



Telecoms: Creating value in a disruptive age

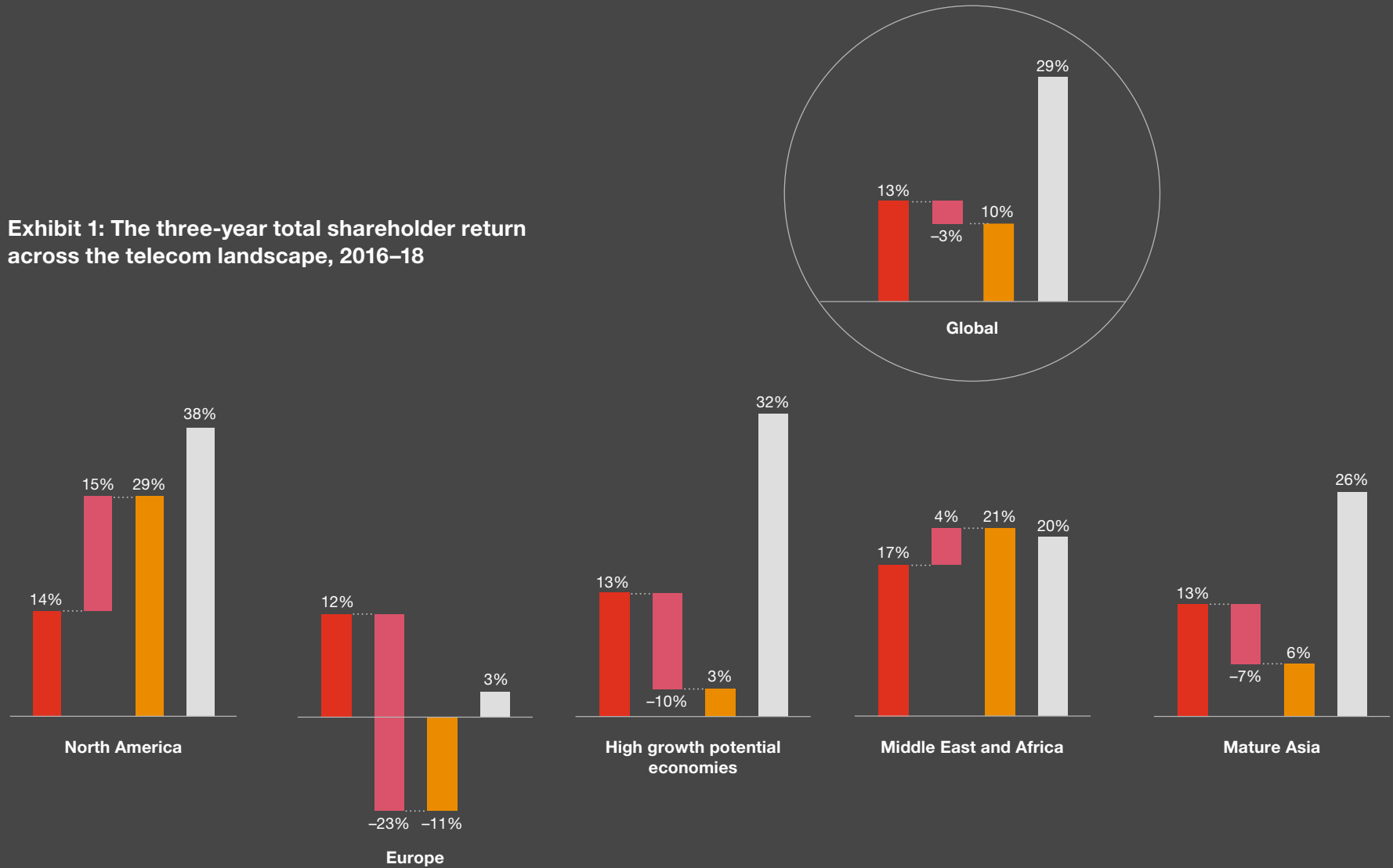
How to build a coherent strategy with
diversification and infrastructure plays

Executive summary

The past several years have not been kind to the global telecom industry. Wireless markets are saturated, fixed-line services are under pressure from cord cutting and both are increasingly commoditised in many regions. Competition is becoming ever more brutal, owing to both aggressive operators within the industry and interlopers moving in from adjacent industries. Regulatory regimes have become less predictable. Consumers are more stubborn in their resistance to price increases. Telecom companies are facing huge investment decisions over the next few years.

Investors have noticed. Total shareholder return (TSR, or the share price change plus dividends) for a basket of 40 telecom companies around the world from 2016 to 2018 came to just 10% for the three-year period. All of that return came in the form of dividends; share prices actually fell 3% over the same span. Results varied by region, of course. North American telecoms returned the highest TSR, at 29% — no surprise, given that the market there is concentrated around just a few big operators. In Europe, by contrast, where a similar-sized total market is shared among many more operators, TSR fell by 11% (see Exhibit 1).

Exhibit 1: The three-year total shareholder return across the telecom landscape, 2016–18



Note: Numbers show total shareholder return (TSR) from 2016 through 2018 as a percentage of investment. TSR by region is calculated as a weighted average of major telecoms in each region. Regional indices used are MCSI indices for large and mid-cap companies, covering about 85% of free float-adjusted market capitalisation in the region. High growth potential economies include China, Malaysia, Brazil, India and Russia. Mature Asia includes Japan, South Korea, Australia and Singapore.

Source: Bloomberg Terminal, analysis by PwC's Strategy&

- Dividend
- Price change
- TSR
- Index

Telecom executives are well aware of their declining attractiveness to investors. In hopes of reversing the trend by boosting shareholder value, many are looking for a better strategic path. There are essentially two options for them to consider. The first path is diversification — increasing revenues and profits by moving into new businesses. AT&T's purchase of Time Warner and Orange's moves into financial services are examples. The second path is an infrastructure play: to double down on or restructure the company's assets while improving results through renewed management focus and increased transparency for investors. This path can position a company for new networking-oriented revenue streams. Case in point: TDC, Denmark's incumbent operator, which recently split into Nuuday for its market-facing brands and TDC NetCo for its network operations; or Telstra in Australia, which has set up a separate InfraCo business division for its fixed infrastructure assets and operations.

The logic of each choice, from the point of view of shareholders and investors, is sound. Those looking for growth will likely be attracted to the companies looking to diversify, whereas those who prefer steady dividends will look to the infrastructure plays.

Many telecoms are hoping not to have to choose, but it is becoming more difficult to follow both paths and bring investors on the journey. Each path requires different capabilities, a clear 'right to win,' and enough investment to demand full commitment. (A company's right to win is its ability to consistently compete with a high expectation of success.) So far, few telecom companies have settled on a single path (or a well-designed combination path) that clearly demonstrates their capability to disrupt new sectors or to deliver predictable capital returns from infrastructure.

On what basis can telecom operators create more convincing strategies? What criteria will matter most to those looking to diversify, or to focus on infrastructure, and give them the best chances for success?

To answer these questions, it is most helpful to consider the conditions under which one or the other strategy is most likely to succeed — and thus to please investors as well.



Winning through diversification



The determination of telecom operators to diversify their activities is entirely understandable. Revenues are flat or down at many companies, thanks to saturated markets, ongoing price wars and commoditisation of services, and consumer resistance to price increases. Yet these companies already possess many of the capabilities needed to compete successfully in businesses that are ripe for digital disruption. The telecom operators have trusted brands, sales reach, customer experience focus, data analytics experience and more.

Thus, just as technology companies have edged their way into a variety of adjacent activities — cloud services, the auto and healthcare industries, and telecom itself — some operators have been looking well beyond the provision of broadband and wireless services for new ways to bring in more revenue from existing customers and broaden their customer base. Areas of interest include financial services and insurance, healthcare, home security and management, telematics, identity and security operations, and media and content. In the US, Verizon is a good example. It has made acquisitions over the years in cybersecurity, IT services, telematics, and media and entertainment.

So far, however, the results have been decidedly mixed for most telecoms, for two reasons. First, many operators have struggled to devote the focus needed to create sufficient scale in the businesses they've chosen to pursue, and to put in place the innovative business models and nimble operating models needed to succeed in the digital world. When they have tried to diversify through acquisition, they have often failed to unlock synergies that could change the competitive dynamic in the market.

Second, some operators have made moves outside the telecom realm into areas where they had no clear right to win in this market. Typically in these cases, the competition was too entrenched and the operator didn't have the right capabilities or business model needed to successfully disrupt the incumbents. Furthermore, carriers that operate in a single country or group of countries because of licensing rules governing legacy telecoms will inevitably struggle against stronger global competitors with internationally recognised brands.

Most telecom companies have the talent, processes and mind-set to perform sophisticated engineering and network maintenance operations. But those capabilities are distinctly different from what’s needed to succeed in fast-moving consumer-centric businesses. These businesses require the ability and willingness to listen to consumers, innovate and iterate quickly, involve partners, and rethink and implement new monetisation models.

To bridge these common gaps in their capabilities, we suggest telecom operators ask themselves two questions when considering what new businesses they should diversify into.

- Does the company have capabilities that clearly support the areas it’s trying to diversify into?
- To what extent would the company’s efforts to move into its chosen adjacent industry disrupt that industry and give it a right to win?

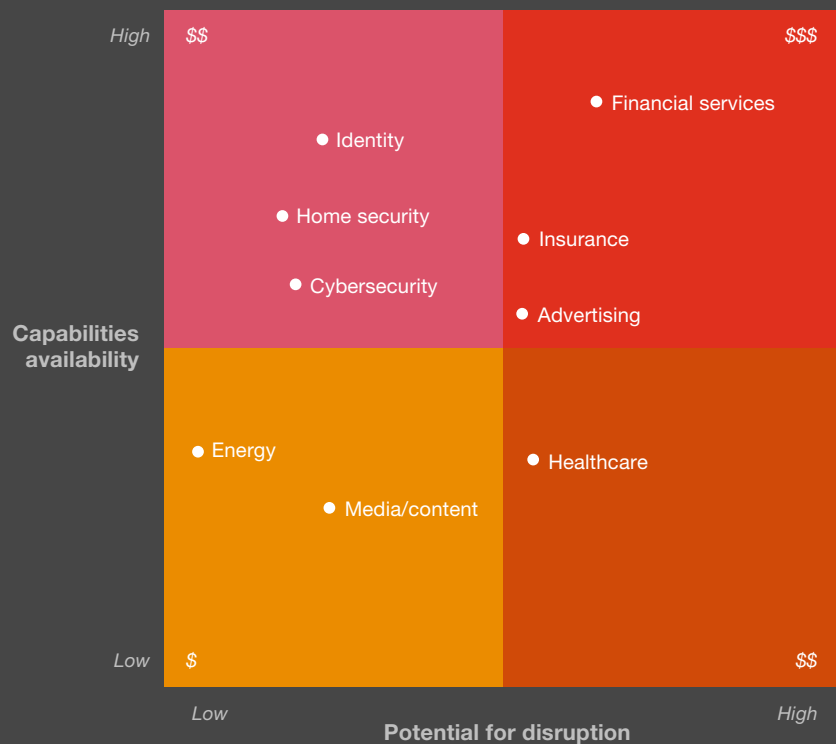
For each company considering its diversification options, there is a range of possibilities. The advantages and disadvantages of each option will vary from one company to the next (see Exhibit 2).

Each quadrant in the exhibit suggests a way forwards for operators, both to analyse where they currently stand in terms of their potential for diversification, and to determine how best to move ahead, and into which industries. The placement of each industry within the diagram indicates our assessment of its strategic attractiveness, and the specifics will vary significantly depending on each individual operator’s market, capabilities set, and data and technology expertise.

For example, Orange began its diversification journey early, initially moving into content, and then into IT integration and cybersecurity. It launched Orange Money in Africa in 2008, then launched a full-fledged banking service, Orange Bank, in France in 2017, with plans to move into Spain in 2019 and elsewhere in the coming years. Its potential for disrupting the financial-services industry is high: Orange’s plan is to focus on online banking and credit services, which are becoming increasingly competitive but remain full of opportunity. The operator’s current capabilities — its extensive network of shops, well-known and trusted brand name, and customer knowledge, which provides it an excellent source of data for accurate credit scoring — should enable it to thrive.

On the other hand, many operators continue to try to diversify into the content and media businesses, including up-and-coming content plays such as e-sports and AR and VR gaming. Every aspect of the content business, however, is already in the throes of massive disruption coming from highly experienced players and deep-pocketed tech companies alike, and, so far, no telecom players have demonstrated that they have the capabilities to disrupt it further. If they are to do so, they must clearly define not just their strategy for pursuing this avenue of growth but the logic behind the business case. (For further insight into diversification strategies for telecom operators, see “Tomorrow’s Data Heroes,” published in *strategy+business* in February 2019.)

Exhibit 2: A framework for diversification strategies



Note: Relative opportunity for monetisation is indicated by \$.

Source: PwC analysis based on observations of industry dynamics and technological trends. The mix of strategies and their placement will vary depending on the circumstances of the company.

The infrastructure play

There is, of course, a whole group of telecom companies that continue to see value in doubling down on their strengths in infrastructure and networking. This strategy can make sense if the goal is to maintain or slowly grow revenues while increasing profits through careful cost management — and thus provide investors with reliable dividend yields.

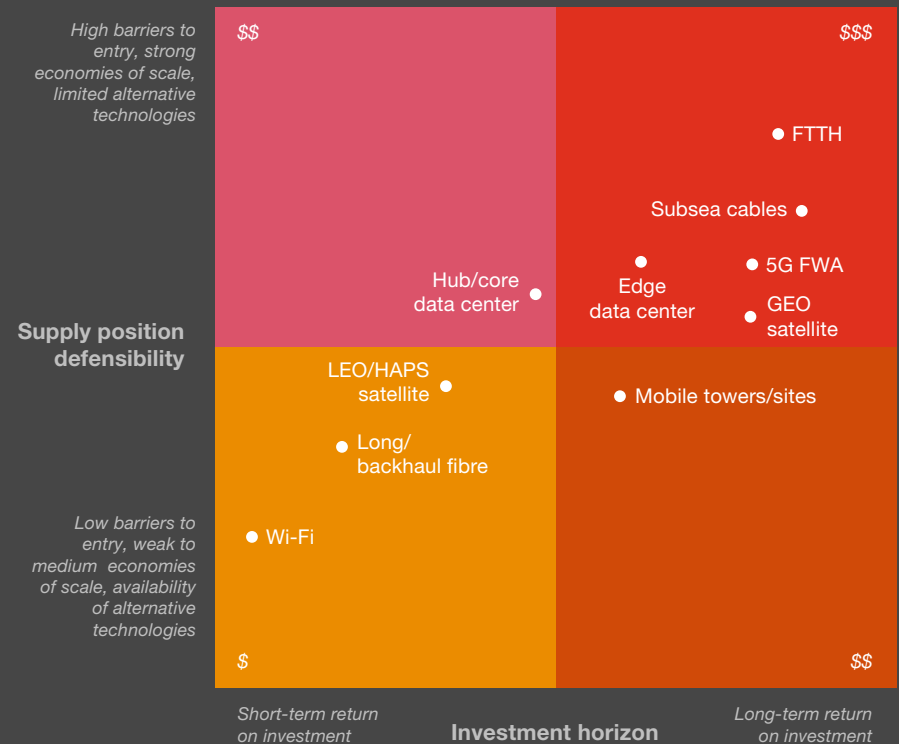
As with a diversification strategy, companies considering an infrastructure-centric strategy need to take two key factors into consideration for each type of infrastructure asset (see Exhibit 3). The first, along the exhibit’s horizontal axis, is the time horizon for returns from a particular type of infrastructure; the second, along the vertical axis, is the ability of the telecom company to defend its position within its market, through economies of scale or high barriers to entry, for example.

Thus, for instance, 5G-based fixed wireless access (FWA) is likely to provide medium-term returns (given the right type of customer base and location). Deploying fibre to the home (FTTH) is likely to have a longer-term return horizon but can create significant barriers to entry for other ultra-fast broadband plays, both wired and wireless. The way each company positions itself on the grid will also depend on its relative capabilities and the dynamics in its market.

A further consideration is the degree of regulatory scrutiny to be expected for each type of infrastructure, in each market. How predictably and favourably will regulators look on the need to balance demand and supply? Will they take a consumer-friendly stance by demanding wholesale obligations, new licences and divestitures? Or will they take a more supplier-friendly stance, allowing M&A for market coverage rollup and prioritising technology innovation and modern infrastructure, particularly fibre, to promote overall economic growth? Providing incentives for new infrastructure and tolerating higher margins would also enable and encourage operators to invest and innovate.

Several possibilities for partnering exist for infrastructure players to generate incremental returns that can flow back into network improvement and expansion. Infrastructure-focussed mobile operators, for example, could act as mobile virtual network enablers, offering networking and business services to MVNOs (mobile virtual network operators). They could work with fixed-network operators that don’t have substantial mobile infrastructure to strengthen their mobile operations in exchange for favourable backhaul services. Or they could partner with various OTT (over-the-top) content and experience providers that depend on superior connectivity to enable new services such as 8K video and virtual reality entertainment.

Exhibit 3: A framework for infrastructure strategies



Note: Relative opportunity for monetisation is indicated by \$.

Source: PwC analysis based on observations of industry dynamics and technological trends. The mix of strategies and their placement will vary depending on the circumstances of the company.

From dilemma to decision



Clearly, trying to be all things to all customers isn't working for most telecom providers — or for their investors. It's time for operators to assess their situation and make the strategic choices needed to jump-start investor interest. A clear diversification strategy underpinned by strong capabilities and with the potential for disruption will resonate with some categories of investor; configuring an efficient infrastructure powerhouse with real economies of scale and high barriers to competitors will attract others.

There is no single correct answer to this dilemma. We are not advocating the need to choose one to the exclusion of the other, although either one alone could be a viable long-term approach. (*A tale of two telecoms*, a report by Strategy&, PwC's strategy consulting business, describes these approaches in more detailed scenarios.) But leaders in telecom enterprises can benefit by making deliberate fact-based decisions and using them as the basis of clear stories to be told to shareholders and other constituents. This will help determine which capabilities they need to move forwards with their chosen strategies — and which they lack. And it will increase their attractiveness to investors who, at the end of the day, have many options for where to put their capital.

Contacts

Chris R. Bartlett

Partner, PwC Australia
+61-414-835-935
chris.bartlett@pwc.com

Chris Bartlett is a partner with PwC Australia, based in Sydney. He is a senior adviser in the technology, media and telecommunications sectors for PwC's Strategy&, focussing on growth, technology, product innovation and operational strategy.

Dr. Florian Gröne

Principal, PwC US
+1-347-346-0457
florian.groene@pwc.com

Florian Gröne is an adviser to executives in the telecommunications, media and high-tech sectors for Strategy&. Based in New York, he is a principal with PwC US. He helps companies develop business models for the digital age and transform customer experiences and the underlying operating, technology and cost structures.

Daniel S. Hays

Principal, PwC US
+1-240-388-7187
dan.hays@pwc.com

Daniel Hays is a principal with PwC US, based in Washington, DC. He is an adviser to executives in the technology, media and telecommunications sectors for Strategy&, focussed on the areas of growth, regulation and operational strategy.

Rolf E. Meakin

Partner, PwC UK
+44-7801-247667
rolf.e.meakin@pwc.com

Rolf Meakin leads PwC's telecom industry consulting practice globally and in EMEA. Based in London, he is an adviser to executives in the technology, media and telecommunications sectors for Strategy& and a partner with PwC UK.

Pierre Péladeau

Partner, PwC France
+33-06-85-07-62-39
pierre.peladeau@pwc.com

Pierre Péladeau is a partner with PwC France, based in Paris. He advises senior executives in the telecommunications and technology industry across EMEA and is a leading practitioner in digital transformations for Strategy&.

Chady Smayra

Partner, Strategy& Middle East
+9711-211-0400
chady.smayra@pwc.com

Chady Smayra is a partner with Strategy& Middle East, based in Beirut. He is an adviser to executives in the technology, media and telecommunications sectors, focussed on growth strategy, digital transformation, new ventures and performance improvement.

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