



X-raying the P&L

For communications players, confronted with one of the most challenging operating landscapes in decades, the priority is to be sure they get the maximum “bang for their buck” for discretionary marketing and network spending. A key means of driving the effort is to expand traditional analysis tools to enable detailed insight into the profitability of individual commercial products, bundles, channels, and customer segments. Such insight will ensure that companies can evaluate the effectiveness of key marketing and network initiatives, as well as benchmark revenue and cost performance.

It is a fact of life for most telcos that their revenues are failing to keep pace with their costs. Slow but relentless industry convergence, driven by technology convergence on all IP networks, has intensified competitive pressures. The more recent turbulence in financial markets and the subsequent recessionary forces have depressed global demand for telecommunication services. At the same time, the days of cheap and plentiful capital have drawn to an abrupt close as credit markets have seized up.

No surprise, then, that a rigorous focus on operational efficiency is set to be a fact of life for the foreseeable future. Under these conditions, a key question for management is, what is the best way to leverage maximum benefits from existing as well as envisaged marketing and network programs?

The focus is currently on expanding profitability analysis across the organization to provide prompt, actionable insights into the performance of commercial products, bundles, channels, and customers. Most operators in developed or emerging markets have a regulatory cost model for determining the prices of regulated services. However, due to time lags in producing results and the lack of granularity and flexibility, such models have proven to be inadequate for commercial decision making. As a result, companies increasingly are seeking to drill much deeper into the profit and loss statement (P&L) to assess performance more accurately and more frequently.

Equipped with insights into performance at a much more granular level, management gains the information it needs to undertake a number of initiatives, including:

- Streamlining product portfolios and discontinuing uneconomical products.

- Investing in high-return product lines and high-return customer segments.
- Constructing tailored bundles with optimized pricing.
- Scrutinizing and prioritizing spending on marketing, particularly customer acquisition and retention expenses (e.g., handset and set-top-box subsidies) based on marginal value creation.
- Increasing target volumes to leverage scale where networks are underutilized.
- Refining targeted outsourcing.

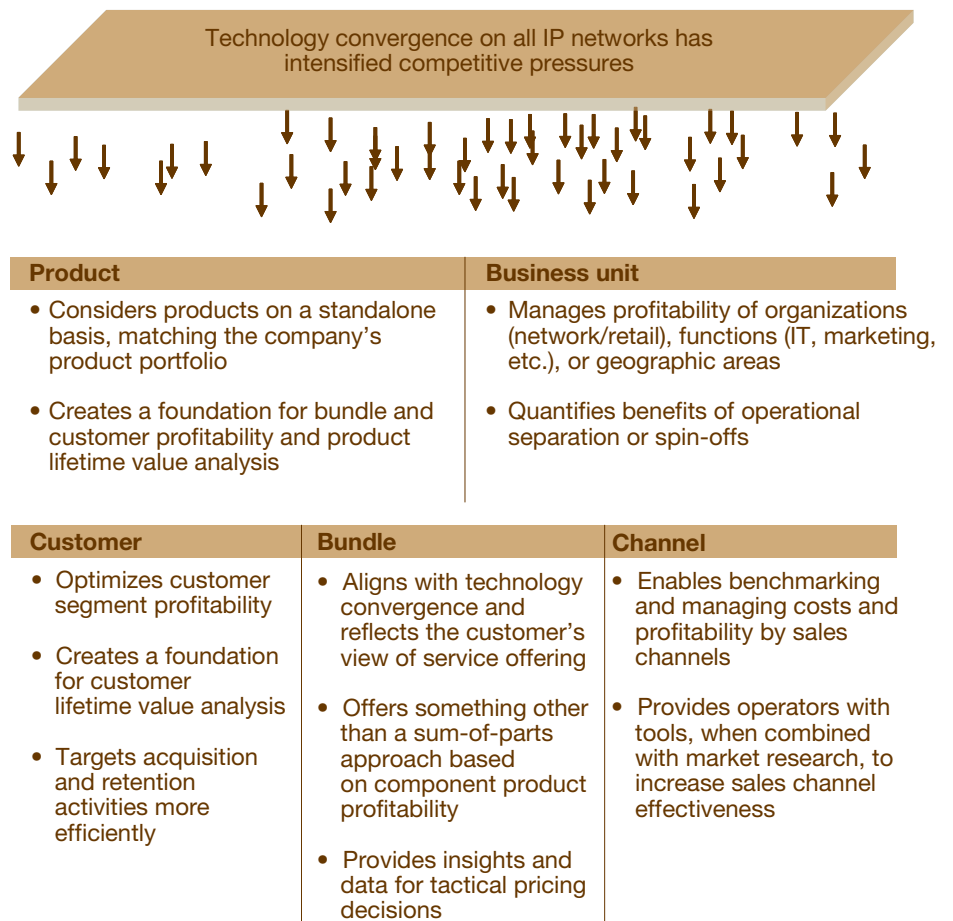
Confronted by a complex and rapidly evolving set of service, device, content, and technology requirements, companies in the communications sector have to be

able to move fast and intuitively to capture market share. At the same time, the fragmentation of customer segments calls for far greater flexibility in terms of pricing, bundling, and product targeting. Provided that management has continual access to detailed P&L insights, it will be able to formulate strategies that make sense in this challenging environment—quickly identifying potential new revenue streams (around data and TV, for instance), quantifying the upside for each one, and prioritizing them according to the anticipated impact on value.

Toward a new focus on profitability

Traditionally, communications companies have tended to focus on profitability at the product level.

Figure 1: Move from product and business unit to customer, bundle, and channel to gain prompt, actionable insights into the performance of commercial products



However, as convergence and recessionary forces have intensified competition, the emphasis has been far greater on exploiting bundling and channels to secure market share. Although those tactics have created exciting new revenue opportunities, they also have created problems in terms of profitability visibility. Thus, there is a need for systematic and regular reporting analysis of bundle, channel, and customer profitability.

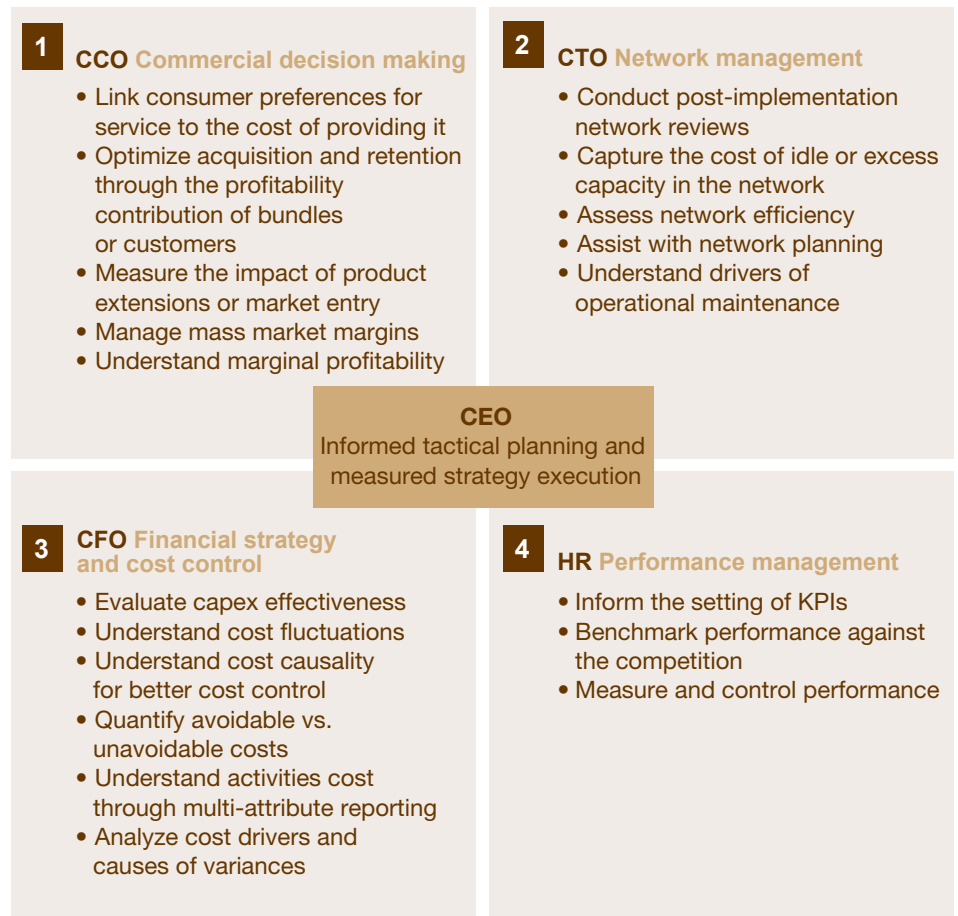
Figure 1 illustrates how the focus on profitability has shifted over time, as well as identifies the key insights that are delivered by each stage.

Channels, bundles, and customers are rich sources of strategic insight. Detailed information about channel profitability enables comparative analysis of channel performance. It also provides management with the data to benchmark the performance of its channels against others in the industry.

Bundles analysis is more challenging than it appears because of the discounts and economies of scope that come with selling bundles of TV, phone, and broadband. Nevertheless, the analysis provides valuable data for tactical pricing, a must-have capability in a competitive and volatile marketplace where margins are narrowing.

Of course, now more than ever, a detailed understanding of the profitability of each customer segment pays off by providing the foundation for customer lifetime value analyses. Combining that understanding with marketing insights and research also significantly improves product and service targeting, as well as ensures that, where possible, costs are limited to those for products and services that customers value (rather than wasted on activities that customers seldom use, or would be happy to do without).

Figure 2: Putting profitability insights to work throughout the organization



Putting the insights to work

Having established that enhanced P&L insights at the product, bundle, channel, and customer levels are essential in today's environment, the next step is to decide where in the organization to use these insights for maximum effect. The reality is that the optimum mix of P&L insights will vary throughout the organization (see Figure 2).

The commercial team will be most interested in observing incremental profits because it can use that information to support tactical pricing decisions and to help prioritize the need for “push, pull or keep products or bundles” initiatives. The commercial team also will be able to leverage these insights in mass-market margin management, as

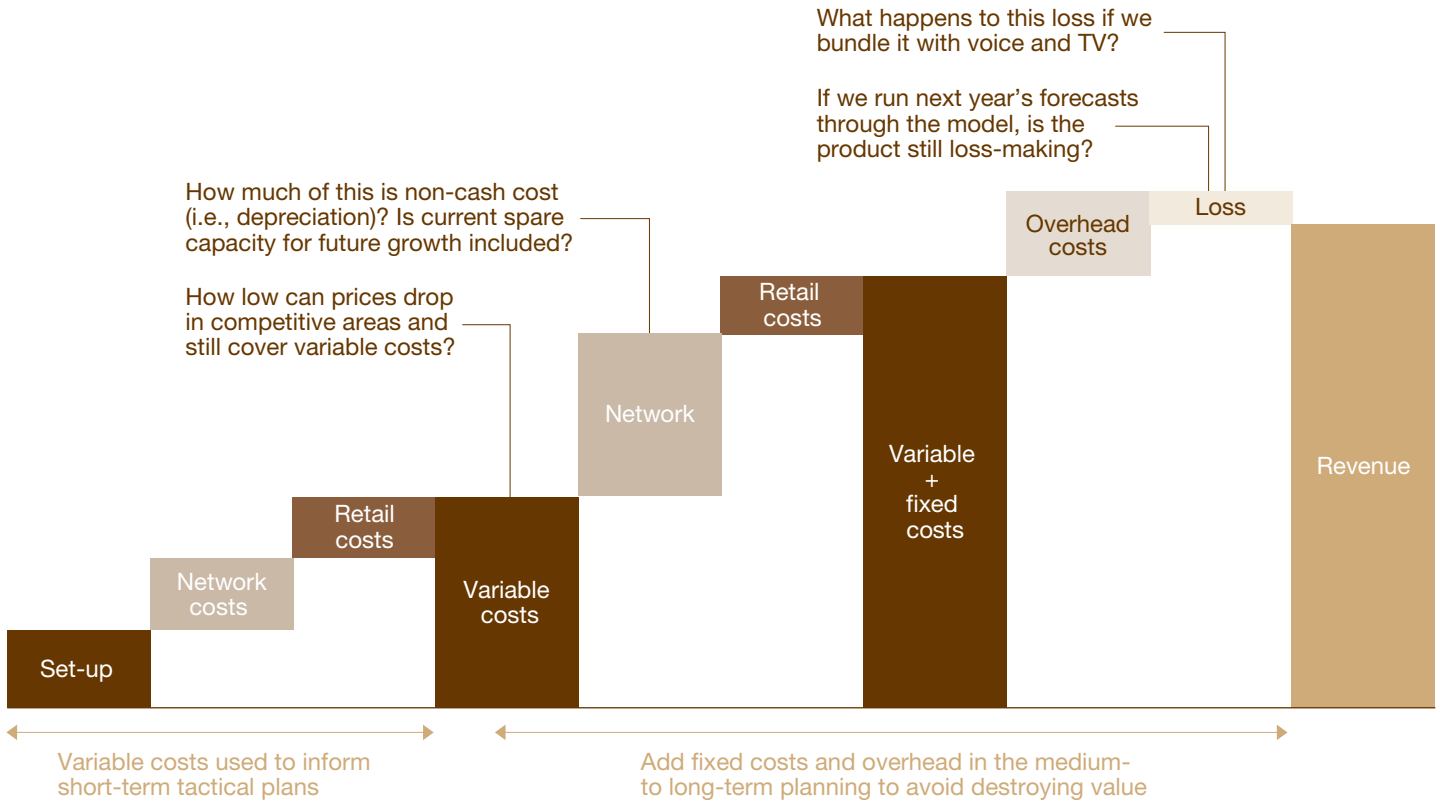
well as in identifying how individual products or bundles contribute to the organization's overall profitability.

Meanwhile, the finance team will retain a focus on fully allocated costs when quantifying costs that are avoidable (e.g., sales acquisition and retention), those that are partially avoidable (e.g., advertising), and those that are unavoidable in the short term (e.g., facilities and information technology). Insights the team gains will equip them to monitor cost fluctuations and enhance cost control.

The human resources and network teams will derive their own benefits from P&L insights. As before, the information requirements of each will need to be closely considered and the P&L information tailored to match

Figure 3: Using variable and fixed costs to inform various commercial questions

Example: A mature broadband market



them. Human resources, for example, will be particularly interested in using data that can inform performance management benchmarking and setting key performance indicators (KPIs), while the network team will target data that facilitates network cost management (e.g., post-implementation network reviews).

Understanding the challenges of implementation and maintenance

The value that can flow from detailed P&L analysis is matched by the complex challenge of its implementation. Crucially, the requirement is not for a one-time solution but rather for a financial-systems-driven approach that enables a business-as-usual reporting capability. Because the information needs of organizations vary enormously, it is very important to design and operationalize a

model that will deliver the maximum ongoing benefit to core teams within the business. And it is essential to spend time deciding what information will be of most benefit to individual departments or teams before building the model that can deliver the level of insight required.

At the model-design stage, management first must decide what it wants to achieve (i.e., should the analysis cover products, bundles, channels, customers, business units—or all of them?), as well as whether an existing regulatory P&L model can be adapted or a new one needs to be developed from scratch. During the planning stage, it is important to avoid falling into the “accountant’s trap”—in other words, make sure that the appropriate cost standard is being used and tailored to the analysis that is being carried out. For example, new product introductions need to be evaluated

carefully as it is natural for such products to appear unprofitable while volumes are sub-scale.

As shown in Figure 3, variable and fixed costs each have a role to play in informing decision making in different parts of the organization. For instance, an operator that was facing intense competitive pressure in the broadband market was interested in finding out how low they could drop their prices in competitive segments and still cover their variable costs. They were also able to rapidly identify the effect of losing customers with low average revenue per user (ARPU) to other broadband providers.

Second, management must decide the calculation period and frequency of reporting requirements. One key question for consideration will be, what constitutes current? Another is, how must one-off costs and revenues be treated? At this stage, the expectations of stakeholders need to

be managed—that is, identify what they expect from the analysis and then let them know what actually will be delivered and how to use it most effectively.

Once a model that makes sense for the organization’s needs is agreed upon, data collection processes have to be put in place with the appropriate degree of granularity and reliability. Key steps at this stage include deciding how to match diverse (e.g., product) identifiers across systems to ensure that costs can be allocated appropriately. At the prototype stage, the processes for data collection often will be manual and resource-intensive. For this reason, in looking ahead to operationalizing the model, companies must consider how best to learn from mistakes and achieve overall automation.

Naturally, buy-in must be secured from the various data providers—no small task, especially when one considers the internal reporting duties that most of them will be handling already. Consequently, thought should be given to incentivising key individuals (in operations, commercial, and technical) by ensuring that commitment to the model is reflected in their yearly performance objectives, and perhaps through explaining the benefits to them as well as the visibility of performance they will achieve with this tool.

Finally, companies need to decide on the most effective means of refining allocation keys in light of ongoing data analysis. That can be achieved by continually seeking feedback from data providers and data users.

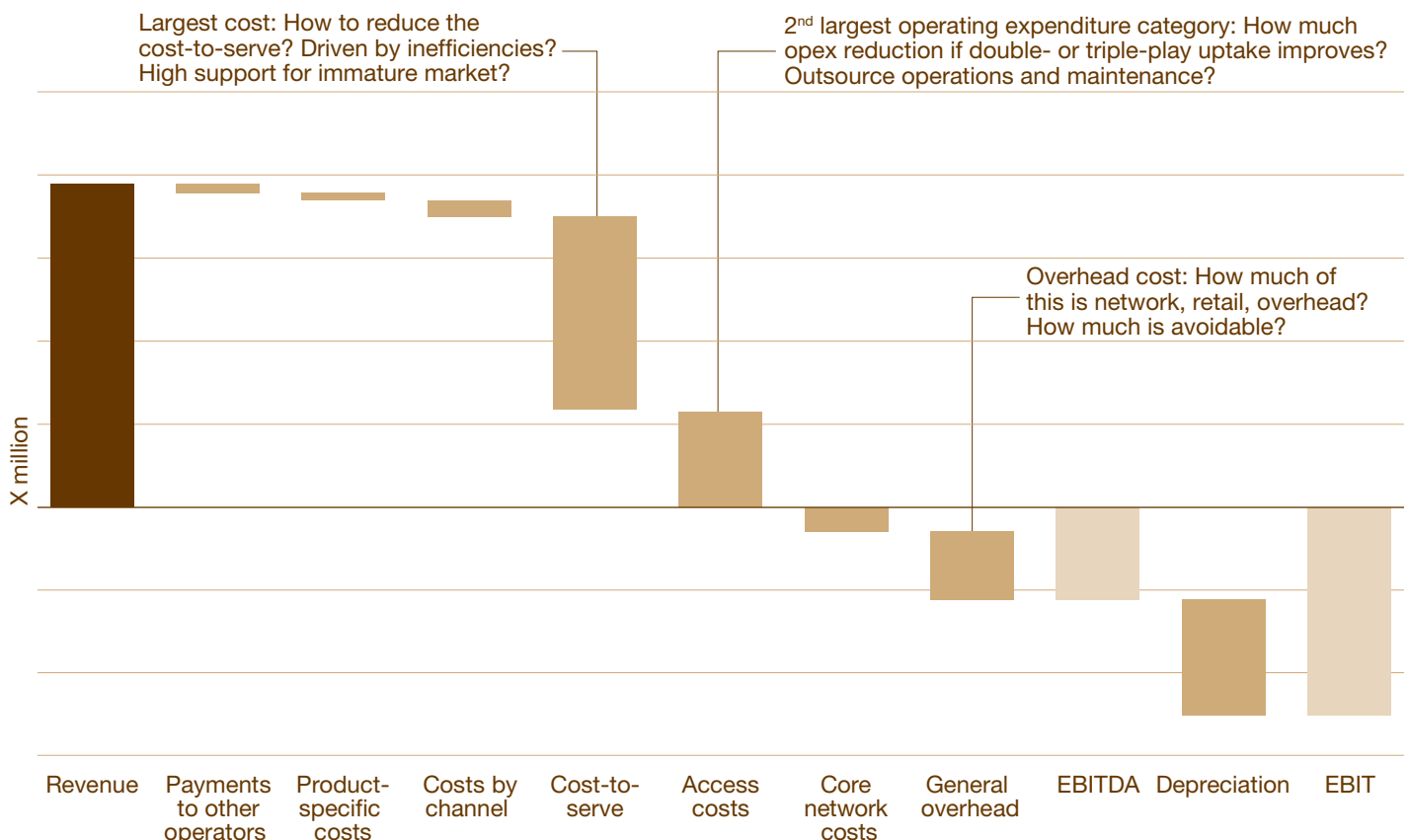
With the preparation and forward planning completed, the company will

be ready to build the model. Initial reviews should be conducted—before sharing the results—to fix any discrepancies that might appear in the data. The various users should be alerted to watch out for any particular trends that are likely to occur, for example, sense-checking data to see whether increases in network costs reflect recent developments. Because the data need to be available as rapidly as possible, the focus on materiality needs to be maintained.

Provided that the reporting templates that have been set up match user requirements, management will be ready to review and analyze the results generated by the model. Feedback can be sought from key stakeholders, all of whom should be encouraged to challenge the data before incorporating the findings into their strategic decision making. The

Figure 4: Profitability reporting highlights opportunities for cost efficiencies

Example: Bundle analysis



model can be refined and re-run as necessary, while being continually reconciled to the organization's budget and accounts.

It is important to share the right data mix with the right people within the organization. With professional guidance, management should be able to decide which insights will be most helpful for decision making across financial, human resources, network, and commercial functions, providing teams in each with valuable insight into core strategic questions (such as how product or bundled features drive costs). If this analysis is combined with conjoint research into the relative attractiveness to customers of such features—such as what is important to customers' buying behavior and what is not—management has a potentially powerful tool with which to maximize profit by refining the product or bundle proposition.

Benefits in practice

In the following examples, we show how detailed profitability analysis delivers real-world benefits to companies. In Figure 4, detailed bundle analysis was used to highlight key costs that could be benchmarked against competitors to help inform decisions about cost reductions. In this particular instance, the client used the insights provided by our model to analyze and ultimately to reduce the cost-to-serve for each of its bundled offerings. The data were used to assess whether or not operating expenditure could be significantly reduced by improving double- or triple-play uptake, as well as by quantifying just how much of the network, retail, and overhead costs could be avoided.

Companies can gain tremendous value from understanding customer segments better and formulating

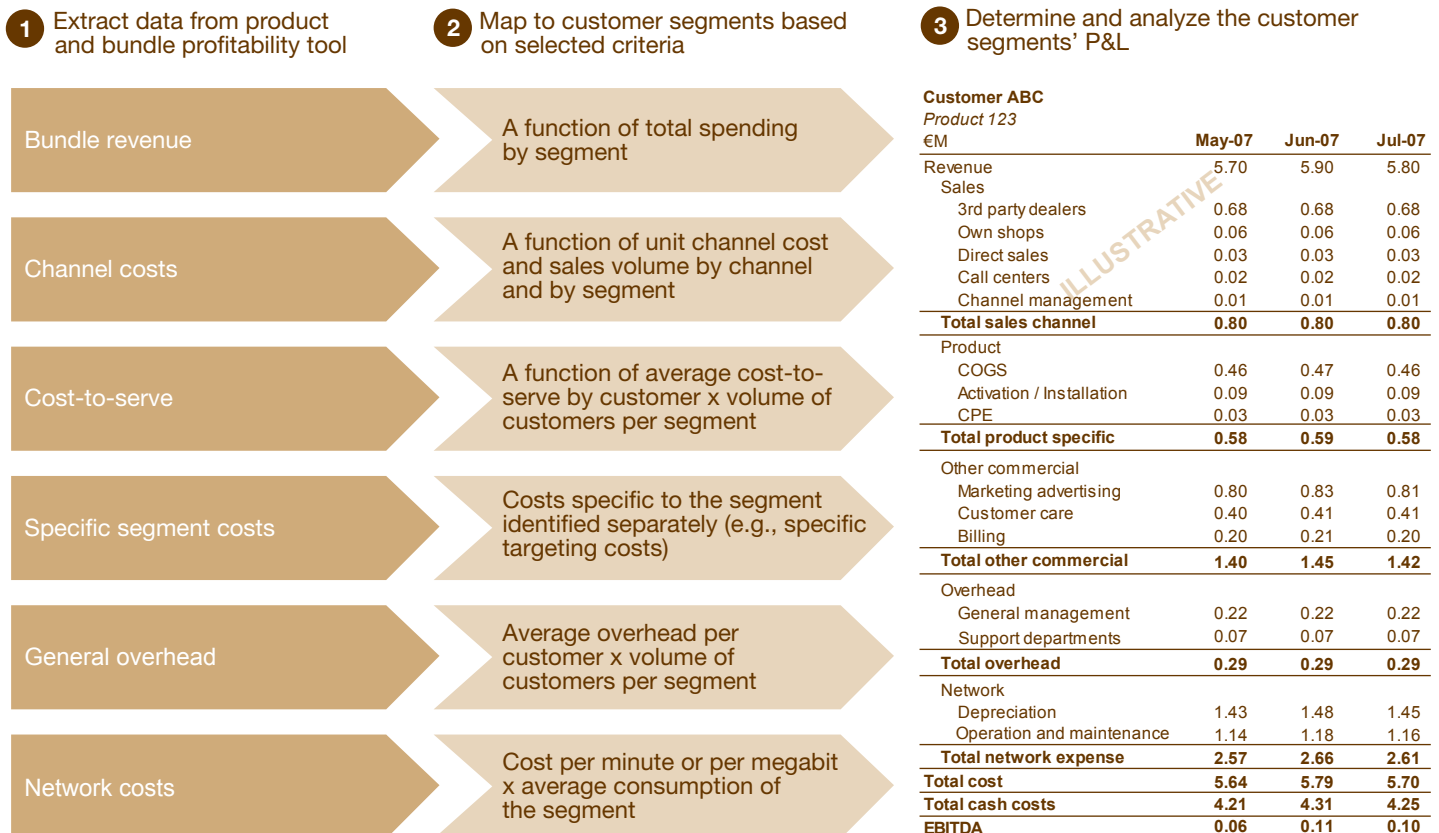
strategies appropriate for optimizing relationships with customers.

A tool used by many operators PricewaterhouseCoopers works with is customer profitability. In Figure 5, we show how to analyze customer profitability, starting with the cost and profitability data of products and bundles and mapping that to core customer segments based on selected criteria. The resulting Customer Segment Profitability P&L is an invaluable tool for assessing future spending decisions and for underpinning tailored retention and value optimization strategies.

Through our work with telecom operators, we have found that in order to make customer profitability actionable, the operator should take an iterative approach:

- Use market research and customer profitability analysis to identify potential levers of future value at

Figure 5: Building customer segment profitability bottom-up by using insights from product or bundle profitability tools



the level of each segment (for example, pricing, product design and mix, customer mix, sales channels, activities that increase stickiness, and superior customer service).

- Prioritize levers by assessing the value that customers place on them.
- Compare value with what it “costs” to realize change in these levers by using developed costing tools.
- Implement tailored initiatives to transform the relationship with customers.
- Re-measure the impact on the profitability of customer segments.

This iterative approach should equip management with strategies that increase ARPU, reduce the cost of churn, increase stickiness, and reduce the overall cost-to-serve.

Operationalizing the model for long-term benefit

Detailed profitability analysis can—and does—deliver real benefits. But if the processes have not been embedded into the organization such that they become business as usual, the longer-term payback will be impaired. Operationalizing the model requires management to commit to a number of actions:

- Incentivize people to provide accurate data on a regular basis, using KPIs, where appropriate, to build these actions into people’s objectives and ensure that accountability for data inputs is understood and maintained.
- Safeguard the ongoing accuracy of data through regular checks on data received, as well as regular Q&A sessions with internal audit functions.
- Ensure the timely reporting of data through integrating the process with the company’s wider reporting and management accounts processes, as well as by maximizing the automation of processes.

- Protect the ongoing appropriateness of data by applying the correct cost standard, as well as by communicating effectively concerning the appropriate measure (i.e., telling the data users what the meanings and limitations of each measure actually are).
- Prevent the maintenance of the process from becoming too resource-intensive by focusing on standardizing and automating the data-gathering and -cleansing actions that need to take place, as well as on materiality.
- Manage stakeholders, the last, but by no means least, step. This means that, from the outset, management must be clear about the benefits, as well as the limitations, of the profitability analysis. Set up feedback loops and monitor them constantly to ensure that problems are resolved promptly and confidence in outputs is strengthened.

PwC has already accumulated substantial experience in planning, building, and embedding these analytical processes into the organizational frameworks of communications businesses. For example, we recently completed a major assignment with one of the largest telecom companies in Europe to plan and build their profitability model. This provided management with consistent, regular, system-driven profitability reporting against the budget for all of their segment-based bundle propositions.

For a global mobile operator, we recently provided a tool to analyze the profitability of each of the global major accounts, drawing outputs from more than 100 geographic areas with separate accounting and customer relationship management systems. Based on this and other experience, we know that, from start to finish, companies should expect such assignments to take between four months and a year.

From that point—and provided that steps have been taken to operationalize the analysis throughout the organization—the benefits to strategic decision making are substantial and ongoing.

Ioana Dobre is an associate director and Jonathan Oxley is a partner in PricewaterhouseCoopers’ Telecoms, Media and Technology Advisory practice. For more information, please contact Ms. Dobre by phone at [44] 20 7804 3206 or by e-mail at ioana.e.dobre@uk.pwc.com; or Mr. Oxley by phone at [44] 20 7213 3286 or by e-mail at jonathan.m.oxley@uk.pwc.com.

The authors wish to thank Catherine Lunn for her contribution to this article.
