

CONSOLIDATION AND COMPETITION:

European Telecom Market Trends and Carrier Analysis

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EXECUTIVE SUMMARY

The European telecoms landscape is undergoing seismic changes that have a significant impact on the IT and communications strategies of enterprise buyers.

Some change drivers – such as advances in technology – are global, while others have a distinctly European flavor and reflect consumer idiosyncrasies and legislative and regulatory initiatives piloted by the European Union (EU).

As elsewhere, the European consumer increasingly demands more speed, availability, security and quality, all delivered at lower costs and in a socially responsible manner. Indeed, corporate social responsibility in the ecological sphere is a factor in spurring investment in cleaner technology such as cloud.

Technology innovation is enabling higher processing and transmission speed and new uses for existing technology, allowing providers to address growing customer demand. But while firms are investing in technology, shareholders are calling for faster returns.

Competitive pressures, meanwhile, are squeezing profits, creating new and disruptive business models and driving industry consolidation as players pursue a variety of mergers and acquisitions. While historically such moves have drawn EU scrutiny, lately this phenomenon has been tolerated and even encouraged, as consolidation is seen as ultimately benefitting the market.

The European Union is also pushing unified telecoms legislation within its borders, which will increase its legislative and regulatory role within each member state. This reflects a strong political will across the main European parties to safeguard the rights of European consumers, as already evidenced in the drive to eliminate excessive roaming charges within the member states.

Understanding and effectively responding to these pervasive trends will be a top priority for CIOs in the coming years. This ISG white paper examines some of the key trends defining the European telecoms landscape and discusses implications and options for enterprise buyers.

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Consolidation

With well over 100 fixed and mobile operators owned by dozens of companies across the European Union, operators argue the environment is too fragmented to absorb heavy investments in new networks. In response, EU regulation of merger activity is softening to allow 'cross border' mergers, with €50B spent on M&A activity in 2014, and significantly more anticipated for 2015.

Highlights include:

- Vodafone has acquired the Spanish cable company Ono for €7.2B as part of a strategy to offer telephone, television and internet services to its European customers.
- British Telecom (BT) is buying EE for £12.5B; the deal will mark the return of BT to the mainstream mobile market for the first time since it spun off O2 in 2001.
- Telefonica, meanwhile, which acquired commercial mobile carrier O2 in 2001 for £17.7B, spent €8.1B (£7B) in cash and shares on German operator E-Plus.

Meanwhile, as a further sign of operator consolidation, three carriers are in talks to buy O2 for £10.25B.

For enterprise customers, the consolidation trend offers a significant opportunity to rationalize plans from multiple carriers. Given the time required to get a consolidation deal to market and then to contract, **ISG recommends aggressively pursuing carrier rationalization options early**, rather than waiting for multiple existing contracts to expire.

Wireless Network Infrastructure - 4G Capabilities

Increased capacity for wireless network infrastructures is being driven by a variety of factors. One key is less onerous authorization conditions, such as removal of unnecessary deployment restrictions and overly complex procedures for granting permits for base stations or wireless hotspot deployments. Easing of rights to share access to Wi-Fi access points is also increasing capacity, as are operational improvements such as the common use of active and passive infrastructures. In addition, spectrum sharing and spectrum trading make it easier and cheaper to deploy and/or renovate wireless networks with new technologies.

Additional factors are common regulatory principles for spectrum authorizations, common criteria for the availability and conditions of spectrum and customization of corporate products with international capabilities within the EU.



4G LTE

When asked to compare 4G speeds to Wi-Fi speeds within and outside the home, one in three consumers surveyed responded, “4G speeds are faster.” Nearly two-thirds felt 4G is comparable to or better than Wi-Fi, while only 13 percent thought 4G was slower than Wi-Fi. This demonstrates a maturing of the technology and reflects the resources major carriers have put into rolling out 4G networks; at least for now, the customer base appears satisfied. Key adoption drivers are:

- Use of LTE to improve the mobile broadband experience to differentiate from rivals, causing rivals to follow suit.
- LTE operators are continually improving network coverage, expanding the reach of the service to more potential customers.
- The most sought after devices can connect to an increasing number of frequencies used for LTE
- Largest LTE operators aren't changing a premium for LTE access over 3G.

Telephony

Traditional telephony is moving to network-connected voice services such as Voice Over Internet Protocol (VOIP), Session Initiation Protocol (SIP) and Unified Communications (UC) by avoiding infrastructure costs of copper and fiber. Providers are investing in SIP home devices by selling SIP-capable devices/routers and services. Cloud telephony is gaining ground among the SME and the enterprise community.

Enterprise voice products are being developed as a result of hosting agreements at data center locations or in-house capabilities. IP PBX, hosting PBX and virtual softphone services are leading the transformation.

Europe's mobile market has seen intensifying competition for several years, which has led to falling prices for voice minutes, as well as regulatory changes such as reduced roaming and interconnection charges.

In response, Mobile Network Operators (MNOs) are focused on migrating prepaid users to contract plans, increasing average use, gaining revenue per user and selling high-end mobile services. To support this strategy, capital expenditure is being channeled to upgrading networks.

Voice to Data

Upgrades have considerable implications for revenue, business models and investment opportunities and will be paramount during the next few years if MNOs are to avoid further capacity restraints on their stretched networks. To alleviate the burden, an increasing number

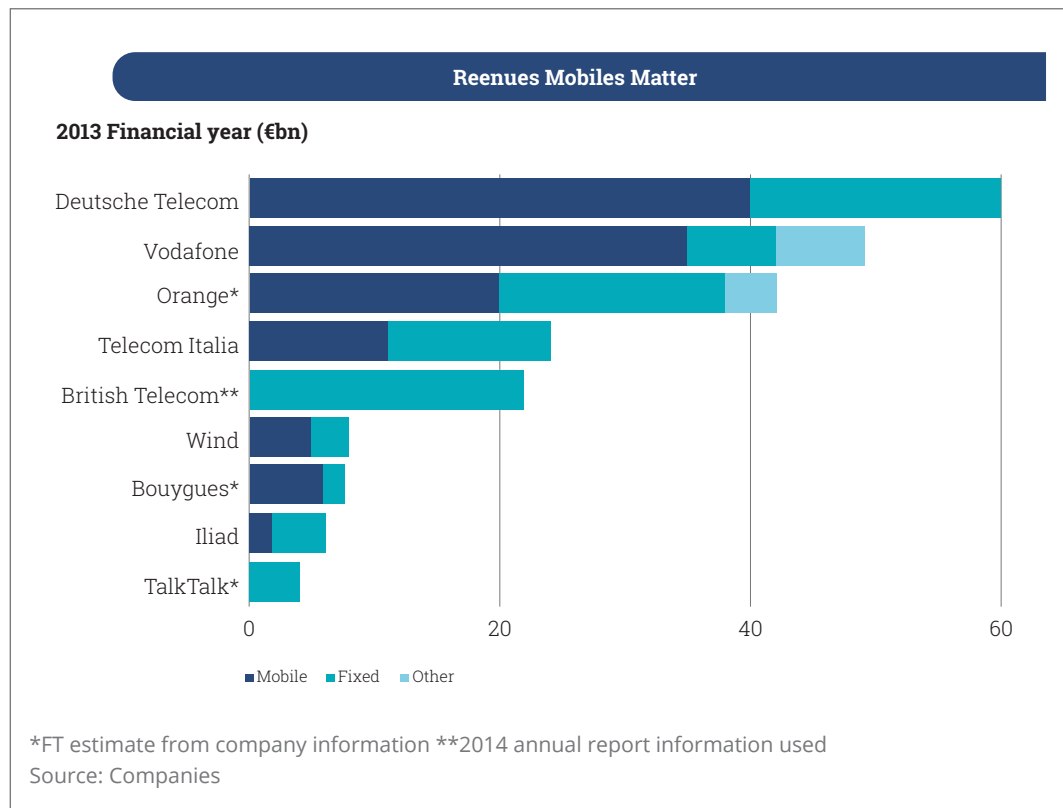
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of operators have abandoned offers of unlimited data use, instead reverting to caps of about 500MBs per month.

Growing MVNO Market Share

By offering branded mobile subscriptions and value-added services, Mobile Virtual Network Operators (MVNOs) have had a significant impact on the market generally, as well on the operating behavior of the host MNOs. Many of the latter are buying up MVNOs and resellers, allowing them to tap into a low-cost segment while retaining their high-end brands. MVNOs, meanwhile, have exploited niche markets and novel business models.

Some MVNOs have successfully targeted expatriate communities, while others have emerged as offshoots from large retailers (particularly in the UK, Germany, France and Spain). Sympathetic regulatory measures have helped the MVNO and reseller sector prosper, and during the next few years some markets will see them command up to a third of mobile subscribers.



Mobile represents a significant portion of the major European telecom companies' revenues, but mobile income has fallen as competition has intensified.



Deutsch Telekom – DT

DT Group reported revenue of €62.7B for 2014, with a 60/40 split between international and domestic. Total headcount exceeds 128,000, with 33,000 employees in the United States and just over 95,000 in Europe, predominantly in Germany and Greece. DT's strategy focuses on four dimensions:

- The best network
- The best service
- The best products
- The preferred provider for business customers

DT is migrating its fixed-network infrastructure to all-IP technology, and aims to complete the transition at all European subsidiaries by the end of 2018. The LTE mobile communications standard is also being launched in all footprint markets. By the end of 2017, DT plans to offer customers in Europe LTE network coverage of at least 50 percent; in Germany, the LTE network is being expanded to provide transmission speeds of up to 150 MBs with a network coverage of up to 85 percent as part of the integrated network strategy. The advanced LTE service is expected to offer speeds of up to 300 MBs.

DT has high expectations of its business customer unit and expects from growth in IT solutions for the Small and Medium Enterprise (SME) segment. A strong position in telecommunications solutions will be used to extend market share of IT solutions for business customers. The focus is on cloud services, security solutions, convergent mobile and fixed-network products, along with solutions for virtual collaboration.

Telefonica

Consolidated revenues were €50B at the end of 2014, with 341 million total accesses and 274.5 million mobile phones accesses; 36.8 million fixed telephony accesses; more than 18.15 million Internet and data accesses and 5.1 million pay TV accesses.

Like BT, Telefonica's strategic focus is to grow and improve the customer experience. As predominantly a mobility provider, the growth of mobile data is seen as a way to monetize the increasing penetration of smart phones.

Telefonica aims to develop digital growth opportunities in areas such as media, financial services, cloud, security, advertising, machine-to-machine and e-Health. The company intends to defend its competitive position and leverage customer knowledge to capture opportunities in the business sector.

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Vodafone

Vodafone reported 2014 revenue at £38.3B, with the EU accounting for 75 percent of that.

The company's strategy is to continue to build on its core strengths to develop a portfolio of products and services based on converged fixed and mobile solutions to global businesses.

Investment is focused on Unified Communications (UC), cloud hosting and machine-to-machine for three market segments – SME, multinationals and carriers. The largest mobility provider in Europe in terms of availability and presence, Vodafone plans to compete against BT by providing wireless customers with broadband, using the fiber network acquired from Cable and Wireless Worldwide in 2012.

British Telecom – BT

BT reported £18.3B in revenue at the end of March 2014, with £16.7B or 91 percent coming from the EU countries, including the UK reporting £14.1B. Global headcount is approximately 88,000, with 72,000 employees based in the UK.

Besides customer service delivery and cost transformation, BT is focusing on:

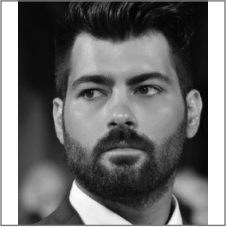
- **Fiber:** Growing the footprint against main competitors are Virgin Media, Vodafone and Colt.
- **Mobility and Future Voice (4G Services):** announced an MVNO partnership with Everything Everywhere (EE) in March 2014, and currently in acquisition talks.
- **UK Business Markets:** Cloud, IP and converged fixed-mobile technology to allow UK customers to improve productivity; investments in network, portfolio, service and sales channels designed to leverage technology capabilities.

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Managing Consultant Yiannis Argyropoulos is a Procurement, Sourcing, Commercial and Project Manager with over ten years of experience of working with large and medium-sized enterprises on stakeholder, vendor and supplier and change management. His client engagements have focused on integration, infrastructure, telecommunications and operational business systems. Yiannis' areas of expertise include operational management in complex environments, supply chain management, process efficiency and multinational operations.



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Before joining ISG, Marcus was EMEA Engagement Director of Strategic Consulting with Tangoe Inc., where his responsibilities included procurement on major global telecom deals, setting supplier strategies and leading negotiations.



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