NTT DATA

How to thrive in 2025: future business models for European telcos

As we enter the 2020s, the routes to commercial success are unclear for established, European telcos.

Despite continued sector growth [1] [2] and the demand for ubiquitous, high-speed connectivity, an increasing number of our client base are seeking our help in navigating the uncertain path ahead. Here we look at the major challenges European telcos face in the next five years and the trends that are likely to define the commercial and consumer landscape. Finally, we look at three strategies telcos should explore to thrive in these uncompromising conditions.

Challenges in the European telco market

Telcos face adversity from many sides as they attempt to recover from a decade of disruption; given the number of challenges, it can be difficult to see useful patterns amongst them, however, broadly these can be split into three categories:

Market aggression:

- Continued pressure and geographic inequality with regard to government regulation;

- Intense competition from challengers throughout the value chain.

One of the takeaways from the 2010s was that customer expectations were increasing exponentially and at a pace that established telcos couldn't match. Much of this pressure came from digital services outside of the telco space (for example, technology pure play companies such as Facebook, Amazon, Apple, Netflix, and Google (the FAANGs) in industries and geographies not inhibited by the same regulatory pressure.

[1] Singhal, P., Forst, H., Majert, A., Sachdeva, A., van Droogenbroek., Baschnonga, A. and Ronchi, E. (2020) Digital transformation for 2020 and Beyond.[online] Available at: https://www.ey.com/Publication/vwLUAssets/ey-digital-transformation-for-2020-and-beyond/$FILE/ey-digital-transformation-for-2020-and-beyond.pdf [Accessed Mar 2020].
[2] O'Dea, S. (2020) Total mobile industry revenue worldwide 2016-2025.[online] Available at: https://www.statista.com/statistics/219546/global-mobile-industry-revenues-since-2011/ [Accessed Mar 2020].

Diminishing revenue:

- An ongoing decline in traditional revenue streams (minutes, messages, and megabytes);

- No clear revenue generation cases for Internet of Things (IoT) and 5G.

Our clients saw that the promises of 4G failed to materialise as anticipated. Customers now expect the same content and data services hyper-charged, but with no additional outlay. 4G and 5G seem to share this profile: a windfall for consumers to the detriment of telcos.

Building costs:

- Prohibitive and protracted OpEx spend, largely servicing legacy systems and business models;

- Massive CapEx investments in next-gen networks (the fibre backbone, fibre-to-the-premise (FTTP), and 5/6G for the future, mixed economy for connectivity).

Telcos are large, complex businesses that find agility difficult because of their established business models and infrastructure. Across EMEA we saw national (or previously national) telcos hit worst, but those who consolidated acquisitions from the mid-90s also suffered significantly. In the 2020s, telcos will need to re-evaluate how they measure value propositions to survive, let alone thrive.

On this final point, although it is broadly accepted that telcos must invest to stay relevant, the commercial use cases for 5G and finding sufficient return on the massive fibre and spectrum investment are uncertain at best. This can be especially problematic for telcos who have traditionally structured commercial and departmental KPIs on very short (one to three year) cycles.

For this reason, and due to the immediacy of the threats outlined above, many consulting and advisory firms are taking a relatively conservative, short-term approach . Examples of strategies include:

- Simplifying digital architectures and driving customer-focused channel change;

- Virtualising networks and optimising them using AI;

- Transforming operations support and business support systems (OSS & BSS);

- Driving business and organisational agility.

Without doubt, for the vast majority of telcos, these are safe and sensible areas of necessary improvement. Indeed, they are likely to bring modest returns and some structural change that can be built on at a later date. However, there is little evidence to suggest that telcos can make these changes at sufficient speed, while also countering external threats caused by a faster-moving set of technologies and adjacent markets. Which is to say, whilst making these changes, effectively telcos will be building 'market debt' i.e. they will continue to fall behind the evolving market standard despite their best efforts.

To avoid this we suggest telcos take a longer view of how the market will develop and look more broadly, beyond maturing trends and technologies (agility, big data, B2C 5G/IoT), at future human needs.

[3]Imtiaz, P., Jain, P ., Kment, V. and Schaubroeck, R. (2019) The building blocks telcos need to create their digital-and-analytics DNA.[online] Available at: https://www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/the-building-blocks-telcos-need-to-create-their-digital-and-analytics-dna [Accessed Mar 2020].
[4]Poddar, B., Mishra, Y. and Ramabhadran, A. (2019). Transform Customer Journeys at Scale- and Transform Your Business. [online] Available at: https://www.bcg.com/en-gb/publications/2019/transform-customer-journeys-scale-transform-business.aspx[Accessed Mar 2020].

Trends that will define future business models for telcos

Customers want – and expect – more for less

The trends that drove low ROI in 4G is unlikely to change in any significant way in the next five years: consumers will continue to want more content from more sources with greater immediacy and at higher definition. However, with the expectation set by subscription and advertising-based models that this content is at a fixed, low price, there will be very limited opportunities to monetise the speed, quality, and availability of content, if at all. Further, given the size, scale, and success of Netflix, Amazon, Disney and others in digital content creation and distribution, opportunities in content will likely be limited to sports/esports and high-end programming that caters to local tastes and content breadth.

In a similar vein, we expect a continuation and increase in customers' demands for a range of digital services (and self-service capabilities) that 'just work'. These will increasingly seem cross-industry and distinct from telcos' core offerings. We advise thinking of these as a combination of human experiences in a world that is a hybrid of the digital and physical, and with increasingly blurry boundaries between these domains. Take 'green-charging', for example. As we see an increase in uptake of electric vehicles, there will also be a need for mobile location and payment services across disparate charging providers. This is a space that telcos could legitimately play in, which in turn could drive new revenue streams in a differentiated offering for the connected car.

Trust as a key commodity

An increasing number of critical personal services (such as banking and travel) and industry services (such as healthcare) are becoming digitised. As political polarisation and the volume and sophistication of cyber-aggression continue to rise, we expect that trust and security will be of increasing importance to consumers and businesses. Indeed, we expect that it will almost become a 'commodity'. This will be particularly relevant to telcos given their ability to protect consumer home networks made more vulnerable by the proliferation of IoT devices, and more so for those who play a role in national infrastructure. Given historical worst case scenarios, such as those felt by banks in the aftermath of the 2007/8 financial crisis (and the corresponding loss of trust), as well as the increase in cyber-aggression, (leading to massive security breaches), for telcos we can imagine that the 'winners' will be those with the least bad headlines, particularly when we consider the unique combination of private data types (financial, preference, personal) entrusted to telcos.

The rise of the customer business

Finally, economic inequality and a shift in generational spending priorities, combined with changing socio-environmental attitudes, will have a significant impact on how we perceive 'the customer'. If we consider, in particular, how the desire and need for work-flexibility and metropolitan living (and its cost) will increase for younger generations, and how deregulation across sectors and access to digital work services will both grow, we believe that there will be a commensurate increase in the number of start-ups and small and medium-sized enterprises (SMEs). This, in turn, will drive a need for a set of services that can support small enterprise growth, including connectivity, data, payment and financial management services, and high-access to sets of distributed customers who don't conform to existing demographic clusters or cohorts. This is certainly an area in which telcos have the ability to offer highly valuable service sets but also one liable to intense competition from technology pure play challengers.

Three strategies to explore for future success: retreat, expand, regroup

Given these customer and market trends, and the intense pressures previously described, we believe that telcos have three broad strategies that will enable them to thrive in 2025 and beyond

Retreat from consumers: mitigating CapEx costs and diminishing consumer revenue

The first strategy, though counter-intuitive, is to retreat away from consumers and the direct-to-consumer model. We know that impending demand for connectivity will increase and that, though infrastructure providers face future disruption from software-based solutions, there will be significant growth throughout the infrastructure value chain. Already, tower providers enjoy one of the highest revenue margins in the sector (40-70%) and tower and cell demand and provision will only increase. In the same way, approximately 89% of the 5G network will be fibre-reliant, so, across the industry, fibre provision is expected to increase eight-fold, representing an obvious opportunity. Finally, the increase in data consumption will also drive higher and differentiated data-centre services.

Here, telcos will be looking to digital-twin computing and photonic technologies to establish competitive advantages in infrastructure services, and to reduce the environmental impact of data flow and processing, in-line with the majority of corporate vision and mission statements. These are major areas of strategic focus for NTT Group and form a large share of our $3.6bn investment in R&D this year. Meanwhile, 'B2B services' (particularly 'everything-as-a-service') as an industry is expected to grow to $420bn globally by 2025, according to a Bain study from late 2018 .

By moving away from the direct-to-consumer model, telcos will effectively be able to charge-through the costs of running and maintaining networks and infrastructure, in a manner that customer expectations do not allow for at the moment. Thiswould allow them to shift from the objective of monetising consumers, to providers of better digital services. The challenges in doing so currently drive a race to the bottom, forced partly by nimble challengers with low overheads, and partly by intense market competition. By retreating from the consumer, telcos can streamline their businesses, removing extensive operating costs and sidestepping these challenges entirely.

This move to a wholesale model has been adopted in the past by previously national telcos, such as Openreach (UK) and NTT DATA's sister companies NTT East and NTT West; however, there are clear opportunities for other fixed line operators to capitalise on their infrastructure given the expected, exponential increases in connectivity demand and the need for connectivity to be satisfied by a mixed economy of fixed and wireless connectivity services.

[5]FTTX Council Africa. (2019). A complete infrastructure overhaul is needed for 5G. [online] Available at: https://techcentral.co.za/a-complete-infrastructure-overhaul-is-needed-for-5g-fttprom/92709/ [Accessed Mar 2020].

Expand to become the 'partner in the pocket': venture into adjacent markets to generate new revenue streams

To give up what is arguably telcos' greatest asset class today (their customers) will seem unpalatable – even unthinkable – to some. For telcos who want to do more for their customers and get closer to them (rather than further away), the second strategy is to expand into their homes, work, and lives.

In-line with the commoditisation of trust, the expected increase in customers running small businesses, and the growth in demand for a range of cross-industry digital services, telcos have the opportunity to own the home and connected/autonomous car. The first stage of this is to shift the way telcos think about the core services they offer. Rather than treating connectivity as a product, increasingly it will need to be seen as a utility. This subtle change will force a re-imagining of the next wave of product offerings: home (IoT) security rather than network performance, business support rather than triple-play bundles (especially for small businesses), and breakdown rather than roaming cost support. These are higher-value and stickier products for consumers, from which telcos can, in addition, re-build trust, truly becoming the 'partner in their pocket'.

The ability to operate in this space and drive additional revenue streams has been helped by shifts in the banking industry. In-line with PSD2 and country-specific regulations (such as Open Banking UK), telcos are also now able to take a greater share of the payment value chain. We advise telcos to explore pay-through and care services that traditional utility and IoT providers, in turn, could use as their mechanism for serving and billing customers. In addition to new revenue opportunities, this strategy can increase liquidity and reduce financial operating expenditures.
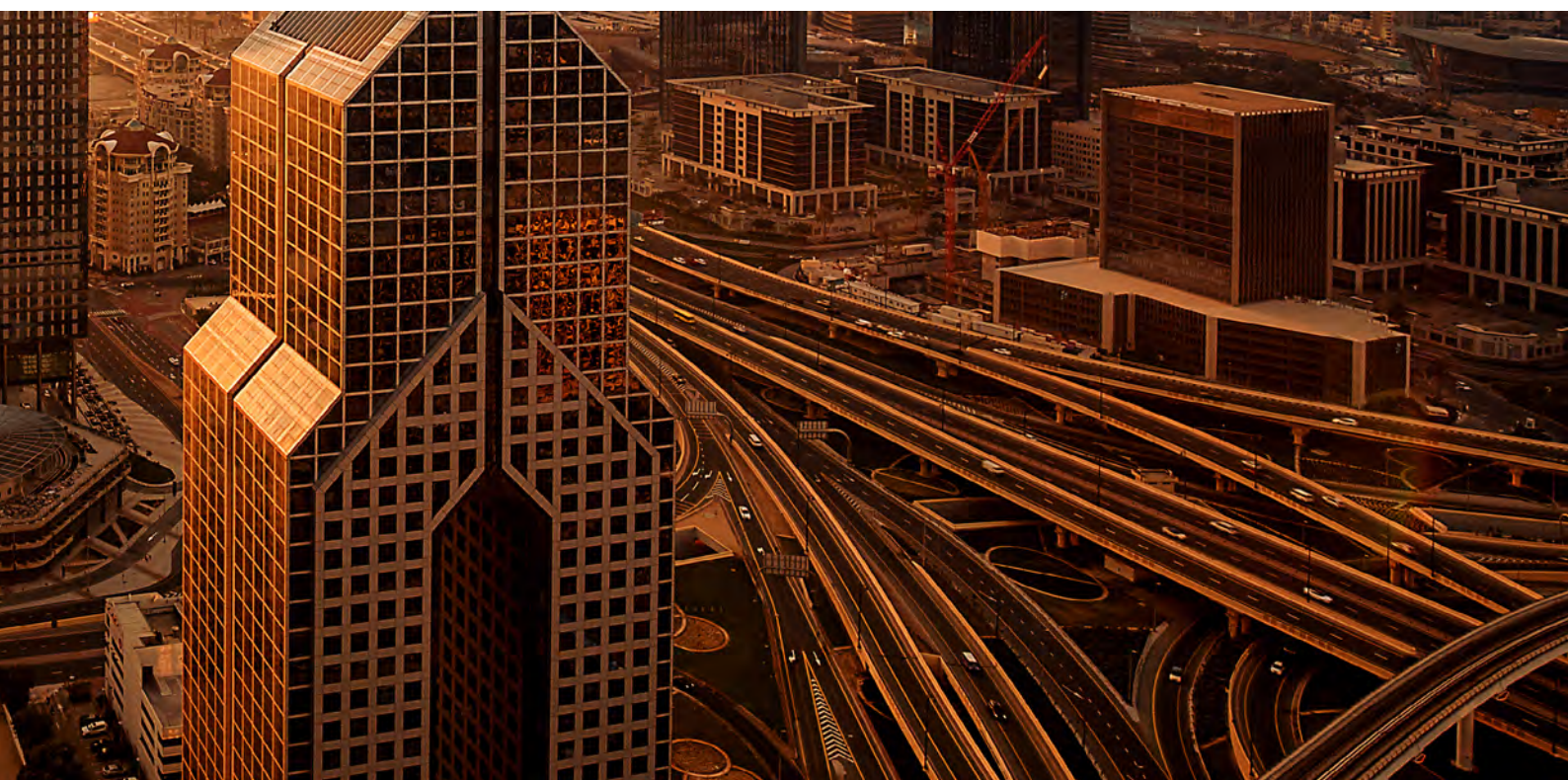
[8]Sawada, J. (2019) Characteristics of Japan through history. [online] Available at: https://ntt-review.jp/archive/nttttechnical.php?contents=ntr202002fa1_s.html [Accessed Mar 2020].
[9]Kellonem, J., Blum H. and Ellis, D. (2018) Telcos' $400 Billion As-a-Service Enterprise Gold Mine. [online] Available at: https://www.bain.com/insights/telcos-400-billion-as-a-service-enterprise-gold-mine/ [Accessed Mar 2020].

Regroup: join forces to create new value propositions at low risk

The expansion of product and service areas, whilst simultaneously engaging in parallel in core network expansion, may be too risky for most telcos to consider viable. For those who remain committed to the direct-to-consumer model, but who are also keen to avoid the 'market debt' threat presupposed by focusing on immediate digital transformation or evolution, there is a third way: to re-group.

There is broad acceptance in the market that ownership of the connectivity and product ecosystem will continue to fragment. Therefore, as a consequence, becoming a lean but critical player in that ecosystem will prove more valuable in the long-term than trying to protect current market position (a 'bend, don't break' philosophy). To increase telcos' footprint in this ecosystem requires a different way of thinking about competition and collaboration. If we accept that future demands of connectivity – in content and data consumption, the provision of critical services, autonomous travel, and connected everything – will increase dramatically and blur the lines between industries, a sensible way for telcos to draw on their strengths (large customer bases, strong core offerings, a large capital base and so on) is to join forces with small, emerging, and established players in the same ecosystem to offer combined products and services.

This is a strategy that is being pursued by NTT DATA's sister company Docomo, who have already made considerable strides in moving from a traditional telco to a tech comms company, including deriving approximately 20% of their revenue from non-telecoms services. Docomo have a created a B2B2X ecosystem for 5G with over 2500 partners; in this ecosystem – collectively – they are creating a number of joint ventures that will drive future revenue growth. They are also investing in the long-tail of 5G products and services that have fewer immediately identifiable opportunities, but still have the potential to disrupt the B2C and B2B spaces.

This is a model that NTT DATA can help telcos move towards; one that limits risk-exposure and has agility built-in, as commercial models and the use cases for 5G become clearer over time.

All change please

The existential threat faced by telcos in the 2020s is easy to underestimate when the challenges are viewed in isolation; however, it is difficult to imagine that telcos can continue as-is given building costs, diminishing revenue, and market aggression. Nor will incremental change in digital simplification, network and OSS/BSS modernisation, and a degree of business agility be sufficient to mitigate these challenges in the mid-term. Many moons ago, in his first job for a national newspaper and media group, the author of this paper was seconded into the new digital services division. Newspapers in 2009 faced their own manifold threats, not dissimilar from those telcos are facing now, albeit without the same scale of CapEx challenges. At the time, the author's boss set him the task of researching digital travel trends, to drive new revenue streams. The initial briefing ended with the boss asking: 'why didn't we invent TripAdvisor'?

In some ways it was a fair question; this newspaper had the trust, respect, and loyalty of a financially-strong base, an ability to create extensive, rich, multi-media content, and a slew of existing relationships in the travel industry. What they didn't have, though, were the technical, digital, and design capabilities needed to deliver a great customer product, the level of sponsorship from the business required to venture into new territories and take real risks, nor the agility to react to market trends and conditions to gain leadership in adjacent spaces.

Whilst considering what changes need to be made to their traditional business models, telcos need to be honest when considering the volume of structural change required to counteract technology pure play companies who will continue to disrupt the market. Understanding the size of this challenge, and the various means to make parallel and iterative changes is the first step. However, significant work is required to avoid the accumulation of market debt and to take market leadership, whether in telecoms services or adjacent product and revenue spaces. Drawing on our deep telco heritage and market leadership in APAC and globally, NTT DATA can help telco partners to explore further the challenges and opportunities that the 2020s hold, and work in partnership to adopt the right strategies to ensure they stay on the path of commercial success.

For those willing to do so, we would strongly recommend analysing the trends outlined, thinking about how the competition will – and are able to – react to these changes, positing a preferred model to follow (retreat, expand, or regroup), and engaging NTT DATA to help get you there.

NTT DATA is a leading consulting and IT services provider, combining global reach with local expertise in over 50 countries. Whether it's business transformation, enabled by digital, data and technologies, safeguarding against security breaches, improving operational efficiency or driving new revenue streams, our vision as the Trusted Global Innovator can help organisations navigate the ever-changing digital landscape and deliver outstanding results.

NTT DATA offers a portfolio of best-in-class consulting services and innovative Enterprise solutions tailored to suit the entire life cycle of IT investment. Supported by our international Centres of Excellence, our team of local experts can deliver on a wide range of services from transformation to agile development and intelligent automation for industries across manufacturing / automotive, banking, insurance, telecommunications, media and public services.

For more information about NTT DATA please visit uk.nttdata.com

NTT DaTa