Operators – you should be making more money

Who will become the Amazon of telecom? Numerous industries have already discovered that pricing can be an effective strategic lever – **now it's time for operators** to do the same, and to finally realize financial returns that match the **true value of their networks**.

"Pricing innovation can impact the bottom line much more dramatically than any other component in the marketing mix"

"THE SINGLE MOST IMPORTANT decision [you have] is pricing power."
– Warren Buffett, CEO, Berkshire Hathaway.

Today's consumers increasingly perceive devices, applications and over-the-top (OTT) services to be the most significant elements of their telecom experiences. Not surprisingly, some of the providers and manufacturers associated with these elements are making a fortune, while many operators are experiencing declining average revenues per user and shrinking profits.

PERSPECTIVE AND PERCEPTION

As a rule, consumers rarely think about the network unless it is not performing properly, and connectivity is increasingly considered as just another utility, like electricity or water. But in truth, the network represents far more value than any content that is being transmitted over it, or any device that taps into it. Without the network – and the significant investments that operators make in its infrastructure – those devices, applications and OTT services would be worthless.

So why aren't operators making more money? It's not for lack of trying. Many have embraced innovations in both products and customer service, and are now adopting business-model innovations to help them deal with evolving ecosystems. But by themselves, these approaches still aren't enough.

CHANGING THE GAME

It's common wisdom that one cannot consistently time the stock market; likewise, merely lowering prices does not provide a sustainable competitive advantage, and often leads to fatal pricing wars. It's also well known that insider information can change the game. And in the telecom world, operators have unique, legal access to insider information in the form of the consumer, application and network data traversing their networks. Until now, traditional telecom systems couldn't adequately capture or analyze this data to support pricing innovation, nor implement that innovation, so there was little incentive to develop pricing innovation as a strategic lever. As a result, operators have not fully realized the financial rewards from the differentiators that they control and that drive value in the consumer's experience.

However, technology that enables such capabilities has developed rapidly in recent years. Today's integrated, real-time, analytics-driven support systems – coupled with software-defined networking, network functions virtualization and cloud technologies – can make operators as nimble and opportunistic as their IP-based OTT counterparts.

This means that the time has come to begin thinking differently about how telecom services can be priced and sold. Other industries have already discovered that pricing can be an effective strategic lever. Operators can – and should – do the same, and finally realize financial returns that match the true value of their networks.

RETHINKING THE OPERATOR'S ROLE IN THE VALUE NETWORK

In many ways, operators today are in an enviable position. They have an active, ongoing relationship with consumers. They support those consumers through customer relationship management systems, call centers and, increasingly,

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through self-care portals. Through their billing systems, they also have a trusted financial relationship with consumers. They have the ability to price and package end-to-end services that OTT players cannot match, including connectivity, end-to-end control over policies and QoS, and convenient charging and billing services for movies and m-commerce. All these and more are legitimate assets in the digital services value network that impacts the consumer experience.

What if you were to break down those assets into the greatest number of individual value components representing potentially chargeable events? What if you could assemble them, even on the fly, into personalized offerings and experiences that consumers are willing to buy, and then price them for the greatest profitability?

This is the essence of what we call experience-based pricing – pricing that is dynamically personalized according to the consumer's need or experience, and based on what an individual user values most while consuming a service at a given point in time or location. Experience-based pricing is based almost entirely on the consumer's point of view. It matches the needs of the consumer and the requirements of the combination of device and service being used, along with other factors such as location, to provide the optimal consumer experience.

For example, high-quality video or TV delivery requires more network capacity than simple web browsing. How much is a consumer willing to pay for the optimal experience of watching a once-in-a-lifetime event, at their location, on their device?

Tailoring the consumer experience to this level of granularity means managing the network at the same or a similar level – and today's systems and technologies provide the operator with that capability. The resulting agility and capacity to personalize the experience contextually makes the operator more valuable to consumers and more attractive as a partner to application developers and OTT service providers. It ultimately translates into increased revenue and higher profitability derived from the consumer, and potentially from the partner too.

IS EXPERIENCE-BASED PRICING WORTH IT?

For operators accustomed to cost-plus or competition-based pricing, experience-based pricing can represent a huge paradigm shift. It requires a significant investment of time, effort and change in both systems and processes. So is experience-based pricing worth the effort and investment required?

In a word – yes. Pricing innovation can impact the bottom line much more dramatically than any other component in the marketing mix. In the book *The 1% Windfall: How Successful Companies Use Price to Profit and Grow*, pricing consultant Rafi Mohammed noted that: "A study by McKinsey & Company of the Global 1200 found that if they increased their prices by just 1%, and demand remained constant, on average each company's operating profits would increase by 11%." With rewards available on this scale, there is no rational reason for not adding pricing innovation to the marketing strategy.

> "Experience-based pricing is not merely an optimistic concept, but is achievable today with next-generation systems and an innovative mindset, process and culture"

We are not suggesting that operators simply raise prices. At its most basic level, experience-based pricing is about moving beyond current innovation around the pricing structure to include innovation around the pricing level and capturing the known units of value that comprise the consumer experience, such as on-demand speed boosting ("turbo-boost") and yield optimization, to give just two examples. These are familiar to most operators and are relatively easy to implement with next-generation systems that are analytics-enabled, operate in real time and are driven by a centralized catalog.

The next – or possibly concurrent – step is finding "hidden" events in value networks for which consumers would be willing to pay *(see Figure 1)*. This value discovery fuels pricing-level innovation based on context. Here is an example from another industry. Like all airlines, Virgin always had some rows in coach with more leg-room than others. It always had seats near the main exit, from which it was faster and easier to deplane. But it wasn't until it realized the consumer-perceived value of those features that it began charging a slight premium for them – and many consumers have been happy to pay more for the extra space or quick getaway. Are there similarly chargeable value elements waiting to be discovered in operators' current services?

Pricing innovation can take many forms. In the US, Netflix has sought deals directly with Comcast and Verizon to assure QoS and a consistent experience for its streaming video services. Operators could therefore make additional profit by directly offering optional levels of QoS to the consumer as well, and by providing the optimal experience based on the consumer's context. The consumer could be charged more (or less), according to perceived need, and the service can be packaged and conveniently billed along with other services. This is not the same approach as turbo-boost add-ons – it utilizes analytics to identify the unique circumstances of how, where and when a specific consumer is using a specific service, and offers varying levels of value accordingly. Think of turbo-boost combined with yield optimization – operators are familiar with yield optimization to capture value from excess capacity, but yield optimization applied to a turbo-boost scenario results in additional value capture in a condition of constrained capacity.

Applying the pricing ideas already discussed could well help operators realize the "1% windfall" we mentioned earlier. However, to realize the full potential of experience-based pricing, operators will need an ongoing process to discover the uncaptured value within their value network. Such value discovery requires a commitment to digging deep, to using analytics to understand what the consumer values, and then to capturing and monetizing that value. It can be a challenge to develop the organizational mindset and processes required, but to realize the financial rewards of experience-based pricing fully, it is necessary to make pricing strategy a part of operators' organizational culture, and to look continuously for ways to increase – and profit from – perceived value to consumers.

THE PRICING MODEL AND BEYOND

What if operators could change the pricing model in at least some parts of their business, according to the experience provided? As an example of pricing-structure innovation, General Electric (GE) traditionally sold jet engines at cost in order to make a better profit through expensive maintenance contracts. Customers had little choice but to go along, although most were not happy with the arrangement. So GE changed its pricing model, and now sells "usage rights" to new engines, which include spare parts and maintenance. Customers only pay for the actual time an aircraft is in use, which means GE is highly motivated to keep

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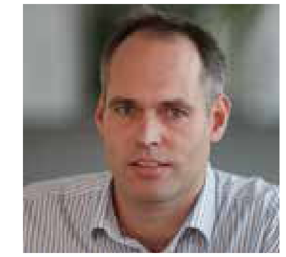

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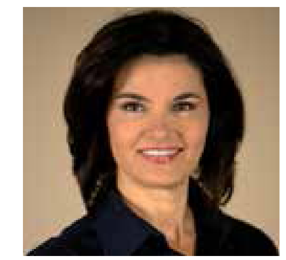

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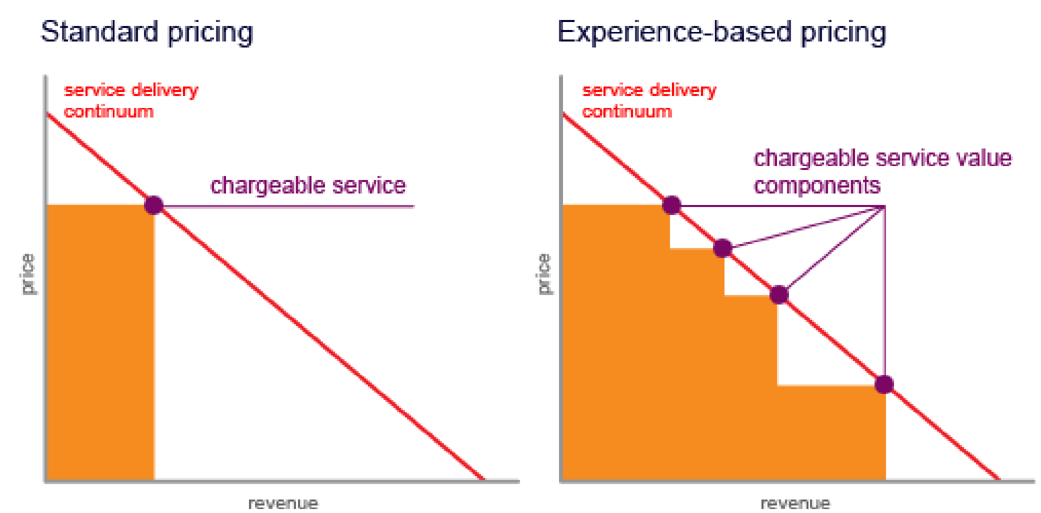

Figure 1: Defining services with increased granularity, down to their chargeable events, results in greater profit potential. The operator can charge for these multiple value components, which are used to deliver the consumer-desired experience.

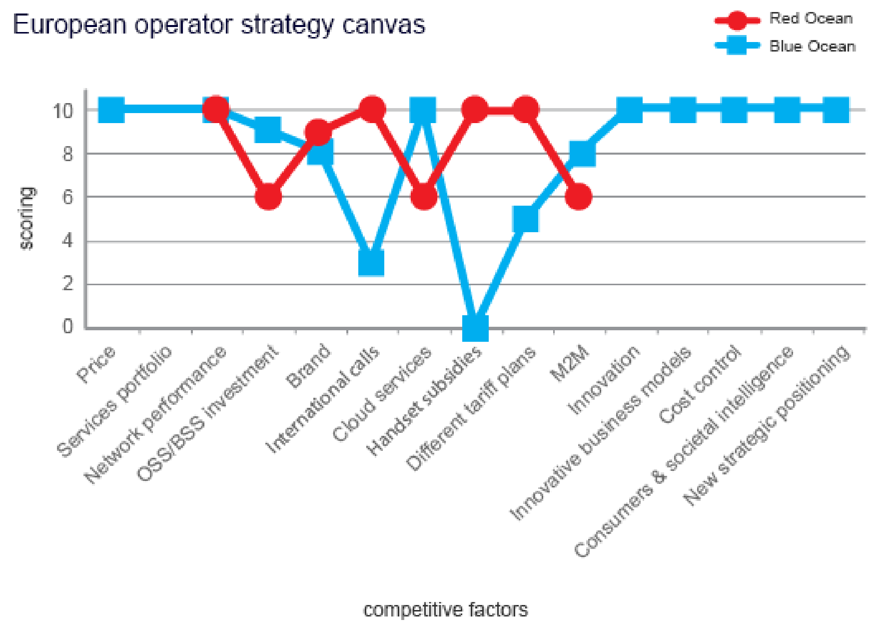

Figure 2: The strategy canvas shows areas and levels of typical operator focus (Red Ocean), which are competition-intense, and where focus could be applied to differentiate (Blue Ocean) with less competitive pressure.

engines in excellent repair. The result has been a rise both in profits and in customer satisfaction.

Pricing model innovations need not be quite as dramatic as those of GE. For example, as part of its Uncarrier strategy, mobile operator T-Mobile has launched pricing that better aligns with what consumers value, including no-contract options with a financing plan for the device, and other operators have followed suit with similar plans.

The fact is that a number of legacy telecom pricing models may well be on their last legs, since today's systems enable a level of *à la carte* pricing structures that was never before possible. Simple business economics will undoubtedly drive operators to use these new models more and more. In the blog post Unboxing the Subscription: Rethinking Mobile Broadband Offerings, we discuss how operators can unshackle themselves from traditional service packages to create segmented offerings that genuinely fit consumer lifestyle or business needs, thereby significantly increasing loyalty and revenue over time.

As the examples above illustrate, the best pricing advantage comes from delivering a differentiated service. The best-selling book *Blue Ocean Strategy* by W. Chan Kim and Renée Mauborgne describes how a number of companies have gone about this process. Cirque du Soleil, for example, went beyond the parameters of the circus industry to find differentiators in the wider live-entertainment industry. By eliminating common elements of the crowded traditional circus field and combining others with value components from contemporary music, dance and onstage storytelling, it has built a wildly successful business that offers a unique experience to its audiences. If Cirque du Soleil can transform its service from a traditional circus into a more compelling entertainment experience, operators can add value to OTT services and form partnerships with other entertainment and media providers to widen their offering and reach.

IMAX has taken a different, but equally effective approach. Instead of cross-pollinating with other types of entertainment, it intensified the experience of watching a film. While most theaters are now arranged in multiplexes with inherent physical limitations, IMAX developed an ultra-large screen, embedded audio speakers into the headrests of larger seats to augment state-of-the-art sound systems, and uses 3D technology to provide a much more immersive experience – one that is completely in sync with today's elaborate action- and effects-laden films. You will probably never find a romantic comedy showing in an IMAX theater. It delivers the optimal experience given the context – the specialized nature of action-genre film content – and profits handsomely as a result.

Ericsson consultant Sami Dob has written a series of blog posts in which he discusses how the Blue Ocean approach might be applied to telecom. In his strategy canvas for a theoretical European operator *(see Figure 2)*, the spaces critical for Blue Ocean success, and that are wide open for a differentiated operator, are a greater focus on cloud services, machine-to-machine (M2M), innovation, new business models, cost control, consumer and societal intelligence, and new strategic positioning. All of these spaces can benefit from the use of experience-based pricing. Other, more traditional areas of competition, such as handset subsidies and international calling, are greatly de-emphasized.

WHO WILL BECOME THE AMAZON OF TELECOM?

Amazon is a model of pricing innovation (both in pricing structure as well as pricing level), having taken advantage of an emerging technology (the consumer internet) and deployed sophisticated consumer analytics that fuel numerous, intraday, supply-and-demand-driven price changes, along with additional purchase suggestions based on experiences of other buyers. At the same time, Amazon has taken advantage of under-utilized assets (its massive data centers) to supply valued cloud services to small- and medium-sized businesses – Amazon's version of yield optimization.

The same pricing avenues are very much in play in the telecom space – and the timing is perfect. Consumers are hungry for innovation and are willing to pay for it. Remember the consumer participating in a once-in-a-lifetime event we discussed earlier? How much would a German soccer fan be willing to pay for a turbo-boost in order to share with friends the experience of their team winning the FIFA World Cup? Context clearly matters for pricing-level innovation. Traditional value chains are quickly morphing into real-time, dynamic value networks of partner ecosystems. New multisided business models complete with multi-partner compensation and settlement are needed to support just-in-time demand for services. Opportunity is clearly knocking.

The aspiring pricing innovator will first dissect their value network and identify value that is potentially chargeable, and then monetize it using next-generation systems. Pricing innovation – in terms of structure, as well as level – increases operators' relevance in the evolving value network and thereby effectively fends off commoditization. Experience-based pricing is not merely an optimistic concept, but is achievable today with next-generation systems and an innovative mindset, process and culture. The benefits are also real and significant – recall *The 1% Windfall*. Using next-generation systems, big data and analytics, an operator can gain the agility needed to address a fast-moving, demanding market on its own terms, and to differentiate, gain competitive advantage and profit in ways that were impossible just a few years ago.

The truth is that operators should be making more money, and experience-based pricing can play a major role in making sure operators do so for many years to come.

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