OLIVER WYMAN

SMARTER WAYS TO ACQUIRE AND RETAIN CUSTOMERS

Telco operators have been focusing on tighter cost management to maintain or improve their profitability levels. Despite those efforts, however, many have failed to make a sustained long-term impact on their largest controllable operating expense: subscriber acquisition and retention costs. But the best operators have made bold moves to overhaul their investment models or they have achieved step changes in their customer investment management capabilities. Both approaches have relied on the same foundational capability: providing managers with a deep quantitative understanding of how customers will react to differences in investment level and structure and the financial implications of those choices. Of course, all this is far easier said than done, but the rewards are considerable: These leading operators have succeeded in reducing their customer investment budgets by 10–20% without harming their acquisition, base margin or churn performance. Moreover, such results don't necessarily require multi-year, corporate-wide initiatives; in fact, significant value can be attained within four to six months.

REDUCING SUBSCRIBER ACQUISITION AND RETENTION COSTS

Given that many telco markets reached maturity years ago, rampant customer growth is a thing of the past. Telco operators are now locked in a battle to develop and retain their best customers, even as they continue their efforts to acquire new ones. As the competition becomes increasingly fierce, companies have launched initiatives to reduce costs in order to maintain past profitability. But those efforts have had limited success on the customer-investment front. In most cases, customer-investment spending has not been effectively controlled – and in some cases it has even continued to grow.

Indeed, reducing subscriber acquisition and retention costs is a huge challenge. Customer-investment spending is at the heart of an operator's ability to acquire and retain clients – less cost is globally desirable, but only if acquisition and retention can be sustained without diluting the base. An additional thing to keep in mind is that market dynamics are usually not favourable to investment cuts: While most competitors quickly follow a subsidy increase (to avoid losing their market share), when facing an attempt by one of the competition to "cool off" the market, they may well prefer to keep subsidies at their budgeted level and gain market share. In that context, some telco operators have made – or are considering making – bold changes to their investment structures *(see exhibit 1)*. Others have succeeded without significantly changing their models. The common factor for the winners: injecting

EXHIBIT 1: OPERATORS WORLDWIDE ARE MOVING BEYOND TRADITIONAL POSTPAID CONTRACTS AS A MEANS TO LOWER SUBSIDIES AND ATTRACT/RETAIN SPECIFIC SEGMENTS

GOALS PURSUED BY OPERATORS WITH NEW HANDSET PROGRAMS

Reduce overall level of subsidies, which has been exploding with smartphones

Make actual cost of devices more transparent to end-users to increase pressure on OEMs to compete on device pricing

Offer new handset options tailored to specific segments (e.g., frequent upgraders) to increase share of preference and loyalty

Where possible, **monetise customer preferences for different handset options** (e.g., option for early upgrade, no payment down) through increasingly sophisticated pricing schemes

TYPE OF HANDSET PROGRAM	$650 SMARTPHONE AND A $50 PLAN		
	Upfront	Monthly	
Traditional contracts			
2-year contract	$199	$70	○
Handset/service decoupling			
SIM-only	$650	$50	◘
Handset leasing	$0	$50+20	◘
Pay over time	$0	$50+27[1]	◇
Hybrid logic			
Name your price (and pay only 24 installments)	$0	$60+23	✧ ◇
	or $100	$60+16	✧ ◇
	or $200	$60+10	✧ ◇
Segment or behaviour-driven options			
12-month upgrades	$0	$70+27[1,2]	✧
Frequent upgrade	$199	$70+10[2]	✧
Segmented early upgrade	$99–$599	$70	△

HOW CARRIERS MAKE ECONOMICS WORK

○ Lowers churn thanks to binding contract; generate extra margin on "late" upgraders; incentivises larger bundles though subsidy ladder (where possible)

◘ Offers alternative for price sensitive subs owning a handset

◇ Decreases handset renewal cycles (financial incentive to keep handset at the end of contract)

Locks-in customers while claiming "no commitment"

✧ Makes handset costs transparent and puts pressure on OEMs

Monetises customer cash constraints and upgrade flexibility requirements

△ Leverages different customer churn and "savability" propensity, early upgrade appetite, and value differences to lock-in customer before they "shop around"

1 650/24
2 Handset give back

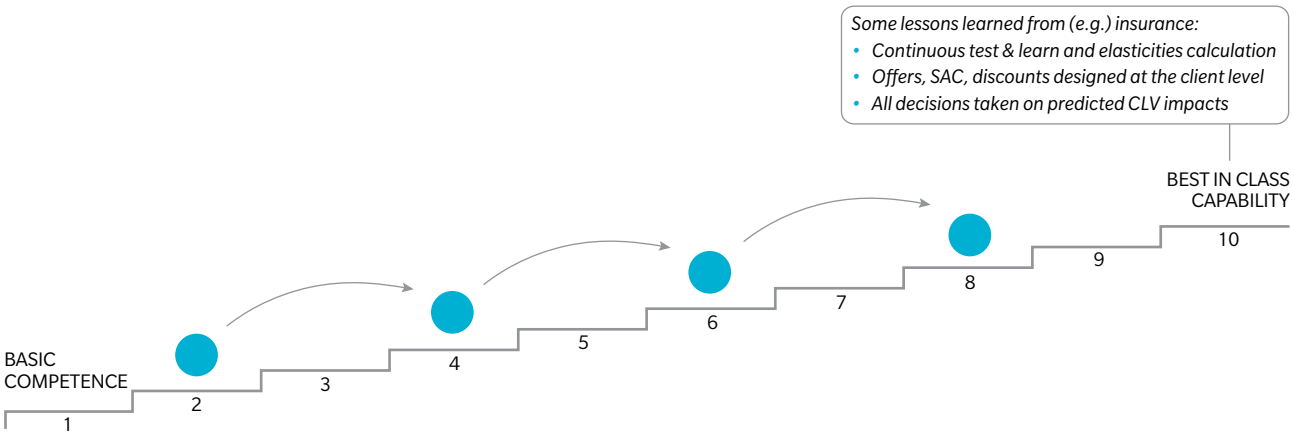
more science into their decision-making processes *(see exhibit 2)*, allowing them to obtain a much better understanding of customers' reactions to differences in investment level (and the resulting financial implications). As such, they haven't had to rely as much on "guesstimates" and can avoid making unsecured bets.

DEVELOPING A WINNING FORMULA

Exactly what kind of knowledge is necessary for companies to make smarter decisions about customer investment management? The leading telco operators have deployed practices and methodologies from advanced industries like retail, consumer credit and insurance to enable them to learn and do the following. For starters, they know how each incremental change in investment level, structure, or timing of the upgrade eligibility rules will affect customer behaviour. They also can predict how many customers will actually churn if their upgrade price is not good enough. Moreover, they understand how customers make trade-off decisions about feature richness versus device investment, and about immediate one-off payment versus future installments. They have a detailed understanding of what the competition will do if they increase their subsidies to get a disproportionate share of gross adds or if they lock-in too many of their customers, leaving a decreasing "acquisition market" for other companies. And lastly and most importantly, the leading operators are able to adapt and apply all this knowledge to optimise their customer-investment policies and to

EXHIBIT 2: UPGRADING CUSTOMER INVESTMENT MANAGEMENT CAPABILITIES

SIMPLIFIED VIEW OF OLIVER WYMAN STAIRCASE



- No understanding of elasticity - investment set based on intuition/last years budget +/-
- Few SAC levels, SRC set relative to SAC
- Handset prices based on intuition and overall SAC level
- Steering of spend and outcomes (e.g. churn, acquisition) disconnected

- Detailed understanding of causalities used to define investment levels
- Industrial measurement, including "test and learn"
- Competitive reaction accounted, and offer structured to create "invisibility"
- Handset price levels set taking into account "handset" cannibalisation
- Budget steering defined and managed bottom up

de-risk the design of new investment models. At the heart of these new, smarter strategies is the ability to over-invest where the return is best, while investing less on an overall basis.

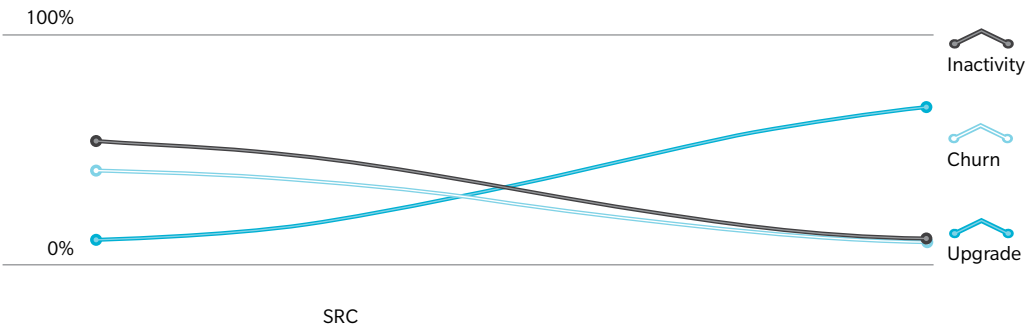
To appreciate the power of such strategies, consider the following example of customer-acquisition elasticity. Leading operators know that that elasticity can vary by a factor of five, depending on the commercial zone or local competitiveness in a region. Thus, a temporary strategy of slightly decreasing the overall customer-investment acquisition levels combined with regional promotions in certain local markets can significantly (and quietly) improve acquisition efficiency without alerting the competition.

With respect to customer retention, sophisticated operators are able to identify large groups of customers where as many as five or six incremental upgrades are needed for another incremental save, and other groups where just 1.5 upgrades will do. Obviously, moving investments to the latter groups will dramatically lift the retention efficiency *(see exhibit 3)*.

They can also quantify the subsidy decrease each customer segment will accept in exchange for earlier upgrades and thus save on overall spending while increasing customer satisfaction with the right "early upgrades" subsidies.

At a more granular level, improved pricing for individual handset models also yields significant returns. The best operators understand each handset's gross and net elasticity. As such, when increasing the subsidy on a given model they can quantify the share of the volume increase coming from the overall market versus from those customers who would have taken one of their offers anyway; they also know which offers and handsets were cannibalised. So they might, for example, over-invest in one of the challenger smartphones to steal share from the popular smartphones in order to reduce their overall investment, and by doing so they can often also reap the added benefits of increased supplier funding.

EXHIBIT 3: CHURN, INACTIVITY AND UPGRADE RATES BY SRC LEVEL



Advanced operators can predict the precise impact of increasing the retention investment (in device/offer etc.) on one particular micro-segment (% decrease in churn, but also % of customers who would have done nothing and now upgrade).

Some segments need as few as 1.5 upgrades per churn save, others 5 or 6, resulting in huge ROI differences.

THREE FUNDAMENTAL CAPABILITIES

As mentioned earlier, only a few leading telco operators have successfully reinvented their investment models or optimised their existing customer investment frameworks. In doing so, they dramatically upgraded their capabilities in three fundamental ways:

- Understanding market and customer dynamics: striving to capture customer's behaviours and competitive dynamics in "stable laws", thus creating powerful insights with which to make customer-investment decisions.
- Continuous learning: setting up operations that enable the continuous learning of customers' and competitors' behaviour in order to make adjustments in the investment strategy.
- The "optimisation ready" organisation: organising the customer investment budget setting, steering, and day-to-day management in a "de-siloed" way.

UNDERSTANDING MARKET AND COMPETITOR DYNAMICS – THE SEARCH FOR "STABLE" LAWS

Most operators have gained a significant amount of skill and experience in defining customer-investment levels and policies. They have experienced teams with a good intuition of the impact of changes in handset pricing or investment levels on market share and churn (for example, if we increase the subscriber-acquisition cost, or SAC, by X, then we will acquire an additional Y customers). They can also measure the margin of key customer segments accurately, and thus quantify their "static" ROI to guide investment level setting. The leading operators, however, do not rely simply on intuition and static views. They have decomposed the overall "chain reaction" in order to quantify the impact of changes to key levers such as acquisition subsidy, retention subsidy, eligibility and so on. The goal is to fully understand and model the way customers make their decisions.

Take, for instance, retention elasticity, which depends not only on customer segments and behaviours but also on the difference between your retention offer and the competitors' acquisition offers. This reflects the way that customers really think – that is, they balance the attractiveness of the loyalty program of their current operator at the moment of contract renewal versus the deals proposed by the competition for new clients. Knowledge of retention elasticity also helps the leading operators engineer the timing of contract renewal for each customer segment in order to favour early upgrade at a lower cost, thus reducing the overall renewal cost. In addition, several secondary effects also need to be accounted for. For example, increasing the investment in retention on customer segment X will lead to fewer "disconnects", which could potentially trigger reactions from competitors because there will be fewer available prospects for them.

Understanding such market and competitive dynamics is not a trivial task and requires more than intuition. Once accomplished, however, a company can develop powerful stable laws and models, which can then be applied to a wide range of situations, from very small tactical moves to de-risking more structural changes, enabling adjustments to be made for optimising those manoeuvres.

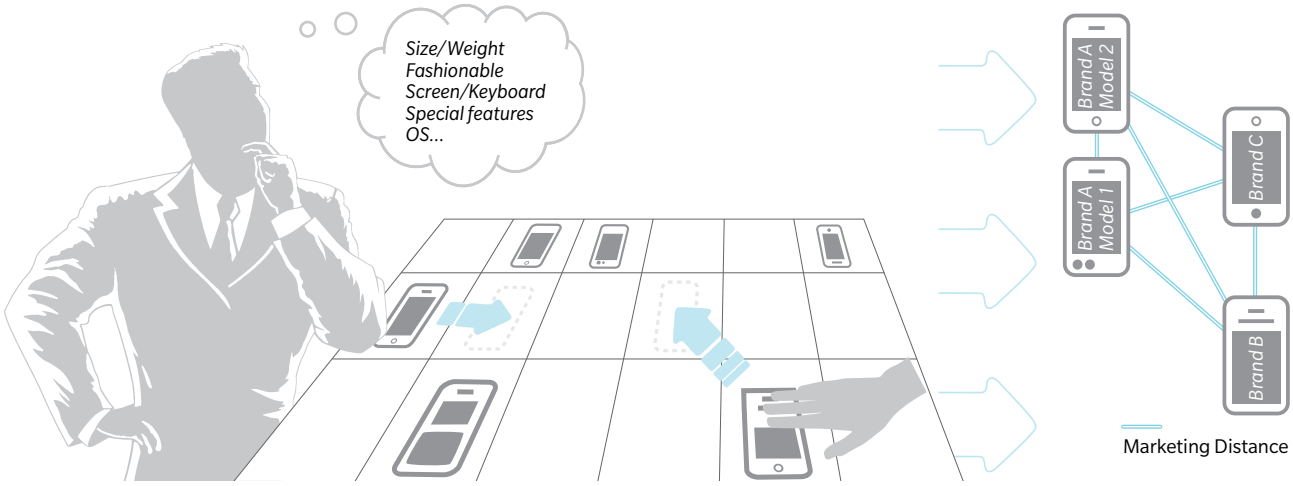
CONTINUOUS LEARNING – A NECESSARY OBSESSION

Many operators know how to measure the ROI of customer investments, and they have detailed reporting to understand the volume and the quality of the acquisitions, with similar numbers for retention and churn. The leading operators, however, are also able to measure customers' elasticity to changes in investment levels, and they can quantify the effect of changes to eligibility rules on a regular – if not continuous – basis. In addition to past data analysis, the most advanced of them apply live testing techniques that the consumer finance and insurance industries have used for years.

Here's how it works. In acquisition, a subset of shops is isolated for testing, and different prices (that is, investment levels) are tested. Results are then compared with a control group of stores.

In retention, hundreds of segments are often managed, with different price levels tested across them through online or telesales channels. Elasticity curves are developed for tariff richness, device pricing, structure and upgrade timing to allow proper trade-offs to be made. Monthly measurements are made to fine-tune the elasticity curves, while regular larger scale testing is run across a broader spectrum of investment levels and to evaluate potential new investment structures. Another technique that the leading operators deploy is "marketing closeness mapping". Commonplace in retail, marketing closeness mapping can be used to understand how new handsets will take market share and to quantify their net and gross elasticities. Such approaches allow qualitative insight to be combined with hard data *(see exhibit 4)*, enabling operators to predict changes in their product mix with much more accuracy. Armed with this information, telco executives can better determine not only the optimal pricing but also the required stock levels, and they become better equipped to negotiate with the handset providers.

EXHIBIT 4: QUALITATIVE "MARKETING CLOSENESS" MAPPING OF HANDSETS CAN BE INTEGRATED WITH THE HARD ANALYSIS TO BETTER PREDICT HOW VOLUMES WILL MOVE AS PRICE IS CHANGED



THE "OPTIMISATION READY" ORGANISATION – REACHING ACROSS SILOS

Telco executives who manage customer investments face many complex decisions. Budget setting, so often tackled in a top-down fashion for lack of a better way, must now account for the deep understanding of the impact of changes on churn and acquisition, including assessments of cross-effects, such as acquisition activity on retention. Rich data are needed with low latency, and test results require constant refresh and analysis. Hundreds of day-to-day decisions must be made based on this information and reconciled systematically with top-level steering: detailed handset pricing, retention investment levels across hundreds of segments and so on.

No organisation can manage so many decisions and processes simultaneously with the use of just traditional ad hoc tools. And the reality is that, in less advanced companies, decision-making often remains "siloed" in different departments, where important decisions are frequently driven by instinct. Many organisations do produce helpful, detailed, value-based performance reporting, but all too often such information is not integrated into the right customer-investment governance, decision-making process or tools. In contrast, the leading players have progressively developed an integrated suite of decision-support tools and processes, linking all the elements of customer investment management: handset pricing, competitive dynamics, budgeting and steering, handset range, sales forecasting and so on. These tool modules are automatically fed with fresh customer data, market information and updated elasticities from continuous analysis. Moreover, the leading operations have clearly defined processes and workflows that provide inputs and help inform the decisions of different stakeholders within the organisation.

CONCLUSION

When it comes to operating expenses, one of the few common priorities for all telco operators is clear: reduce customer investments. But cutting those costs is anything but simple because customer acquisition and retention greatly depend on such investments. Some operators have made substantial gains by changing their investment models, or by upgrading their capabilities to optimise investment within an existing structure. Either way, the requisites for success are the same: a deep quantitative understanding of customer and competitor behaviour, a continuous learning capability and an organisational ability to embed this science into decision-making processes. The best operators have achieved those capabilities by adapting practices from the financial services, insurance and retail industries. They have upgraded their analytical capabilities, introduced a culture of systematic measurement and continuous learning and have created the governance and the tools to embed these critical competencies into their organisational DNA. With the right focus, these changes can be realised relatively quickly, with significant value typically being unlocked within four to six months. And the rewards can be considerable. It is not uncommon for operators to save 10–20% of their investment budget while holding steady on customer churn, base margin and acquisition performance. The impact on the bottom line? Such savings typically translate into one to two points or more of EBITDA improvement.

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].
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