

point of view

Wireless customer profitability: Traditional volume and penetration metrics alone miss an increasingly complex picture. Where do we go from here?*

Customer valuation formulas must grow in depth and scope to reflect a shifting wireless landscape. Deeper insights can offer a strategic advantage.

Highlights

Capex and customer retention costs are on the rise as price-oriented competition dominates.

Margins and profitability trump penetration and volume.

Lower 4G transmission costs are key to modeling new approaches to 'bandwidth hogs.'

Bigger isn't always better. The low end of the customer revenue base can drive growth also—if costs and services are appropriately scaled.

The new bottom line

Beyond market share

As US penetration nears saturation levels, market share gain is less important than keeping profitable customers and protecting margins.

Rise of the smart phone

As mobile devices become mini-PCs, seismic shifts are underway from pricing to retention to capex.

Quality over quantity

Tomorrow's pre-pay customer could be just as profitable as a 'premium' smart phone user.

Capex implications

As companies place big bets today on customer behavior tomorrow, a deeper dive on profitability can help inform investment strategy.

Ubiquitous mobility, surging data traffic, and consumer price sensitivity are changing the rules of the game.

1 in 3

US wireless companies reported an increase in customer retention expenses of more than 50% in PwC's 2009 survey.[†]

Symptoms abound. Retention costs are soaring. Price is fast emerging as the dominant force in customer decision making. Consumer mobile penetration is nearing the saturation point, and surging data traffic is accelerating capex and the transition to 4G networks.

The result? Wireless companies are feeling the squeeze on the bottom line.

While the economic climate will eventually improve, the US wireless market is not likely to return to business as usual—or at least as we knew it in the pre-recession days.

The US wireless sector is entering a new phase in its rapid evolution. Growth will be driven less by finding new customers and more by making existing customers more profitable. Similarly, volume of usage alone is hardly a reliable proxy for growth and profitability.

Going forward, wireless companies need to consider a much deeper dive into the profitability profiles of each of their different customer categories.

The good news? With this enhanced visibility, companies will have a far more robust and nimble set of tools to advance the bottom line in every customer interaction.

The implications reverberate throughout a company's operations—from initial sales to customer service to retention offerings.

More granular customer insights also are key as carriers escalate their capex to keep pace with surging data traffic and the mass proliferation of smart phones, wireless tablets, and other devices that put PC-like capabilities and connectivity in consumers' hands.

Large carriers invested more than \$160 per subscriber in their networks in 2009—a more than 30% leap over 2008, according to PwC's *2009 North American Wireless Industry Survey*. From initial customer engagement to long-term strategic planning, more precise understanding of how customers impact the bottom line is an operational imperative.

With operating expenses surging over the past year and EBITDA margins under pressure, 2010 is a defining year for companies to address the growing complexity of customer profitability.

[†] Source: *PricewaterhouseCoopers' 2009 North American Wireless Industry Survey*

Every kind of customer—from the ‘premium’ smart phone user to the pre-pay consumer—can contribute to profitability and growth.

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A closer look at customer profitability allows wireless companies to lay the foundation for a new corporate mindset where the bottom line is considered in every customer interaction.

Profitability strategies are dictated by individual customers’ (or categories of customers’) unique mix of products, usage, and interactions with their carrier.

A more granular point of view allows companies to:

- Gain clearer insights across the customer base into who contributes to (and detracts from) profitability.
- Adopt targeted and scaled strategies to ‘go the extra mile’ for high-performing customers and to more carefully mitigate the costs of unprofitable customers.
- Develop customized tools that ensure every touch point—initial contract, handset subsidies, service and retention efforts—keeps the bottom line of that unique customer in mind.
- Craft tiered pricing options based on the cost profiles of different customers (eg. smart phone users vs. less data-intensive customers).

Where the battle once focused primarily on customer experience, the emphasis is now also shifting to include price, across the range of customers—from ‘premium’ users to value-oriented family plans to the pre-pay market.

Customer retention costs exemplify the implications to underlying cost structures. Costs are now increasingly associated with higher priced, more complex, and data-hungry devices.

In 2009, more wireless companies offered average subsidies in the \$125-\$200 range, with the most rapid growth in the \$175-\$200 range, according to PwC’s *2009 North American Wireless Industry Survey*. There was a sizable drop in subsidies below \$100.

While there is a premium for smart phone subscribers, there also is a wide difference in costs between high-bandwidth and standard users. Bottom line? The profitability profiles of wireless customers have never been wider—and will only increase.

In this new climate, we believe management must rethink a key component of its strategy: the definition of a profitable customer and the resulting implications for the business model and cost structure.

All customers are not created equal.

Q&A

Q: With smart phones usage and data traffic both on a steep incline, what are the implications to pricing models for premium users?

A: Greater understanding of how different customers use wireless networks can help shape the next generation of service plans. While headlines have focused on network capacity and start-up costs, a far wider web of considerations must be addressed, such as growing customer service and network security costs around increasingly complex devices, services, and applications. Equally relevant are adaptive strategies for sharing the value chain with content providers and applications developers, and for doing so in a more data-driven environment.

Q: How can carriers fine-tune their approach to low-end customer categories?

A: By understanding with precision where and how these customers impact the bottom line—for better and for worse. Any kind of customer can be profitable if services and offerings are appropriately scaled. One underutilized area is Internet-based transactions. These often are the lowest cost service options, yet they account for only 9% of postpaid and 5% of prepaid customer interactions.

Q: How can wireless carriers integrate new customer profitability insights into their company's capex decision making, especially regarding 4G?

A: In our *2009 North American Wireless Industry Survey*, large wireless carriers reported a 50% year-over-year leap in capex as a share of revenue. While 4G should trigger a significant drop in data transmission costs, the ROI picture will be more complex. Some users will stick to primarily phone calls and the occasional Internet search, while many others will embrace 4G's speed and ease and increase their appetite for more data-intensive content. This will create an even wider divide in the most and least profitable customers—making adaptive strategies such as tiered pricing all the more essential to begin planning now.

Q: How can companies use these insights to protect margins at every stage of customer interaction (initial contract, handset subsidies, service/retention)?

A: Do a company's best customers know their loyalty and business is valued? Could a carrier offer these customers free priority service, while charging less-profitable customers for this option? Could they offer an occasional goodwill gesture, such as a free app or music download? Do retention offers aim to keep every customer 'at all costs' or scale offers to ensure each relationship is profitable?

Contact information

To have a deeper discussion about customer profitability and how it might affect your business, please contact:

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