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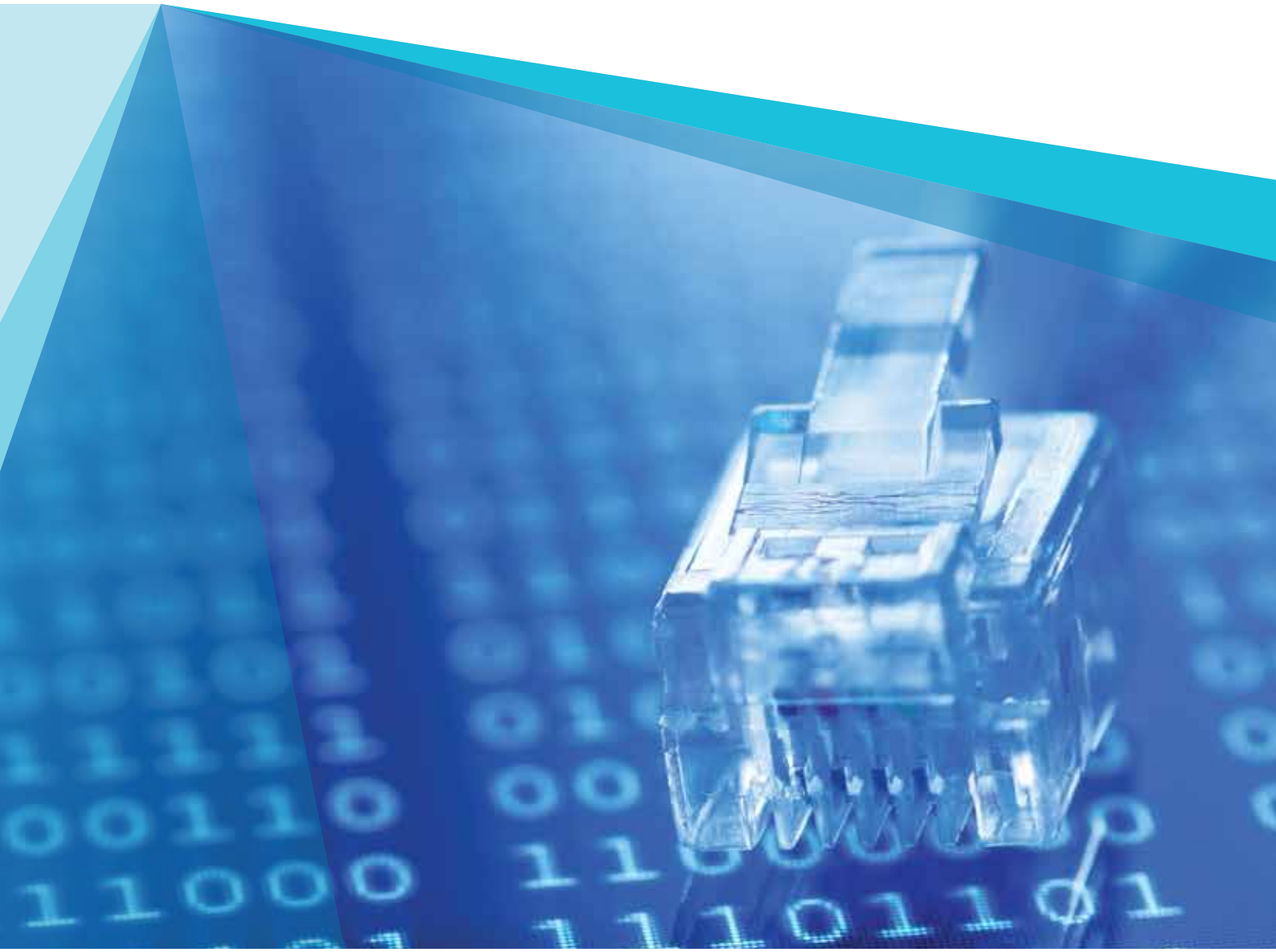
A PRACTICAL, DATA-DRIVEN APPROACH FOR GENERATING VALUE



A PRACTICAL, DATA-DRIVEN APPROACH FOR GENERATING VALUE

The telco industry is suffering a period of continued declining growth and increasingly tight margins. To succeed in this challenging environment, many companies have deployed techniques like customer value management (CVM) but with limited success. Recently, to achieve additional substantial gains, the leading telcos have been adopting a more practical, data-driven approach that shortens the feedback cycle of analysis, action, and follow-up measurements. The approach, which focuses on seven specific business levers and is used to address a range of commercial trade-offs, has enabled companies to unlock 100-300 bps of EBITDA within four to six months, with potential gains of up to 700 bps of EBITDA over one to two years.

The telco industry is struggling, with most fixed and wireless operators experiencing declining revenues and decreasing EBITDA. In this tough environment, many executives have experimented with traditional value-management techniques to allocate and balance resources in the optimal ways for driving the best overall ROI for their businesses. Such efforts, however, have often failed to reach their full potential. Indeed, many executives viewed those techniques as too complex for the benefits they brought. More recently, however, many leading telcos have begun to adopt a much more practical, data-driven approach that focuses on improving the management of the most important business decisions.

The approaches share a common obsession for driving useful results for the business. Data-driven decision-making is then embedded in the business process, so that rather than having marketers doing marketing and the business intelligence (BI) group doing analysis, BI is totally embedded in the decision-making process, and both work together to obtain better results through smarter use of data. These leading operators use the shared business understanding to do away with unhelpful precision that adds complexity, and work on evolving their approaches as they unlock value in a gradual way, gaining organisation-wide support. In these new approaches, understanding causal relationships is critical to enable decisions to be made with known outcomes. This is particularly important in markets facing structural market changes, such as handset decoupling or subsidy reductions. Finally, these new approaches are much more agile, with much shorter feedback cycles of decision, action, and measurement, enabling executives to keep their decision-making edge up to date.

Technically, the approaches rely on agile development and tools that can be quickly rolled out and improved on the fly, rather than classic IT development, with its long cycles, high costs and limited flexibility to evolve.

Data-driven decision-making thus becomes a business reality that enables the operator to extract more value from each commercial lever, and in doing so make trade-offs across the organisation. The approach enables executives to find the optimal growth path for their companies while supporting some of their key strategic decisions.

SEVEN BUSINESS LEVERS

To appreciate how this more practical, data-driven approach works, executives first need to understand its fundamental mechanisms for generating value through seven core commercial/operational levers: Customer investment, pricing and promotions, base management, distribution optimisation, bad debt, customer experience/service, and network infrastructure.

1. CUSTOMER INVESTMENT

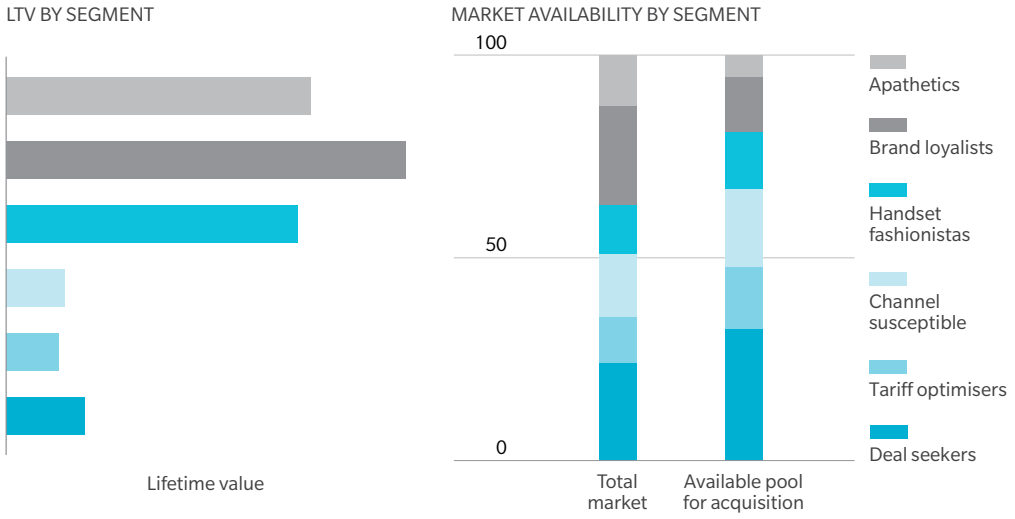
Although customer investment is typically the largest operating expenditure (OPEX) item over which telcos have control, only the best operators have made significant advances in reducing it. These best-in-class operators now rely more on hard data when making changes to the subscriber acquisition/retention costs (SAC/SRC). Specifically, they understand the causal drivers of customer decisions, and they run regular tests to quantify customers' reactions to any changes in investment levels and hence can more accurately determine the financial implications of such decisions. A 5% increase in acquisition spending relative to competition might, for example, have no benefit in acquisition share (thus driving up only costs), or it may lift share by several points. With respect to retention, the same operators can identify customer groups for which only one upgrade is needed per save (with good returns) versus other groups for which five or six upgrades are required (and returns are unacceptable). Operators that keep this information updated and systematically use it when deciding on SAC and SRC allocation can deploy their resources much more efficiently. Moreover, these companies can minimise the risks of making larger structural changes (for example, separating the handset investment from usage pricing) because they understand in detail the drivers of customer decisions and have confidence in the likely outcome of those moves. As a result, the leading operators have succeeded in reducing their investment budgets by 10% to 20% without harming customer acquisition, base margin, or churn performance. This typically translates into 100 to 200 bps of EBITDA.

2. PRICING AND PROMOTIONS

Historically, telcos focused their pricing offers on driving volume and having a differentiating marketing "shout". Today, most operators have taken a more sophisticated approach, developing offers with a clear view of the base effects, expected churn and ARPU dilution. Still, however, many operators continue to spend more money to attract the least valuable parts of the market, namely, the rapid churners and deal seekers. So to attract deal seekers, for instance, they offer high upfront discounts on the tariff or handset, but such customers tend to have lower loyalty and are thus less valuable over the long term. Instead, the best telcos focus their efforts on the most intrinsically valuable and loyal customers. These segments want more innovative and flexible tariffs, and they are attracted by rewards that grow over time. Thus the leading operators drive loyalty with offers that get better the longer the customer stays. These leading operators also have put in place agile decision-action-measurement cycles that build up a powerful cycle of learning and differentiation. Applying these types of advanced techniques to engineer customer offers typically delivers in excess of 50 bps of EBITDA.

Segments can be identified that have very different value and that are attracted by different offer structures. In our experience, a good value proposition refresh, coupled with the right channel remuneration, can provide a disproportionate share of the best segments.

EXHIBIT 1: SELECTING THE BEST CUSTOMERS IN THE MARKET



3. BASE MANAGEMENT

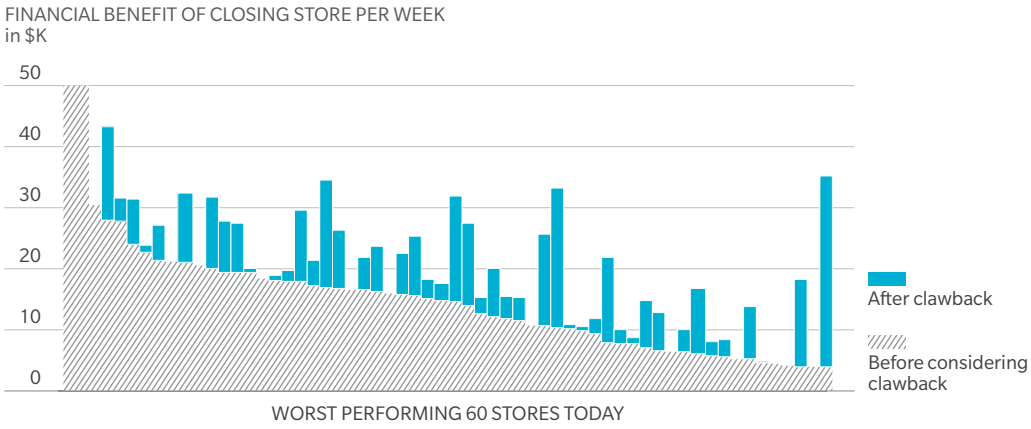
Telcos have traditionally focused their base management on selling public offers to their existing customers, with few exceptions outside of reactive save teams. Now, the leading companies are tailoring "private offers" to individual customers, increasing the attractiveness for subscribers while creating margin upside for the operator. They have put in place an approach whereby decisions on private offers are totally based on precise data about customers' behaviours. These telcos know a customer's usage as well as his or her likelihood to adopt certain products and services at different price levels, and they keep this information fresh with regular testing. Thus they can deliver attractive offers that help drive better adoption and reduce churn. The top telcos also deploy "surprise and delight" tactics that create cost-effective exit barriers or that lead customers on data-usage journeys to grow their ARPU. Such approaches not only reduce churn and increase margin, they also fly under the competitive radar because they do not alter public offers or rate cards, and this helps to maintain market stability. Together, such techniques for better base management can be worth at least 100 bps of EBITDA, and often much more.

4. DISTRIBUTION OPTIMISATION

Most carriers have yet to bring their distribution channels up to speed with their counterparts in dedicated retailing. The leading telcos, however, have begun to address that deficiency. Indeed, the best operators are starting to employ more advanced retailing capabilities to optimise their store footprints, formats, and local offers. They know, for example, the precise effect that opening or refurbishing a shop will have on the business they can capture from the competition, and the cannibalisation effects across all their channels (other own shops, indirect retailers and online) depending on the local environment and surrounding shops. They also recognise that the advantages of price reductions can vary by five to 10 times, with aggressive strategies more likely to pay off at competitive locations. Obviously, the potential gains here greatly depend on the scale of an operator's distribution operations, but a typical carrier can unlock an additional 100 bps of EBITDA by bringing its distribution management up to the standards of a good retailer.

EXHIBIT 2: DECIDING ON STORE CLOSURES CONSIDERING CANNIBALISATION

FINANCIAL BENEFIT TODAY OF CLOSING THE WORST PERFORMING STORES, WITH AND WITHOUT CONSIDERING CLAWBACK



Very different decisions would be taken with and without clawback: The best operators can quantify the incremental contribution of each store, based on an understanding of the surrounding store environment. So when they want to close any particular store, for example, they know how much volume will be clawed back within their distribution network (i.e., to other own stores, indirect or online) or be lost to competition.

5. BAD DEBT

The management of bad debt has a far-reaching influence, going well beyond the control of non-recoverable income and fraud. For most operators, the opportunity costs of failing to manage bad debt properly are even greater than the direct costs. Consider a company that disconnects potentially reliable existing customers or that rejects valuable prospective clients because of bad debt. As it turns out, only a relatively small number of delinquent payments are fraud-related or incur high costs, and even though some operators reject as many as 40% of new customer acquisitions, at least half of those would turn out to be valuable accounts. The leading telcos have therefore devised strategies to manage bad debt and access to service in ways that enable them to extract more value and improve the customer experience. They leverage a broad range of tailored customer approaches, using analytics to understand the best approach for each customer and the change in behaviour that will result from any action they take. Regular testing of approaches helps ensure this understanding remains up to date and is used almost "real time" in deciding on customer entry or risk-management profiles in the base. Even relatively advanced operators have been able to unlock an additional 100 to 200 bps of EBITDA in this way.

6. CUSTOMER EXPERIENCE/SERVICE

Many telcos have undertaken aggressive actions like offshoring to slash their customer-service costs, resulting in some operators losing their positions as service leaders. Other carriers took the opposite route, gold-plating their customer experience to a level that was financially untenable and difficult to justify. The leading telcos have been able to strike an effective middle ground, with "just right" customer experience, because they have developed the capability to quantify exactly how changes to specific touch points will affect the customer's service experience, perception, and resulting behaviour. As such, they can carefully evaluate the cost that each proposed change will incur and, in doing so, they can then prioritise their actions based on a detailed cost-benefit analysis. This knowledge is kept up to date

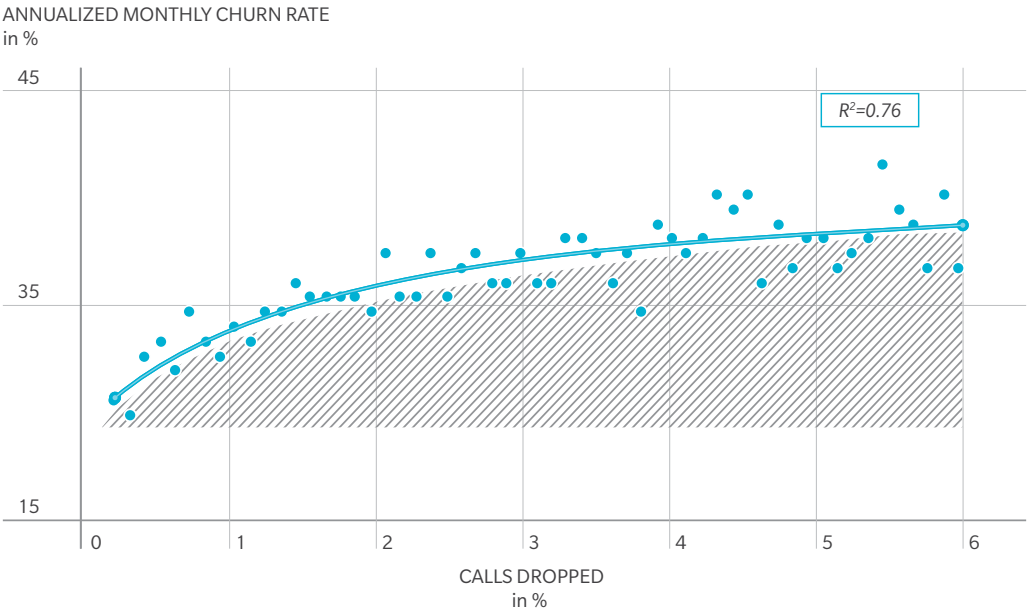
with regular surveys and live testing, ensuring that changes in customers' priorities are captured. This process is essential for justifying the business case of large moves, but it can also often yield surprising results in uncovering smaller issues that have a disproportionately big impact on perception and value (and that cost relatively little to address). Better service management based on these techniques can yield an additional 50 bps of EBITDA.

7. NETWORK INFRASTRUCTURE

Traditionally, a telco's marketing function defined the customer offer and network requirements, using the network expenditure budgets (CAPEX and OPEX) as an input for its models, and the network teams decided how and where to make those investments. In contrast, leading telcos have taken a more sophisticated approach of value-driven CAPEX and OPEX deployment. For them, the marketing function now has detailed data on the impact of network deployment (see Exhibit 3) and maintenance, enabling a deeper understanding of how network quality will influence customer perception for different segments and how that, in turn, will influence behaviour in usage, churn, and market share/adoption. Using that information along with an understanding of localised costs, a telco can then determine the value impact of any change. Now, instead of working in separate "silos", marketing collaborates with the network teams to ensure that any deployment delivers maximum value, taking into account how the customer experience and behaviour will change by segment. Telcos that manage their networks in this way can deliver around 100 to 150 bps of EBITDA.

Leading telcos understand how different network attributes influence customer churn and usage behaviour. In this example, a strong relationship exists between network quality and churn, with higher-value customers being even more sensitive and reactive.

EXHIBIT 3: UNDERSTANDING HOW DROPPED CALLS INFLUENCE CHURN BEHAVIOUR



IMPLEMENTING THE SEVEN LEVERS

Of course, every company's situation is unique, but operators of all types and sophistication levels have garnered benefits from using the approaches described in this paper. In less advanced markets, even small changes towards data-driven decision-making have reaped quick benefits. And in more mature markets, operators with a strong business intelligence (BI) group and experience using value management techniques have profited from more advanced approaches that have typically required the addition of new capabilities for any particular business lever. Those capabilities have generally included:

- decision support tools that are adapted to the optimal business processes (and not the other way around),
- a reporting framework that provides a consistent forward-looking view, explaining performance on the most important actionable levers and providing drill-down capability so that executives can quickly get to the root causes, and
- bottom-up budgeting, based on specific, accurate details of how proposed changes will affect customer and competitor behaviour.

Obviously, building such capabilities is hardly a trivial matter. But, when done properly, they can become the foundation of a practical, data-driven approach with seven powerful business levers. And by recognizing the interlinked nature of those levers, telcos can move away from a "silo" mentality and towards the integrated management of top line and costs. The result: a much more centralised view of resource allocation, enabling a carrier to make optimal decisions based on a thorough understanding of the various trade-offs involved. Using such a practical, data-driven approach, best-in-class operators have already achieved real, tangible successes. Undoubtedly the potential gains are considerable: up to 700 bps of EBIDTA across all seven levers when moving from a good starting capability level to best in class.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across 25 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,000 professionals help clients optimize their business, improve their operations and risk profile, and accelerate their organizational 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.

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