facing up to the future

With a quarter of the year still to go, it's already clear 2001 will go down as the European cellular industry's *annus horribilis*. In fact, problems were already becoming apparent mid-2000 but brushed aside with the confidence of an industry that had enjoyed sustained growth for the best part of a decade. Today, falling ARPU for voice and saturated markets, the mounting cost of debt coupled with deferred technology and service roll-out mean everyone is feeling vulnerable just as a global economic slowdown begins to bite. Can it really get any worse?

Few of us seriously doubt the wireless industry's ability to bounce back or its long term commercial viability. But it's also clear securing even medium term stability will require a comprehensive review of technology roadmaps, service strategies and business models. Above all, operators, vendors and their partners will need to temper their vision of enhanced service evolution with a healthy dose of realism.

Along with over-bullish acquisition strategies by some of the larger players, most argue the problems of European operators centre on the burden of debt incurred in the battle for 3G licences. There are certainly undercurrents of resentment in the prevalent description of licence fees as an upfront tax on ▷



Debt-burdened and vulnerable, it's been a bad year for mobile telephony. But with renewed focus on the corporate sector and better customer understanding there is light at the end of the tunnel

Jason Chapman
Senior Analyst
Gartner Group



the business case

future revenue streams. However, it is important to look at the spectrum auctions in context or risk losing sight of other, perhaps more significant, factors that have contributed to the current downturn.

There is no doubt many operators paid more than expected for 3G spectrum. The total across Western Europe will come to a cool €120 billion, with UK and German operators shelling out a total of €88 billion between them. But consider the conjuncture. Between 1990 and 2000 the number of mobile subscribers worldwide grew from 11 million to a little over 430 million. More than half these users were based in Europe. At the end of 1999, the GSM Association put the continent's subscribers at 170 million. A year later the world's most mature GSM market was boasting more than 275 million subscribers. It is not surprising that such a buoyant market encouraged enthusiastic investment more than it engendered caution.

What the financial community was being asked to invest in was a vision of technology and service evolution founded on this robust subscriber base and wedded to the era's other ubiquitous technological phenomenon – the internet. For many European operators, the spectrum auctions have been as much about capacity as enhanced service offerings. But the industry's pitch to the financial markets has always highlighted 3G's potential to make the internet truly mobile. With the dot.com bubble still on the rise and literally billions of SMS messages fuelling the conviction that the combination of mobility and data would strike a chord with consumers, the 3G vision looked like a compelling investment proposition.

operators, vendors and their partners will need to temper their vision of enhanced service evolution with a healthy dose of realism



All of which was 18 months and a lifetime ago. Since then the dot.com bubble has burst and we have seen a radical shift in perspective as regards the e-economies. It's no longer good enough to demonstrate you can reach millions with your product – you also need a strategy to ensure a good percentage pay for it. The same fairly fundamental principle is now being applied to the 3G business case. It is no longer enough to build development strategies on the back of what you believe the technology can do. It is also necessary to demonstrate that this leads to service strategies for which there are identifiable markets capable of generating significant new revenue streams. In addition, operators are now pitching to investors that are themselves exposed through lending for acquisitions and 3G licences; investors that might well have been involved in some of the infrastructure vendor financing deals that have been offered operators. Such institutions will be looking long and hard at any proposition that means additional exposure.

All of which adds up to an extremely conservative investment market and at least one very predictable consequence. As far as the mainstream media are concerned, the 3G service offering has now moved from being something everyone will soon be using to a colossal miscalculation that could ultimately bring an industry to its knees.

In reality, the current downturn should be regarded as a wake-up call to operators and vendors alike to stop allowing technology to drive the offering and concentrate on matching services to consumers. Financing will dry up if investors are not presented with significant and above all plausible ROI. At present, few are being offered sight of new revenue streams they can believe in. To make matters worse, over the past few months it has also become clear that for a variety of reasons 3G roll-out is going to be deferred. Is it any wonder the markets are shaky?

At this point it is worth pausing to think back a few years. In a number of important respects the industry has been here before. There are certainly clear parallels between the early days of the GSM industry and the current challenges facing the market in the roll-out of 2.5 and 3G networks.

At the birth of GSM few saw the cellular industry as offering much potential outside the business market. The prospect of rolling out national networks looked extravagant in the context of what was likely to be predominantly metropolitan demand. Like today with 3G, the standards took a long time to become fixed – although given the complexity of the task accomplished both then and now it seems churlish for developers to resent these particular delays. Back in 1992 at the GSM World Congress, George Schmitt of Germany's D2 Network prayed that 'God send mobiles', underlining the industry's failure to deliver the volume of handsets required to kick-start the embryonic GSM juggernaut and initiating a trend that would persist through WAP and GPRS. With some vendors now admitting commercial 3G handsets are unlikely to hit the market in volume until 2003, once again the industry's history seems to be coming back to haunt it.

The point is that in spite of this inauspicious start the European cellular industry has consistently confounded expectations in terms of growth and market share. However, with equal consistency it has failed to anticipate critical trends that have fuelled such growth. The most obvious example here is SMS – a service that was viewed as a niche corporate offering by the industry but adopted primarily by the youth market (approximately 20 billion messages a month sent worldwide). Likewise prepay was regarded as both expensive to implement and of marginal interest as a marketing tool. In the event, prepaid services have turned out to be one of the most significant drivers in both mature and developing GSM markets.

there are now a number of additional reasons why targeting the business sector in the first instance makes sense in the present climate

Of course, it is easy to be wise after the event and until very recently most European operator's problems centred on coping with escalating demand. But times have changed. There is a great deal more at stake now than a decade ago and the industry's failure to recognise the potential of SMS and prepay is symptomatic of a culture in which technical preoccupations have come to smother a clear understanding of what customers actually need.

An ability convincingly to address end-user demand will be critical not just in satisfying the preoccupations of investors but also in the evolution and implementation of marketing and roll-out strategies for 2.5 and 3G networks. In this financially constrained market, operators are unable to contemplate rapid roll-out of 2.5 and 3G networks and services except where such provision can be targeted with precision and guaranteed ROI. In addition, new service strategies must focus on retaining, maintaining and then enhancing current ARPU from existing customers.

For most operators, there are few more important customers than those in the corporate sector. There is no doubt the 3G roll-out strategies of many operators are focused on the corporate market. This is a tried and tested path for the cellular industry – we saw it with the launch of 2G services and more recently with the GPRS trials and early service offerings. But there are now a number of additional reasons why targeting the business sector in the first instance makes sense in the present climate.

The first has to do with protecting against churn in this profitable sector. Operators need to keep their corporate accounts on the migration path to 3G, especially with new incumbents entering the market. This is a sector that is willing to pay for technology that enhances efficiency and facilitates greater flexibility. If companies find competitors are benefiting from services unavailable to themselves they will simply jump boat. If new players entering the market find incumbents slow to ▷

satisfy business sector demand, they will not be slow to poach this key source of revenue.

Identifying such services is also fairly straightforward – the business world wants fast and efficient access to emails, the internet, extranet and intranet facilities. In short, a fully functioning mobile office. So maybe this is the time to forget about videoconferencing and 2Mb over the air interface. The kind of services the business community are looking for can be made available at perfectly acceptable access speeds at the early stages of 3G-roll-out. In addition, the ability to launch such services will be significantly less constrained by the availability or otherwise of 3G terminals. After all, very soon most business users will be able to access mobile office facilities via a laptop or PDA and a PC card.

businesses have always shown themselves to be willing to pay for technology that saves time and gives them an edge

The second reason for focusing on the corporate market is that it enables operators to roll out pockets of 3G and focus higher data-rate services very tightly on potential high usage areas. Although operators will clearly need to adhere to regulatory timetables for roll-out, within such timetables they are likely to be extremely cautious about moving any faster than necessary. Most have come to terms with the fact that the 2.5G stepping stone is likely to endure somewhat longer than initially anticipated.

Finally, a focus on mobile office functionality for the corporate market enables operators to access new budgets within the business sector. Traditionally, most operators have sold to corporate telecoms managers whose main preoccupations have been monitoring collective minutes of use and keeping track of handsets. The arrival of mobile office functionality gives operators the opportunity to develop bespoke business solutions and applications for corporate clients. This facilitates access to IT personnel and budgets, a process that has already started with 2.5G services, forging relationships incumbents will be well positioned to leverage in the migration to 3G service portfolios.

As market confidence has foundered, it has become increasingly fashionable to question whether even corporate users will be prepared to pay a premium for enhanced data services. The answer is that within reason businesses have always shown themselves to be willing to pay for technology that saves time and gives them an edge. For example, a couple of years ago few business users would admit they would be prepared to pay premium prices for a PC they could carry around with them. These days few are to be seen without their laptops and prices have steadily fallen as competition has increased. It seems likely that the 3G mobile office model will follow a similar trajectory.

Another symptom of the technology-over-service culture that must be avoided in the months and years ahead is the tendency to launch developments as technology improvements rather than innovative service offerings. Both WAP and GPRS have suffered from such an approach. Only the wireless industry cares about anything called WAP, GPRS or 3G. The rest of the world and more specifically its customers are only interested in services. In addition, it is essential to manage user expectations in the promotion of new products. For example, there might have been more mileage promoting an enhanced messaging service to ride on the coat tails of SMS, rather than attempting to sell something called wireless application protocol that somehow turns a phone into a PC.

As an industry, it was perhaps over optimistic to think we could sort out licences in 2000 and launch the first commercial European networks in 2001. W-CDMA is a very complex technology and we are just beginning to understand the implications of that complexity for network deployment. Gartner believes European operators will roll out 3G later than anticipated, with soft launches late 2002 followed by highly targeted corporate services throughout 2003. Mindful of developments in the terminal world, we do not expect to see significant mass market take-up until late 2003/early 2004.

On the positive side, the development of mass-market product offerings will benefit significantly from the early corporate experience. However, the key to success in both business and consumer markets will be about getting closer to consumers than the industry has managed to date. Having identified niches and needs it is then a case of minimising misleading hype – especially in relation to data speeds – and establishing realistic delivery schedules. Success in 3G means forgetting you are selling technology and focusing on delivering services. It is also about keeping your nerve. □

i *www.gartner.com*