Yet Another Metamorphosis for GCC Telecom Operators

Telecom operators in the Gulf region survived the financial crisis and maturing markets by adjusting to the end of explosive growth. Now new industry trends are in the mix. How ready are they to adapt again?
After years of strong growth, Gulf Cooperation Council (GCC) telecom operators have slowly adapted to the new realities of their maturing markets. Now another batch of new trends could have a profound impact on the industry, leaving GCC telecom groups to focus on redefining their service portfolios, improving the customer experience, and tapping into the opportunities that data-savvy consumers, businesses, and governments offer. Success in the next few years will depend on creating synergy across product portfolios and adjusting operating models to meet these new trends head on.

Didn’t We Just Adjust?

Years of strong growth and limited competition have delivered some of the industry’s highest margins to telecommunications operators in the GCC region. Rising oil prices contributed to sharp increases in the level of gross domestic product per capita, creating an attractive telecom market. Between 2004 and 2007, GCC telecom revenues grew 15 percent annually, with earnings margins hovering around 47 percent.\(^1\) Fueled by growing profits and healthy cash flow, GCC operators went on a buying spree across the Middle East, Africa, and Asia, acquiring existing operators or licenses to launch their own networks.

But that period of continuous expansion came to an abrupt halt during the financial crisis when annual revenue growth for GCC players fell to just 4 percent (see figure). Several factors contributed to falling numbers, from a saturated market to new competitors (see sidebar: End of the Telecom Boom on page 3).

To adapt to this maturing market and increased competition, operators in the GCC lowered prices, improved the customer experience, and—sometimes reluctantly—looked deeper into

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**Figure**

**GCC telecom operators were hit hard by the financial crisis**

**Compound annual revenue growth rate**  
(telcos)\(^1\)

![Graph showing compound annual revenue growth rate](image)

\(^1\) Data is based on companies in 22 developed countries, 30 emerging countries, and the four largest GCC companies.  
Sources: Bank of America Merrill Lynch, Bloomberg, company annual reports, A.T. Kearney analysis

\(^1\) Earnings in this paper refers to earnings before interest, taxes, depreciation, and amortization (EBITDA).
their organizations to improve efficiency. It began with small cost reductions, followed by several GCC groups launching major cost-optimization programs in their home markets, addressing their supplier base with strategic sourcing initiatives, and outsourcing select non-core activities. Improving speed and quality and becoming more customer-centric would require a transformation of the entire organization.

Groups that had acquired operators across continents during the boom times shifted from expansion to creating synergy, albeit with limited success. Synergy is not an easy concept to attain and is often complicated by cultural, language, and legal differences. The level of control proved to be limited as some groups had not acquired majority stakes, which made actively managing their portfolios a challenge. It is not surprising, then, that some operators started divesting some of their stakes, such as Zain selling its African operations to Bharti Airtel and Etisalat divesting its Indonesian operator.

A Whole Host of New Trends

GCC operators are now turning their attention outward again—adapting to new industry dynamics and getting ahead of the latest trends in the global telecom industry:

**Data, data, and more data.** The Middle East has not been immune to the worldwide explosion in data, driven by data-savvy consumers and the deployment of a vast portfolio of mobile applications. Statistics from YouTube, which accounts for 24 percent of global mobile traffic, reveal that Saudi Arabia has the world’s most YouTube clicks per Internet user (more than 90 million daily page views). The Middle East ranks second after the United States in number of daily views, with 167 million video views per day. The Middle East and Africa are expected to have year-on-year data increases of 133 percent through 2014.²

**Technology.** To meet the rising demand for data, operators must continually expand network capacity and roll out new technologies, such as fiber-optic networks and high-speed mobile broadband (4G), all while facing pressure from shareholders to limit capital expenditures and maintain healthy cash flow and attractive returns. Next-generation high-speed mobile networks are rapidly being rolled out around the world, with GCC operators ahead of most of their

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² Cisco
³ Economist Intelligence Unit, International Telecommunications Union
Western peers. Several GCC telecom operators have made huge investments in fiber networks and Internet-protocol television (IPTV) platforms, although the financial returns are not yet clear. Newer players are competing with embedded media ecosystems, such as Netflix (streaming), Apple TV (set-top boxes), and Samsung (smart televisions). Because they only need broadband connections, the embedded systems are far more competitive than IPTV.

**Aggressive OTT players.** The rise of new competitors, broadly dubbed over-the-top (OTT) players, has the potential to impact the global telecom industry. They offer attractive services via their own platforms and ecosystems, including voice over Internet protocol (VoIP), instant messaging (IM), and services such as TV, video, and music. And while subscribers pay telecom operators for fast connections, most revenue comes from pay-per-usage and advertisements. Operators benefit by charging subscribers for data consumption, but it is often restricted by data packages that offer unlimited data. As a result, the battle between operators and OTT players has begun for voice revenues (especially high-margin mobile international traffic), short message services (SMS), and media.

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**Subscribers want the latest smartphones, tablets, applications, and content**—most of which are neither owned nor sold by operators.

Several examples illustrate this. The first quarter of 2012 registered a decline in usage minutes in almost all regions of the world: North America (-5.3 percent), Asia Pacific (-0.6 percent), and Western Europe (-0.4 percent). The Middle East grew, but only by 3.5 percent.\(^4\) OTT player WhatsApp carries 5 percent of global messaging traffic, which is directly affecting operators. For example, the total number of messages sent in the UAE dropped by 10 percent between 2010 and 2011.\(^5\) This trend could already be accelerating in some GCC markets, where some operators have seen reductions in SMS traffic of more than 30 percent in less than a year, mostly driven by free Internet-based offerings such as WhatsApp, Viber, Facebook, and BlackBerry Messenger.

**Consumer behavior.** Not so long ago, subscribers would make conscious decisions about which telecom operator to join, if they had a choice at all. Low-value subscribers generally chose the best value-for-money option, and high-value subscribers chose the operator with the best network and the most extensive portfolio of value-added services. Regardless of how or why these decisions were made, subscribers often developed emotional bonds with their telecom operators. Well, those days are gone. Today’s subscribers want the latest smartphones, tablets, applications, and content, most of which is neither owned nor sold by an operator. Subscribers are just users now, taking advantage of an operator’s network to connect to services with which they do have an emotional bond—Facebook, for example.

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\(^4\) ABI Research

\(^5\) The Telecommunications Regulatory Authority of the United Arab Emirates
Don’t Just Adjust to the New Dynamics—Embrace Them

GCC telecom operators face significant challenges, and how they build on what they have achieved so far will define their long-term prospects. Companies that adopt the following four approaches will have the best chance of success:

**Redefine pricing, retention, and customer experience.** While GCC telecom operators will profit from the increased demand for their data services, this is only part of the story. In fact, it is estimated that data produces 90 percent or more of operators’ network traffic volume but generates only 10 percent of revenues. With the demand for mobile data potentially unlimited, operators that replace unlimited flat-rate data plans with usage-based data pricing and packages, and focus on customer segmentation, tiered services based on customer life-time value, and premium “out of bundle” services, will be best placed to reap the benefits. Smart plans that integrate voice and data bundles and link them to devices are one possibility for the forward-thinking operator. In the United States, Verizon has launched a data-centric “share everything” plan offering unlimited voice minutes, unlimited text, and shareable data that can be used across 10 devices; other U.S. operators offer similar packages. GCC operators could also gain valuable insights and the ability to offer more-personalized services—assets they are not yet fully exploiting—by tapping into their vast reservoirs of customer data.

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**Make digital diversification a top priority.** Diversifying from traditional telecom services and taking advantage of the opportunities that the high-speed, high-priced mobile networks offer is crucial for achieving attractive returns and defending against OTT players. Although value-added services such as m-health, m-education, and m-banking have been available for some years, GCC operators have yet to actively make them available. Offering high-quality voice solutions as part of a data package will limit the impact of eroding revenues and profitability from voice over Internet protocol (VoIP) players such as Skype. Improving features in the instant messaging (IM) domain such as providing multiuser conversations, picture-sharing, and status updates through partnerships, alliances with other players, or proprietary platforms will help operators withstand the decrease in short message service usage.

Third-party application stores such as Apple’s and Google’s have completely taken over operators’ portals and revenues from mobile application downloads are set to surge from $8.4 billion in 2009 to 23.6 billion in 2014, with operators capturing only a fragment of that value. Application stores offer tremendous potential for revenue-sharing relationships between operators and third parties.

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6 Nomura
7 Pyramid Research
Operators’ capabilities in billing, marketing, and distribution make them potentially good retailers and attractive partners.

Investing more in machine-to-machine communication—which is expected to be a major growth market—is another step in the right direction, as is securing the right partnerships to bundle connectivity with high-value products (e-readers, cameras, laptops, cars).

The relatively recent arrival of the fast-growing cloud services market makes this the ideal time for telecom operators to capitalize on the opportunities the cloud has opened up in consumer and enterprise businesses with the right value propositions, technology, and go-to-market partnerships. A good example is Orange’s partnership with the Virtual Computing Environment coalition, formed by Cisco, VMware, and EMC. Orange delivers a broad range of cloud-based services while managing and owning customers as the single point of contact. We expect GCC operators to play a more prominent role in this space.

GCC operators have started to realize the digital opportunities. Etisalat, for example, recently established a new unit specifically focusing on developing the group’s digital strategy.

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**Reassess and actively manage operator portfolio.** This trend started in 2010 when Zain sold its African operations to Bharti Airtel, and was followed by the failed attempts of Batelco and Kingdom Holding to buy Zain KSA and of Etisalat to take over Zain’s other Middle East operations in 2011. More recently, Etisalat divested its Indonesian operator, PT XL Axiata. Given the performance of certain operators in GCC groups’ portfolios, selective divestments are expected, especially in countries with relatively lower average revenues per user and high competition. However, some GCC players will continue pursuing larger scale via acquisitions and in-country operator consolidation in an effort to become global players. For example, earlier this year both Ooredoo (formerly Qtel) and Etisalat indicated an interest in buying Vivendi’s 53 percent stake in Maroc Telecom, Morocco’s biggest telecom operator. Ooredoo has also indicated its interest in starting operations in Myanmar, one of the last real underserved and high-growth markets in the world.

Overall, Africa remains the region with the most positive telecom growth outlook, although several markets are both relatively small and fiercely competitive due to a large number of operators (in some cases four or more). Some of these operators are owned by smaller regional telecom groups or investors that often have Middle Eastern roots, such as Bintel (Bahrain),

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* Id.
Comium Telecom (Lebanon), Expresso Telecom (Sudan), LAP Green (Libya), VTEL (Jordan and Dubai), and Warid Telecom (Abu Dhabi). It is not unlikely that in the near future these groups will want to divest some of their African operations. But when they do, unlike the wave of acquisitions around six years ago, GCC groups will not buy at all costs.

**Transform the operating model to align with today’s industry dynamics.** To cope with increasing network complexity, investment requirements, and the financial expectations of shareholders, GCC operators will continue to improve their balance sheets by off-loading assets and to adopt a more asset-light model in line with developments in Asia, Europe, and North America. As a consequence, more managed-services outsourcing deals of core activities such as network operations and maintenance are expected, as is the selling of assets such as towers to specialized tower companies. Smaller GCC operators have already started to do this, such as du in the UAE which announced in 2012 it had entered a major five-year network managed-services agreement with Chinese equipment vendor Huawei. Operators will benefit from the scale and expertise of these third parties and be able to move from the traditional network and infrastructure focus to critical topics such as pricing, retention, customer experience, and digital diversification.

**Smart Planning**

The GCC telecom industry continues to be a highly dynamic sector and GCC operators are faced with considerable challenges. But operators have reason to be optimistic. With their consumer insights and proven ability to deliver breakthrough customer experiences, they are uniquely positioned to defend themselves and tap into the current trends. Those that act now and choose the right mix of defensive and offensive moves to limit revenue losses will have a good chance of remaining relevant and maintaining healthy growth and margins.

**Authors**

Marc Biosca, partner, Middle East
marc.biosca@atkearney.com

Rob van Dale, principal, Middle East
rob.vandale@atkearney.com
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