether through differentiated and relevant connection services for the Internet of Things (IoT) (like priority access and geo-localisation for health monitoring) or by offering the ability to add lines for in-home smart appliances. Through their existing business-to-business role as a connection operator for IoT service providers, their direct link to handset-integrated or locally connected sensors and, in the case of converged services, their direct link to home hubs, wireless operators are ideally positioned to play an important role in this area

Exhibit 2: Illustrative examples of alternative pricing structures



Source: Oliver Wyman.

Of course, each operator could combine different elements of these themes and come up with a unique, differentiated value proposition. As illustrated in Exhibit 2, there are many possibilities for carriers to evolve their pricing.

Whatever the most relevant themes end up being for different carriers, they represent an opportunity for the wireless industry to reinvent its value proposition and move away from an otherwise looming utility business model where the basis of competition is largely driven by efficiency. This in turn will allow carriers to sustain EBITDA levels in the long run that will help them invest in next-generation networks and continue their history of bringing ongoing innovation to consumers.

CONCLUSION

The wireless industry is at a turning point. The radical simplification of pricing around the world is leaving little room for differentiation between carriers in a commoditising market. It does not have to be this way, however. As has happened in other industries, there is ample room for mobile operators to rethink entirely the way they are pricing their core products and the experiences they can deliver to consumers.

ABOUT OLIVER WYMAN

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