Telecom Retail Stores: Solving the Ownership Puzzle

As the role of telecom stores changes, prudent operators will review the split between owned and franchised stores.
The global telecom industry looks very different today than it did just a few years ago, thanks to two trends. On one hand, markets are maturing, with the developed ones experiencing high penetration of telecom services and the emerging ones seeing a flattening of the growth peak. On the other hand, digital is changing the way companies interact with their customers. Online platforms are fast becoming central elements of sales and service strategies in all industries as shopping shifts to the Internet, especially if the deals are better and the choice is greater.

Although the brick-and-mortar store is far from disappearing, its role is evolving. Stores can reinforce a brand and convey elements in ways that online channels cannot—customers can pick up the newest phone and test it in the store, assessing how it feels, how it sounds, and how fast it browses the Internet and downloads apps. These and other aspects of the in-store experience have a major influence on purchasing decisions.

Branded stores are a key spending item for telecom operators, typically contributing 5 to 6 percent of total operating costs. But are they worth the expense? Have stores adapted to the new mobile shopper? Can operators get more out of their branded stores?

Although the brick-and-mortar store is far from disappearing, its role is evolving. In today’s environment, one of the best ways to improve store operations is to look more closely at the ownership mix—the split between owned and franchised stores. In fact, companies that revamp that mix can improve earnings by up to 2 percentage points per store.

Despite maturing markets and the digital shift, most operators continue to work with an outdated ownership mix that was designed in a one-channel environment when growth was the primary focus. Stores were designed to sell devices, which made sense during the massive shift from feature phones to smartphones. Today, however, that wave has leveled out. And with pricing structures moving to shared plans for multiple devices, many of which are not sold or subsidized by telecoms, it is time for a fresh look.

Rebuilding the Ownership Mix

The proportion of owned to franchised stores can affect conversion rates, store productivity, fixed costs, commissions, and, perhaps most importantly, customer satisfaction. Most operators agree the right mix is important, yet many focus instead on network size, footprint, the channel-value proposition, and store layout. Current trends indicate the focus should also be on ownership mix.

There is significant value to be gained from a branded network—more sales, improved service, better profitability—by restructuring the ownership mix, and we helped one Asia Pacific operator do just this. Saddled with a large number of owned stores in various regions, the company had made significant investments in time and talent to build regional support for the stores. After it franchised most of these stores and created a lean organization to support them, sales became more productive, customer satisfaction improved, and the total cost of sales was reduced.

For another Asian operator, the solution was different. The company had franchised many of its stores in key urban locations, with an eye toward sharing capital and risk with franchisees. However, most of the franchisees struggled to make a profit. Rentals were excessive, and the
customer experience was suffering from a lack of motivation in the franchisees. After terminating some franchises and bringing the shops back in-house, the customer experience returned to competitive levels.

Today's branded-retail challenges provide an opportunity to reassess the ownership mix and capture untapped value.

Putting the Puzzle Together

Defining the right ownership model is not a straightforward exercise. The following five principles come into play:

1. **Don’t have a fully franchised network**

Owned stores are indispensable for directly interacting with customers and better understanding both their needs and the current trends. We recommend designating at least a minimum number of owned stores that can serve as proof-of-concept innovation laboratories for existing and prospective franchisees. Four factors can help pinpoint the ideal number:

- **Importance of brand promotion and the customer experience.** When brand promotion and the customer experience are vital to success, ownership is the best way to drive innovation and provide a consistent customer experience throughout the store network. For example, one U.S. operator owns a large part of its branded network to ensure a consistent customer experience. The result: Churn rates are significantly lower than the market average.

- **Product complexity and new product launches.** Store ownership is the better option when the product portfolio is complex and new product launches are frequent because it simplifies the required staff training and provides more control over the network. Franchises prefer to focus more on sales and less on creating a new product category or retail concept. For example, where prepaid services are widespread, such as in India, Brazil, and Thailand, the number of owned shops tends to be lower because there are fewer products and less complexity.

- **Availability of capable franchisees.** The quality of franchisees can be an important factor in determining the optimal number of owned stores. Australia, for example, has a well-developed corps of capable franchisees, but linking up with them can be challenging because there are so many attractive franchise opportunities.

- **Need for test beds.** Owned stores can act as test beds for new products, retail formats, and channels before they are rolled out across the network, while well-run franchised stores can provide support and stability. The best franchises have state-of-the-art IT systems, well-defined processes that facilitate transparency, and a consistent customer experience.

In some industries, the answer to the own-or-franchise question seems clear. In the fast-food business, with its widespread geographic coverage, low financial risk, and easy-to-sell products, franchising is the preferred model. But even when the answer appears straightforward, underlying realities cloud the picture. For example, McDonald’s—a franchising icon if ever there was one—owns 20 percent of its global fast-food chain. Even though its franchises register superior performance (their EBITDA percent is four times that of the company-owned stores), McDonald’s owns more than 6,000 stores out of more than 30,000 around the world.1 This builds credibility among franchisees, helps the company set operating standards, and provides effective test-marketed

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1 EBITDA is earnings before interest, tax, depreciation, and amortization.
concepts, products, and pricing strategies. Interestingly, only a small fraction of the 1,500 McDonald’s in China are franchised, while most of the 300-plus stores in India are franchised.

In some cases, ownership is the best option because products and services are too difficult to standardize or must be closely controlled. For example, the luxury industry requires substantial control of both the brand and customer experience, which makes franchising undesirable. Consequently, LVMH’s Louis Vuitton products are distributed only through company stores while most of its other brands are sold in a network that includes franchised and distributors’ stores.

However, this scenario is changing. Even luxury firms have entered the franchise game, seeing results that contradict long-held suppositions. In fact, many luxury brands now rely on franchises to expand their businesses, especially in emerging markets. For example, Danish jewelry company Pandora owns less than 5 percent of its branded retail stores.

There is significant value to be gained from a branded network. Today’s branded-retail challenges provide an opportunity to adjust the ownership mix and capture value.

2. Franchises are a must for large store networks

Franchising is the preferred model for large store networks. Operators in India, Spain, and Malaysia have huge branded networks and have franchised large portions of them. Following are some of the advantages:

- **Capital sharing and faster rollout.** Because large branded networks require a significant amount of capital, franchises provide a means to share the capital and risk of network expansion while making the cost structure more variable. Also, a store mix with a larger number of franchises expedites network rollouts because local know-how can speed up recruiting, reduce training needs, and accelerate the choice of location. (Some franchisees already have retail space which makes network expansion even faster.)

- **Regional expertise.** Large networks invariably extend into regional and semi-urban locations. Franchises have a better understanding of local culture, can help form stronger customer relationships, and can be invaluable when identifying the best store locations. The model in these scenarios is to maximize franchising in regional areas. One operator in Thailand, for example, owns all of its Bangkok stores but franchises stores in the rest of the country.

- **Lean organization structure and less complexity.** Owning many branded stores requires a complex organization, which can create inefficiencies. Franchising minimizes the complexity of managing shops.

- **Market penetration.** Where there is a strong focus on improving market share in a target market, operators often take the franchise route. This is faster and more flexible if the network size needs to be reduced.
A look at the ownership models of various telecom operators shows that there is no single ownership mix solution, but there is almost always a large proportion of franchises for larger networks. Three ownership mix categories dominate the market: **owned reliant**, where operators own more than 30 percent of the branded network; **mixed**, where operators own 20 to 30 percent; and **largely franchised**, where operators own less than 20 percent (see figure 1). There are a few exceptions, such as when an operator faces performance issues with franchises and owning the stores will better ensure sales and customer-service performance.

### Figure 1
**Ownership mix across select telecom operators by region**

<table>
<thead>
<tr>
<th>% owned</th>
<th>Number of branded stores</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 30% (Owned reliant)</td>
<td></td>
</tr>
<tr>
<td>20 to 30% (Mixed)</td>
<td></td>
</tr>
<tr>
<td>Less than 20% (Largely franchised)</td>
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Source: A.T. Kearney analysis

### 3. Own the blockbuster stores

Maintain ownership of the largest stores doing the most transactions. Medium-sized and smaller stores are better candidates for franchising. For example, flagship stores are almost always company-owned because their size and typically high-rent locations are usually too costly for a franchise. These stores focus on brand promotion and a superior customer experience and allow access to resources for designing and running the store. The flagship stores of Verizon, Vodafone, Telstra, Telefonica, and T-Mobile, to name a few, are all company owned.

Most operators have a variable payout: The greater the number of transactions, the greater the payout. When transaction levels are very high, the commission payout is more than the store’s operating cost. The transaction cutoff point varies by operator. Owned stores are preferable at both ends of the spectrum: those with extremely high transaction levels because of cost considerations and those with extremely low transaction levels because they are unprofitable and franchisees are not interested (see figure 2 on page 6). These latter stores may become candidates for closure unless they are essential for specific reasons, such as coverage. There is a middle range of transactions at which point commission payout is less than the cost of owned stores. This range is best for franchising. The commission structure and the stores’ cost structures determine the applicability of this metric.
4. Focus on the right partner selection

In the United States, owned stores perform better than franchises in terms of sales effectiveness and customer satisfaction, while for some operators in Asia Pacific and Europe franchises outperform owned stores in these same areas. In all markets, three lessons should be taken to heart:

It’s essential to understand the importance of the ownership mix and to capture its value.

- **Develop the expertise to identify and select the right franchisee.** There can be major differences in performance among the franchisees working for the same operator with a similar store profile. An operator’s ability to support and nurture the franchise is a key factor for success. Choosing small entrepreneurs allows an opportunity to leverage their motivation and focus, while large, organized franchises usually bring expertise, experience, and other resources to the table but might run on slightly higher cost.

- **Target entrepreneurs.** Entrepreneurs risk their own resources and thus are more motivated to perform well. However, the entrepreneurial attitude among franchisees differs from region to region, so performance may also differ.
Strengthen operations. Among other factors, organizational issues, unmotivated franchisees, and weak regional leadership will always work against successful outcomes. Controlling franchised stores is crucial to optimizing performance, especially concerning the ability to train, monitor, and structure store operations to deliver a consistent customer experience.

5. Manage the mix with non-branded retail

In times of reduced sales per store, the fight over footfall becomes more imminent. Operators need to carefully manage the mix of branded versus non-branded retail while ensuring enough customer traffic and sales volume for everybody. The role of non-branded retail will increasingly reduce over time as markets mature and the focus shifts to better customer experience. However, a clear strategy on the channel mix and defined roles for branded versus non-branded and owned versus franchised shops, together with their consistent translation into the footprint, are prerequisites for winning the battle for customers.

It’s All About Prioritizing

There is no one-size-fits-all solution to the ownership puzzle. An effective model in one market could be less effective in another. The question is not so much whether to franchise, but how much and with what type of stores.

It is essential to understand the importance of the ownership mix and commit to capturing its value for an immediate impact on the bottom line. There are no tidy benchmarks or simple answers, but there is a broad body of experience from which to learn (see case study: New Ownership Mix Helps Mobile Operator Tap into Profits on page 8). In the end, it is all about prioritizing four criteria (performance, strategy, market, and financial), aligning them with the strategic intent, market situation, and competitive position, and then rigorously applying them (see figure 3).

Figure 3

Four criteria can help gauge whether to own or franchise a telecom store

Performance
- Determine level of ownership that optimizes sales, profitability, and customer experience for each segment and type of store.

Strategy
- Commit to retail innovation
- Ensure a consistent brand experience
- Use franchises as test beds

Market
- Identify the targeted geographic coverage
- Establish the market share goal in each area
- Ascertain the maturity of the market

Financial
- Calculate the acceptable level of investments
- Choose between a fixed or variable cost structure

Source: A.T. Kearney analysis
There has never been a better time for telecom operators to revisit their ownership mix. Today’s business challenges provide an opportunity to focus on the mix while planning strategies to mitigate the challenges. Long-term rewards will follow in the form of improved sales, service, and profitability.

Case Study: New Ownership Mix Helps Mobile Operator Tap into Profits

A Western European mobile incumbent was facing increasing price pressure as a result of regulatory initiatives and fierce competition. The operator also realized that its sales setup was far from ideal, as the presence of branded retail was low because of the dominance of smaller cities in the country average. The operator was hampered by the dominance of the indirect retail arguing for even higher commission levels and the fact that the owned shops in smaller cities were not profitable (a third were not profitable or barely profitable).

By introducing a franchise concept, the operator not only converted the non-profitable owned stores to profitable franchisees but also significantly increased the coverage of smaller cities by extending the branded retail network by 70 percent. The key to success was selecting the entrepreneurial franchise model, where one franchisee essentially runs only one shop and franchise chains are not allowed. When integrating with its fixed-line sister company the operator also extended the franchise concept to an integrated telecom.

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