The Customer Value Challenge
Managing the Commercial Investments of Telecoms in Europe
The Boston Consulting Group (BCG) is a global management consulting firm and the world’s leading advisor on business strategy. We partner with clients in all sectors and regions to identify their highest-value opportunities, address their most critical challenges, and transform their businesses. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organizations, and secure lasting results. Founded in 1963, BCG is a private company with 66 offices in 38 countries. For more information, please visit www.bcg.com.
The Customer Value Challenge

Managing the Commercial Investments of Telecoms in Europe

European mobile operators have historically been growth machines—their metrics, incentives, and systems finely tuned to increase their customer and revenue base. They have been bred to keep pace with their competitors and have played the game with amazing success. Most markets have reached saturation in an astonishingly short time.

But operators must now adapt to maturing markets and a global recession. Paradoxically, customer acquisition costs are continuing to rise while market and revenue growth slow. In the top five European markets (France, Germany, Italy, Spain, and the United Kingdom), gross additions to the customer base were higher than ever in 2007, but net additions represented about 25 percent of the total, down from nearly 75 percent in 2000. (See Exhibit 1.) Operators are, in effect, spending close to 7 percent of their mobile revenues in those markets, or nearly €7 billion a year, to exchange customers with one another.1 “Most of the mature European markets have now become massive washing machines, spinning customers every year and occasionally CEOs, too,” one executive told us.

Several years ago, when established operators realized that growth would eventually slow, they began maximizing cash flow by reducing costs. But today, the mobile industry has reached a turning point. Operators will no longer be able to shrink their way to success. Instead, to create significant future value, they will need to serve existing customers more effectively and generate value from those relationships.

In order to understand this changing landscape, we talked to financial analysts and to executives at several of the largest European telecom operators.2 Most of the executives we spoke with said they are fully aware of the need to shift their focus from volume to value and from “getting the next customer” to “delighting the existing ones.” They recognize that progress has been slow, partly for operational reasons. “Customer-relationship-management systems take a long time to deploy, and we are unsure of our media-related strategies, for instance, as a way to extract more value from client relationships,” one executive said.

But they also acknowledge that larger challenges impede their evolution. To rev down their growth engines and create a business model suited to mature markets, operators need a fundamental cultural change: improved cooperation across functions, new skills, better metrics, and committed leadership. It is not easy to step off the treadmill onto a different path in order to run a business whose economics have shifted.

The Customer Acquisition Paradox: Higher Costs, Lower Returns

In fully penetrated markets with limited revenue-growth potential, operators are spending more than ever to acquire a steadily decreasing number of customers who have never had mobile service. In some markets, the net-to-gross additions ratio is much lower than 25 percent. Most dramatically, in the United Kingdom, only 3 million out of 27 million in gross additions in 2007 represented new customers.

In essence, roughly one-third of the U.K. market’s customer base switched operators in order to take

---

1. Seven percent assumes that 75 percent of subscriber acquisition costs, which generally total 8 to 10 percent of revenues, is spent on customer churn.
2. See the Acknowledgments for a list of the companies whose executives we interviewed.
advantage of the latest handset or promotional offer. Handset manufacturers and independent retailers, which are responsible for more than half of all U.K. customer acquisitions, profit handsomely from this turnover. Although the imbalance between gross additions and net additions is most pronounced in the United Kingdom, it is prevalent throughout Europe. (See Exhibit 2.)

The Need for a New Business Model

In most markets, operators need a new business model more than they need new customers. Analysts predict that, over the next three years, mobile telecom revenues will grow only modestly, at 1.5 percent annually, and that earnings before interest, taxes, depreciation, and amortization

---

**Exhibit 2. The U.K. Mobile Market Faces the Largest Challenges in Managing Customer Investments**

Sources: Merrill Lynch; BCG analysis.
Note: Because of rounding, the sum of the figures for churn and net additions in some cases do not equal the figure for gross customer additions.
(EBITDA) will rise only marginally faster. They foresee capital spending stabilizing at about 9 percent of revenues, limiting the ability of operators to further reduce that line item to improve free cash flow. (See Exhibit 3.) If those predictions are accurate, fundamental value creation from 2008 through 2010 will likely be half that of 2005 through 2007.

Operators wanting to do better need to break the pattern. If growth was the hallmark of mobile telecom’s first era and cost control that of its second, customer focus and customer value will be the fuel that propels the industry into its next phase of development. As one executive told us, “Now is the time to think first of existing customers and truly take care of them, rather than keep focusing on acquiring customers from our competitors.”

By making this shift, operators should be able to significantly improve the return on their customer investments and increase earnings by up to 15 percent. But focusing on customers instead of market share and volume will require a full-fledged transformation of existing organizations.

**Barriers to Transformation**

In our interviews, executives cited both external and internal barriers to reorienting their business model and focus. Among the external barriers is competitive pressure, which in some markets has led operators to subsidize prepaid handsets, even though they pay a high price for the practice. “We know there will be ‘box breaking’ and that customers will use the subsidized handset on another network, but we can’t afford to let market share go to competitors,” one executive said.

Another problem is the influence of independent retailers, a high-cost channel that potentially contributes to customer turnover but whose power in most markets is hard to break. Few operators are willing to forgo large retailers, for fear of losing market share to competitors. But operators are also hesitant to go so far as to purchase them, even though this approach would increase their retail footprint. After all, acquirers would effectively be subsidizing their competitors by bearing the costs of removing a sales channel from the market.

A third barrier is advertising by handset manufacturers emphasizing the latest bells and whistles, which pro-

---

**Exhibit 3. Analysts Expect European Operators to Lower Their Capital Spending Only Marginally**

![Capital-spending-to-sales ratio (%)](chart)

**Sources:** 2008 analysts’ reports: Bear Stearns (Vodafone), ING, Dexia (T-Mobile), and ABN AMRO (Telefónica); BCG analysis.

**Note:** Ratios represent an average when estimates from more than one source were used.
promotes churn by stoking demand for new products.

Taken together, those factors can create a triple whammy for operators. In the United Kingdom, for example, operators typically spend more than €300 in handset subsidies and retail commissions to acquire a new customer—quite a hefty price tag when that customer might switch to a competitor less than a year later.

Although external forces should not be underestimated, the executives we spoke with also recognize several internal barriers that have slowed their progress toward transformation. And many of them believe that by dealing with these issues, they can better equip their organizations to tackle the external obstacles. The biggest internal barriers relate to metrics, organization and decision making, channel management, and multichannel development.

Metrics. Executives acknowledge that volume and market share are still the primary measures of their performance, especially at the senior-management level, and that these indicators can mask the underlying economics. These metrics do not, for example, account for the margin that individual customers generate or link the cost of acquiring a customer to his or her true value over the service life. A single operator’s return on customer investments can vary by a factor of four across different countries in Europe. Given that disparity, operators have a long way to go before they have aligned their investments on the basis of expected return.

Most operators are developing better metrics to gauge the effectiveness of their customer-acquisition-and-retention campaigns. But surprisingly, top executives frequently do not rely on those metrics, and their use across functions is sporadic. One executive highlighted the paradox: “We want to maximize customer value as long as it does not affect market share.” Perhaps if compensation incentives were tied to longer-term financial targets, many of the traditional volume and market-share metrics would fall out of favor.

The executives we spoke with also said that the financial community often exacerbates the tendency to focus on the wrong numbers, even though the most sophisticated analysts rely on several different measures.

Organization and Decision Making. Mobile operators’ organizations have been tailored for hypergrowth, with highly specialized and efficient teams perfecting their individual activities. This setup has worked amazingly well, but it has not encouraged teams to work together. This state of affairs is unsustainable if operators want to ensure sound financial decision making that takes into account the lifetime value of customers. In particular, the sales, marketing, customer service, and finance functions must collaborate in order to ensure that customer investments, pricing, and service levels are both attractive to customers and profitable for operators.

Channel Management. Operators still focus on products and vest substantial power with product managers, who understandably want to manage sales channels to maximize volume. Most operators also still base commissions largely on volume and price plan targets, rather than on the actual value that customers generate. Few reward channels according to customer service and consultation, demonstration of new products and services, and contract renewals. Executives recognize that they need to move in that direction but cite the complexity of making the shift. “We are still experimenting to define how we should approach the customer and shape our retail organization in a fully penetrated market,” one executive said.

Multichannel Development. Operators would like to move more of their sales and service activities to the Web to create better economics. They recognize that many multichannel retailers, such as Tesco in the United Kingdom, perform better than their purely brick-and-mortar competitors. But they are still deeply wedded to traditional retail outlets. Even with markets approaching saturation, operators are reluctant to scale back on their physical stores. Some are even increasing their retail footprint, which executives claim is essential to assisting customers and driving the adoption of complex services.

At least in the short term, rather than directing customers to less costly online channels, several operators are trying to ensure that each channel provides a consistent and connected experience. Some have started to invest in systems that collect and display all customer interactions, regardless of the channel in which they
In Search of Success Stories

Some companies have managed to substantially outperform others by overcoming the barriers outlined above and making more productive customer investments. The mobile operators most recognized for this transition are O2 and Orange in the United Kingdom and E-Plus in Germany. But some of the best examples are from outside the mobile industry—in retail banking, consumer goods, and retail.

Accurately Measuring and Managing Performance. Sound metrics are the bedrock of successful customer investments. The most efficient companies use hard data to measure both value creation and customer satisfaction. Top executives have access to meaningful return-on-investment metrics by segment and make critical decisions on the basis of this information—which is as prominent on their dashboards as volume and growth metrics.

Capital One, through its “information-based strategy,” has become one of the most successful issuers of credit cards in the United States. The bank applies a systematic and scientific method to its credit-card business, analyzing a multitude of variables for each customer and relying on dozens of models to predict consumer behavior. Armed with this information, Capital One is able to tailor offerings to narrow slices of its customer base in ways unavailable to most of its less agile competitors. Even though the bank has suffered along with the rest of the industry in recent months, its approach to customers is still instructive.

Efficient companies use hard data to measure both value creation and customer satisfaction.

Companies in asset-intensive industries, such as airlines, rail carriers, and hotel chains, commonly use yield management tools to optimize return on investment. Few mobile operators, however, use analogous methods, such as analyzing network utilization at peak hours, as part of the assessment of customer lifetime value. For carriers just starting to measure and monitor customer investments, the quest for perfection should not be the enemy of progress. It is better to start with a simple tool or framework than to build, tweak, revise, or rethink a better mousetrap that no one will ever use.

Focusing on Customers Instead of Products. Increasingly, high-performing companies pay people on the basis of objectives related to customer value and satisfaction rather than volume. They foster collaboration among teams and functions that traditionally may not have worked together. They also put a strong emphasis on reinforcing or acquiring new skills, particularly those relating to customer knowledge and “below the line” marketing techniques that have measurable response rates. Their marketing and sales departments rely heavily on quantitative and financial skills frequently missing or “siloded” at other companies.

At Procter & Gamble, the consumer is at the center of everything the company does and stands for. P&G spends more than $350 million annually to understand consumers and the market. The insight gained is embedded throughout the organization and incorporated into all business functions and processes—at every step of a product launch, for instance.

In the telecommunications industry, some operators are moving in this direction. In the United Kingdom, O2 has aligned functional silos to take its existing customers’ perspectives into account when making decisions. Now those customers are eligible to receive promotional offerings typically available only to new customers—a sea change in the U.K. market. O2 has also focused on direct sales by buying retail outlets and encouraging renewals by placing equal weight on retention and acquisition. These measures have helped cut churn in half. Meanwhile, a strong financial culture enables O2 to focus on attractive customer segments. Collectively, these strategies have helped the company’s U.K. operation outperform its peers over the past three years, enabling it to gain the number one position in the United Kingdom and subsequently widen its lead.

Adapting and Varying Products and Services. The most effective retailers analyze purchasing patterns in order to customize and personalize their offerings according to the economics and characteristics of different channels. As a result, the value of each channel, for both customer and
retailer, is aligned with its economics. One way to do this is to tie commissions and subsidies to customer value creation.

Tesco has five different store formats, in addition to Web and catalog sales. The U.K. food retailer varies prices and goods depending on the location of the sale. A basket of goods that costs €23 in a Tesco Superstore, for example, can exceed €30 in one of its Express stores, which offer fewer private-label options.

Tesco is also able to actively manage the customer experience across all sales channels by leveraging its Clubcard loyalty program, to which 90 percent of store customers and all Web customers belong. Tesco has created 13 customer segments that enable the chain to tailor store inventory to clientele and to customize and personalize offerings. The retailer can create 8 million coupon variations in a Clubcard mailing, depending on customers’ recent purchases and the segment to which they belong. Imagine being able to offer, through a call center or online, truly customized price plans to individual customers.

Some companies have taken even more radical steps, either adding an entirely new channel or suppressing a traditional one. In the United States, Best Buy, a consumer electronics retailer, has been able to counter flat sales and declining margins with the Geek Squad, a channel focused on serving customers by advising them about technology products and providing technical support in the store or at home.

In the broadband market, Free has built market share in France with its innovative triple-play offer (voice, video, and data), entirely circumventing indirect channels. Customers learn about the service largely through word of mouth and viral marketing, and can acquire it only by visiting Free’s Web site or placing a call. This unique approach has enabled Free to build market share while spending 30 percent less than its competitors on customer acquisition. In the past four years, Free’s share has jumped from 17.4 percent to 19.8 percent of the French broadband market.

**Developing Multiple Channels.**

The most successful multichannel companies coax customers into frequenting a variety of channels, depending on their need for sales, service, or information. They manage and monitor how customers use each channel, while increasing sales and lowering costs. All channels, including the Web, are highly developed and linked with one another to create a consistent customer experience. For example, sales reps in stores and at call centers have a full view of all customer interactions in every channel.

In the banking industry, Bank of America is explicitly driving online penetration as a core strategy. It has invested heavily in this channel and has become the leading U.S. bank in terms of the number of customers who bank and pay bills online and over their mobile phones. These customers have greater access to and control of their finances, thus strengthening their ties to the bank.

The French bank BNP Paribas takes a slightly different approach. Although all channels are available to all customers, each has a distinct role and target customer profile. For instance, the bank serves high-value customers with skilled and dedicated relationship managers at its branches and provides specialized savings services online, while directing lower-value customers to generalists or other channels. Like Tesco, BNP Paribas has extensive customer-relationship-management (CRM) capability, which allows it to reach and serve customers through the most efficient channel. Thus, branches focus on higher-value product sales and value-added services, while call centers handle incoming requests, arrange appointments, and close simple, lower-value sales. The Web is reserved for the provision of both marketing and transactional information; it is also used in some sales to existing customers and, thanks to viral marketing, plays a growing role in client recruitment.

In the mobile industry, new entrants, which lack a historical presence in retail, tend to rely heavily on alternative channels, such as the Web. Operators that offer both broadband and mobile services have an edge in developing multiple channels. They can— and often do—leverage their online portals to drive traffic to Web sites that handle mobile sales and service.

**The Customer-Centric and Value-Driven Company**

Most operators have started to address some of the technical aspects
of improving their customer investments. They have bought or built CRM systems and have developed models that assess customer value or contribution, and they are trying to adjust their commission and reward systems. They are progressing along the steps necessary to become a customer-focused operator. (See Exhibit 4.)

But most operators need to do more to focus on and deliver value to customers—and, in turn, extract greater value from them. They must embrace what we refer to as a systematic value orientation and true customer centricity.

In order to become more value driven—the “easy” side of the transformation—operators require a higher level of economic acumen at all levels of their organization, especially in customer-facing units. Partly spurred by the growing numbers of financially savvy individuals working within the sales and marketing functions, some operators are developing this expertise. But in most organizations, financial sophistication is not equally rooted in all departments. Operators still need to develop a comprehensive plan and clearer communication, especially with shareholders and the financial community, about the need to generate customer value and not simply growth.

True customer centricity is the more challenging goal. Operators will not achieve it simply by flipping organization charts on their side or trying to add new structures. Structural solutions cannot fully address the cul-

| Exhibit 4. Mobile Operators Move Through Four Stages on the Way to Customer Centricity |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|
| **Maturity level**              | **I**           | **II**          | **III**         | **IV**          |
| **Metrics**                     | Focus on profits and losses | Occasional ad hoc studies performed to understand how decisions affect value | Frequent use of customer satisfaction and value analysis to help guide decisions | Focus on value, ROI, and customer satisfaction |
|                                 | Decisions based mostly on experience | Limited system perspective | Complete system perspective | KPIs broken down by customer segment |
|                                 | Resource allocation driven mostly by competitive and market conditions | Resource allocation based on rough estimate of segment profitability (for example, ARPU and churn) | Resource allocation based on estimated ROI but not consistently or systematically | Decisions supported by value- and data-driven tools |
| **Organization and decision making** | Marketing, distribution, customer care, and finance work in silos | One function dominates customer-related decisions | Systematic involvement of all departments in customer-related decisions | Customer-centric organization (client-marketing teams) with heavy collaboration across functions |
|                                 | Silos have different objectives (such as ARPU, sales volumes, costs, and EBITDA) and incentives | Objectives remain mostly unrelated | Some value-based objectives | Objectives and incentives based on shared value and customer satisfaction |
| **Channel management**          | Same offers, price plans, and handset prices in all channels | Some offers directed at specific channels | Specific offers used to bias mix toward more profitable channels | Differentiated value proposition based on specifics of channel |
|                                 | Commissions based on price plan | Basic commission-control mechanisms, such as clawbacks | Commissions somewhat tied to customer value | Commissions and subsidies based on actual customer value |
| **Multichannel development**   | Traditional channels (direct, indirect, and call center) remain predominant and focused on acquisition | Some development of alternative channels (Internet sales and service account for 5 to 10 percent of gross customer additions) | All channels fully developed in acquisition and services (Internet sales and service account for 10 to 20 percent of gross customer additions) | All channels fully developed and linked to provide a consistent customer experience |
|                                 | Limited Internet presence (accounting for less than 5 percent of gross customer additions) | Limited functionalities, little experience consistency, and few links across channels | Limited cross-linkages or | Clear view of each channel’s purpose and contribution to sales and service targets by customer segment |

Source: BCG analysis.
tural change that needs to occur. There are three fundamental cornerstones of success for the mobile operator of the future:

- **Leadership.** Leaders must define and communicate operators’ new vision—specifically, the shift away from growth and toward value creation. They need to alter culture, mindsets, and behaviors and actively manage the likely shifts in power and control arising from customer centricity. Leaders will need to resist several natural temptations, such as to maximize market share, and develop work patterns that emphasize value creation. They will need to make explicit demands on teams and departments to achieve specific milestones relating, for example, to channel mix and customer satisfaction by segment.

- **Cooperation.** Cooperation enables employees and functions to become more productive. It is a large part of what enables an organization to move toward customer centricity. Yet at most mobile operators, departments and functions do not cooperate sufficiently. In order to achieve customer centricity, operators need to develop and enforce collective goals by adequately addressing complexity and competing demands. The heads of marketing, sales, and finance can reach agreement on broad principles, but employees in those functions also need to collaborate closely to solve customers’ problems and improve their experience. When people cooperate across functions, individual intelligence and energy are harnessed and operations become more efficient.

- **Engagement.** Employee engagement is what separates great from good performance. Many executives believe that the disciplined application of rules creates excellent engagement. But they would be better off focusing on the **intelligent interpretation** of rules. Engaged employees find ways to negotiate the detours and frustrations of serving customers effectively. They know how to work across organizational boundaries and see the big picture. In the new world of slower growth, operators need employees who understand today’s business realities and are able to redefine their work in exciting ways. The future is likely to be difficult for all operators, but those that are able to motivate their employees to meet the challenges will have the best chance of surviving.

Of course, these cornerstones are easier to describe than to establish within an organization. The temptation to create new structures and processes is strong but, in our experience, misguided. Instead of structural solutions, **smart rules** should be the key tools for producing an organization geared to value creation and customer centricity.

Smart rules are nonnegotiable principles that help create highly collaborative organizations by reinforcing leadership, cooperation, and engagement. Some airlines, such as Southwest, have improved the customer experience by encouraging collaboration between flight and ground operations—departments that are frequently at odds. Rather than create rigid performance rules, Southwest allows these teams to manage the cross-unit tensions among speed, reliability, and quality. By giving employees the freedom to make on-the-spot decisions and better use of their collective intelligence, Southwest achieved the fastest turnaround time between flights in the industry.

In our work with organizations, we have found that those that adopt smart rules are far more effective in improving performance than those that rely on complex, cumbersome structures, systems, and processes.

There are many ways to initiate a customer-centric and value-driven transformation. Operators can start with high-visibility initiatives such as relaunching spending on customer acquisition and retention, or they can introduce new metrics or retention targets. However they begin, operators need to create a comprehensive transformation program, under direct CEO leadership, to ensure success. And they should focus more on how their people work together and with customers than on the shape of their org chart.

Mobile operators that seize the opportunity to reorient their organization and culture around customers and value will be better at winning and retaining customers. They will generate greater loyalty and higher revenues per user while doing a better job of fulfilling unmet customer needs. And they will deliver superior results while their competitors remain stuck on a treadmill, struggling to stay in place.
About the Authors

Olivier Tardy is a senior partner and managing director in the Paris office of The Boston Consulting Group. You may contact him by e-mail at tardy.olivier@bcg.com.

Guillaume Charlin is a partner and managing director in the firm’s Paris office. You may contact him by e-mail at charlin.guillaume@bcg.com.

Mikaël Journo is a principal in BCG’s Paris office. You may contact him by e-mail at journo.mikael@bcg.com.

Acknowledgments

The authors would like to thank interviewees at KPN, Orange, Swisscom, Telecom Italia, Telefónica, O2, T-Mobile, Vodafone, JPMorgan Chase, Royal Bank of Scotland, and Société Générale for their time and insights. This report would not have been possible without their help. They would also like to thank their colleagues Wolfgang Bock, Stepan Breedveld, François Candelon, Joaquín Cava, Patrick Forth, and Marc Vos for their contributions.

For Further Contact

BCG’s Technology, Media & Telecommunications practice and Marketing and Sales practice sponsored this report. For inquiries, please contact the practices’ respective global leaders:

Ron Nicol  
Senior Partner and Managing Director  
BCG Dallas  
nicol.ron@bcg.com

Miki Tsusaka  
Partner and Managing Director  
BCG Tokyo  
tsusaka.miki@bcg.com