Winning the OTT War: Strategies for Sustainable Growth

The invasion of over-the-top (OTT) services has begun. It is time for telecommunication operators to prepare their positions and choose their weapons to win the battles for mobile voice, messaging, media, and cloud services.
YouTube, Skype, Facebook, WhatsApp Messenger, Viber, and Netflix are well-known examples of over-the-top (OTT) services that have many believing the demise of mobile operators is inevitable—and not without reason. YouTube now accounts for 24 percent of global mobile traffic, Facebook Chat consumes 22 percent of all instant message-related mobile bandwidth, WhatsApp carries 5 percent of global messaging traffic, and Netflix boasts nearly 30 million streaming subscribers.

Exciting developments are taking place in the United States, Korea, and Japan as telecom operators push new service concepts into the market.

The OTT invasion is occurring on four distinct battlegrounds, and telecommunication operators that have a variety of strategic weapons in their arsenal stand the best chance of gaining a foothold:

**Mobile voice.** Operators face a significant risk of eroding revenues and profitability but still have the opportunity to influence consumer behaviors. **Strategy: Hold ground, and manage the impact.**

**Messaging.** The challenge here is to reverse the shift in consumer behaviors from traditional short message services (SMS) to social networking and instant messaging, although SMS is not going away any time soon. **Strategy: Manage retreat, and shift focus.**

**Media.** This is the battle for consumer mindshare and future relevance. As winning strategies and business models are still unclear, telecom operators prepare and experiment. **Strategy: Embrace the concept, and act to win the battle for mindshare.**

**Cloud services.** This nascent, fast-growing market is opening up opportunities in consumer and enterprise businesses. **Strategy: Prepare to seize the opportunity.**

Following are in-depth looks at the four OTT battlegrounds (see figure on page 3).

### Battleground 1: Mobile Voice

Interest is increasing in mobile voice over Internet protocol (VoIP) apps such as Skype, Viber, mig33, and Google Talk. Operators in most markets still have an opportunity to influence consumer behavior, defend the perception that circuit-switched voice is superior in quality, and slow the global impact of VoIP.

Three elements need to be in place before mobile VoIP can become a compelling consumer proposition:
- Strong, widespread indoor mobile broadband coverage
- Ubiquitous and interoperable apps in a large share of smartphones
- Longer-lasting batteries that can handle the power drain caused by active apps
Proof of this can be seen in Australia, Germany, Japan, South Korea, Sweden, and other countries that have pervasive third-generation (3G) coverage, deep smartphone penetration, and a remarkable affinity for mobile apps. But even in these markets, we have yet to see much impact on mobile minutes of use (MOUs), despite VoIP accounting for more than 40 percent of fixed calls.

So even on VoIP-friendly battlefields, operators should be able to hold their own if armed with the appropriate strategic weapons:

**Introduce “smart” plans.** The most obvious, and currently most used, strategy in mature markets is to create integrated voice and data bundles and link them to devices. For example, nearly 70 percent of Vodafone UK’s customers are already on integrated bundles.

Of course, knowing when to introduce data-only plans for handsets is where art meets science. Moving or reacting too early to challengers can significantly erode average revenue per user (ARPU). For example, when Japan’s KDDI launched data-only plans in 2010, Docomo refused to follow suit, a stance that had no negative impact on its market or its revenue share.

**Create differentiated quality positioning.** Given the challenges in delivering quality VoIP and high-definition voice, operators should not underestimate their ability to shape the quality perception of traditional voice networks. This is a significant opportunity to differentiate voice quality for higher-value customers.

Figure

**The four emerging OTT battlegrounds**

- **Voice**
  - Hold ground

- **Messaging**
  - Manage retreat

- **Cloud**
  - Get ready

- **Media (LT)**
  - Embrace the concept

- **Media (NT)**
  - Embrace the concept

Note: LT is long term; NT is near term.
Source: A.T. Kearney analysis
Launch an OTT solution. Some operators are experimenting with so-called “mashed up” OTT services and solutions, either by collaborating, as Sprint is doing with Google Voice, or through acquisition, as Telefonica did by purchasing OTT player Jajah and launching its own mobile VoIP app. Because launching in-house OTT services or partnering with OTT players can be a double-edged sword, taking the precautionary step of adapting the services to the operator within the competitive context is advisable.

Wholesale to mobile VoIP providers. This can be an especially effective strategy if there is potential to charge mobile VoIP providers for both traffic and differentiated quality-of-service standards.

Not all the currently pursued strategies will work, of course. For example, operators in some markets, including the United Kingdom, Japan, and South Korea, that tried to block the use of VoIP or to charge a VoIP premium did not succeed. This strategy was never going to be sustainable from a consumer, competitive, or regulatory perspective.

In addition, it is not yet clear whether the introduction of the operator-led Rich Communication Suite (RCS, also called Joyn) will be a success. The previous attempt in 2006 and 2007 to establish a similar global operator solution for instant messaging failed because consumers, not operators, decided which OTT applications they wanted to use.

Overall, however, mobile operators are still in good shape to hold their ground against the mobile VoIP invasion.

The outlook for the messaging battle, unfortunately, is less encouraging.

Battleground 2: Messaging

The impact of messaging has drawn a lot of attention, especially after Dutch telecom KPN announced in 2011 the extent to which WhatsApp has eroded its SMS traffic. A similar effect is now evident in rapidly declining SMS usage on iPhones and Android phones, a reduction that may well hit 20 percent by the end of 2012. In South Korea, for example, KakaoTalk has become the prevailing messaging provider, with more than 40 million users and a 100 percent presence in the country’s smartphones.

It will be impossible for operators to reverse the shift in consumer behavior from peer-to-peer messaging to social networking, instant messaging, and peer-to-many communication. And while there is no reason to assume that SMS will disappear, it is likely that it will gradually become less important for many consumers.

The bottom line is that operators will have to manage their retreat from this battlefield and shift their focus to enterprise and machine-to-machine (M2M) messaging by employing a few strategies:

Leverage defensive SMS plans. Tiered SMS bundles can help slow down the impact by inducing a proactive but predictable cannibalization and by preventing churn. For example, one European operator created segment-specific plans that included zero, 100, or unlimited SMS messages. Although this triggered a move by value-conscious customers to zero SMS plans, it provided less incentive for customers to look for alternatives and stabilized the migration within six months. However, timing is crucial to preempt a premature cannibalization.

Emphasize enterprise messaging. We see a significant opportunity for SMS as a below-the-line mobile marketing and advertising tool. Operators have underestimated the potential of mobile marketing for third parties or shied away because of a reluctance to be perceived as spammers.
Smaller businesses especially will benefit from an operator-provided marketing engine that helps them target customers and manage spam perceptions.

**Change the paradigm in subscriber identity module (SIM) connectivity, and move to M2M.** M2M is far more than just machine-to-machine SMS, although we see a huge potential in vertical applications for finance, transportation, and health. Operators can leverage third parties by opening up network application programming interfaces (APIs), both in messaging and other applications, and partnering in go-to-market programs.

In summary, mobile operators will do best by getting comfortable with the fact that SMS will decline and start focusing on mobile marketing and M2M connectivity.

**Battleground 3: Media**

This will be the most exciting battleground, and the most hard fought. The emergence of OTT video and media services has changed the telecom game. Not only does OTT fuel the data traffic explosion, but consumer mindshare and future telecom relevance are at stake. This battle will be fought on many fronts—television, video, gaming, music, advertising, and other digital services—and among adversaries that include telecom, media companies, OTT players, device and equipment manufacturers, and even artists.

The success formula here is to provide superior service. Content might still be king, but customer experience rules in the digital era. For telecom operators, this means an all-inclusive approach must be at the core of a winning value proposition. Integrated telecom operators might have an initial structural advantage, although we expect mobile operators to form partnerships across mobile, fixed, and media.

**While OTT services are evolving fast, consumer behaviors are shifting faster, so operators will have to create business models that are both agile and adaptable, and partnering will be the best way to do it.**

The economic value that can be won in this battle might be small in the near term, but it has long-term significance. It will distinguish winners from losers, and as such, the conventional strategic wisdom is to establish a strong bridgehead with the following tactics:

**Clarify the strategy.** Which battlegrounds, what business models, which technology platforms, what organizational approaches? As dodging the fight is not an option, this is a time for operators to pick their battles and fortify their positions.

**Innovate and experiment with new business models and approaches.** While the general direction seems clear, no proven business models and approaches exist yet for telecom operators. Thus, operators will have to experiment with new forms of content and services, multiscreen integration, enabling technology platforms and business ecosystems, and extensive partnerships.
Moving from subscription to ad-funded models will be difficult for most established mobile operators to accept, but that is the new reality of competing successfully in digital services.

Leverage telecom advantages to provide superior customer experience. Three core actions will be essential for telecom operators:

- Deliver a distinct, end-to-end experience, particularly in seamless multiscreen and service offerings.
- Integrate new digital ecosystems and manage multiple partnerships.
- Analyze and continuously spot consumer behaviors in real time.

We are already seeing some exciting developments in the United States, Korea, and Japan as telecom operators push new service concepts into the market. For example, South Korean firm CJ HelloVision’s TVing app, which allows users to view programs on computers, tablets, smartphones, and smart TVs, has impressive content, open customer reach, and wide device compatibility. In Singapore, SingTel is repositioning itself as a digital services provider by expanding into media content and its digital business. In Spain, Telefonica Digital has unveiled plans that target more than $6 billion in revenues by 2015 by entering new areas ranging from mobile commerce and advertising to M2M, e-health, video and content, digital security, and cloud computing.

This battle is just beginning, which makes it even more imperative for telecom operators to seize the opportunity and establish the kind of presence in the media-services market that will keep them relevant with consumers.

Battleground 4: Cloud Services

This is the newest OTT battleground, and Apple has fired the loudest shot across the bow with last year’s launch of iCloud. The result is that every telecom is contemplating its response to Apple’s move in the cloud market, a market that is evolving quickly in some countries. In Australia, for example, cloud services generated about $500 million last year and will likely reach $1 billion by 2015.

At this stage, there are only a few cloud players beyond Apple with compelling value propositions—Google, Microsoft, and Amazon, to name the most obvious—but we expect many more to join the fray. Telecom operators are especially well positioned to leverage their customer relationships and network assets and carve out a distinct position.

It will be interesting to observe the telecom battles for the enterprise and consumer clouds. For the former, telecom operators will have to develop vertically focused, targeted solutions, primarily by partnering. Orange, for example, is partnering with the Virtual Computing Environment Co. (VCE), formed by Cisco, VMware, and EMC2, to deliver a complete IT infrastructure that integrates best-of-breed virtualization, networking, computing, storage, security, and management technologies.

On the consumer side, operators already benefit just by enabling cloud services and getting customers to sign up for higher-level data plans. Other opportunities exist in the creation of open platforms to aggregate cloud services and applications and broker cloud services between operators, system integrators, and developers. Most importantly, consumer cloud services increase stickiness, as consumers deposit many of their digital valuables such as photos, music, and videos with the operator.
Because the cloud market is so new, this is the optimum time for telecom operators to begin to capitalize on the opportunity. Defining the right value propositions and structuring the right technology and go-to-market partnerships will be key to winning on this front.

Preparing for Victory

The OTT invasion has begun on four challenging battlegrounds. We believe telecom operators will be best prepared to meet those challenges if they take the following steps:

**Choose your battlefields.** An understanding of the factors driving OTT voice, messaging, media, and cloud is key to choosing the appropriate business weapons, positioning your troops, and determining whether your competitive posture is offensive or defensive. Above all, be clear about where, when, how, and with whom you are going to compete.

**Redefine value propositions and business models.** The OTT influx will force operators to rethink their value propositions. While OTT services are evolving fast, consumer behaviors are shifting faster, so operators will have to create business models that are both agile and adaptable, and partnering will be the best way to do it.

**Create new platforms and approaches.** The mantra of the new digital era is customer experience. Delivering a memorable one will require new technology solutions, of course, but more important will be a deeper integration of network, IT, product and service development, and mobile, fixed, and media assets.

**Rethink organizational approaches.** OTT media and video services will compel operators to be more creative and flexible. This will demand a set of organizational changes in structures, skills, systems, and mindsets.

**Remain flexible and ready to adjust.** As on real battlefields, your opponent’s moves will be unpredictable. While setting a broad strategic direction is a priority for telecom operators, the winners will be those able to understand changes in consumer behavior and creatively adjust their strategies accordingly.

**There cannot be one OTT strategy.** Indeed, each battleground—voice, messaging, media, and cloud—will demand a different strategy and a different combination of offensive and defensive tactics. Some battles will be won, some lost. But overall, we believe that telecom operators, with their consumer insights and inherent ability to deliver breakthrough customer experiences, are uniquely positioned to win this war.

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