

Opportunities for Action in Technology and Communications

The SME Market for Telecom Providers: Sailing into the Winds of Change

THE BOSTON CONSULTING GROUP



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For most telecom companies, the outlook is unsettled and unsettling. They can sense the winds of change, and they know that the once-familiar telecom market is in flux—especially the sector consisting of small- and medium-sized enterprises (SMEs). In the typical advanced economy, this sector currently provides about 45 percent of telcos' business-client revenues. In the next five years, however, that figure will probably surge to about 70 percent as clients in the large-corporate sector cut back on their telecom spending by flexing their purchasing power and replacing traditional telecom services with newer products, such as calling plans that use the Voice over Internet Protocol (VoIP). All of a sudden, it seems, SMEs are set to dominate the telecom market. Telcos had better start showing them some serious respect.

In the past, SMEs tended to follow a standard purchasing pattern: they turned to the incumbent telco, with its broad product offerings, to fulfill all their telecom needs. No longer. An SME today—when upgrading its data network, say—may opt to migrate to a new-entrant telco not only for its data network but also for voice service. And once that happens, the SME will likely remain loyal to its new provider—and be very difficult to lure back. The winners and losers will be decided over the next few years as the brisk breeze of technology upgrades sweeps through the industry.

From our work with telcos around the world—both incumbents and new entrants—and from conversations with senior industry executives, we have identified four key strategies that any telco must implement

if it hopes to enjoy smooth sailing in the windy weather ahead. These strategies relate to

- *selectivity*: segmenting the SME market and choosing the right sales channels
- *precision*: offering the right products
- *concentration*: establishing a dedicated unit to serve SMEs
- *adaptability*: ensuring effective delivery of services

Selectivity: Segmenting the SME Market and Choosing the Right Sales Channels

There is no such thing as a typical SME. A 400-strong firm of financial consultants spending \$500,000 a year on high-tech telecommunications or a one-person bakery with an annual phone bill of \$300—together they exemplify the broad range of the SME market. Two SMEs of the same size may differ greatly in *ticket size* (the total payments made to a telco) since telecom usage can vary one hundredfold depending on type of business, corporate structure, and other factors. And two SMEs of the same ticket size may differ greatly in cost to serve depending on such variables as location, number of sites, and product complexity. Above all, two SMEs of the same ticket size may differ greatly in *potential* ticket size depending on their growth prospects or development plans.

When attempting to segment, pursue, and serve the SME market, telcos have some tricky calculations to make. Take one example: the choice of sales channel to serve a particular type of SME. There are two initial options, and telcos need to negotiate the associated conflicts very carefully.

A large telco can pursue SME opportunities through independent partner companies (indirect channels) or through its own sales force (direct channels). France Telecom, for example, makes this decision on a case-by-case basis. If a telco outsources most of its marketing to indirect channels, then it forfeits control over sales (unless it has an exclusive arrangement with its partner companies). If it relies primarily on direct channels, then it risks alienating its partner companies—and perhaps driving them to favor a rival telco or to set up as competitors themselves.

A telco that opts to serve an SME through the indirect channel must choose between two ways of dealing with the partner company. A telco that opts for direct sales must orchestrate two ways of dealing with its customers.

- *Indirect Channels: Equal Versus Preferential Treatment of Partner Companies.* A large telco may treat its partners equally—giving all of them the same incentive to sell as much as possible—or it may enter into an exclusive arrangement with selected preferred partners (based on geographic region, say, or type of client). For instance, British Telecom runs a two-tier system of partners: a standard indirect-channel operation, which deals with nonexclusive partners, and a parallel network of small, privately owned companies that operate under a separate brand (BT Local Business) and that sell the telecom services of BT exclusively.
- *Direct Channels: Limited Versus High Interaction with Customers.* There are two broad types of direct channel: limited interaction (a call center or Web site) and high interaction (a full-scale sales team and service staff). The limited-interaction channel is less expensive but also less attentive and less flexible. When it is used inappropriately—for very

demanding transactions, say—the result is lower rates of customer acquisition and retention. When a high-interaction channel is used inappropriately—such as for routine sales or simple upgrades—the result is needlessly higher costs.

By making the right channel choices when pursuing business with SMEs, telcos stand their best chance of minimizing cost to serve and maximizing reach and sales. Of course, the optimal balance will vary according to local economic factors, telecom needs in different countries, and the individual telco's asset and customer base.

Precision: Offering the Right Products

One common pitch that telcos make to SMEs is a bundling of services. This suits the SME, for which a one-stop solution is much simpler than using multiple vendors, both for initiating services and for sorting out any problems that may arise. And it suits the telco by increasing the SME's ticket size, thereby justifying the costs of acquiring and retaining the SME as a customer.

But choosing which bundles, or even which individual services, to offer is far from straightforward. A telco must consider how its product offerings could affect its indirect channels, which often offer more extensive kinds of bundles—for example, an Internet protocol (IP) network supplemented with computers, cabling, and applications. When a potential conflict looms, the telco may have to make a tradeoff, holding back a lucrative product in order not to lose a partner's goodwill. Consider a fully managed IP virtual private network (IP VPN) service, for instance. The telco that provides such a service benefits from additional recurring revenues and better insight into data

communication usage. However, the partner company that mediates the sale could suffer a proportional decline in revenue since it will lose the opportunity, for example, of selling routers to the customer.

In our view, the best way to proceed is generally by a smart compromise: the telco should go ahead and boldly offer all centrally managed services in its product portfolio, but it should also reassure its partners by offering them a strong incentive to sell those services themselves. This incentive structure works most effectively when the telco rewards its partners by referring customers to them instead of by giving them just the customary percentage of the service fee.

Concentration: Establishing a Dedicated Unit to Serve SMEs

Serving SMEs presents an organizational puzzle. The capabilities and resources required in order to do it well are a complex mix of those needed to serve the corporate sector and those needed to serve the mass-retail sector. Those two sectors typically command dedicated organizational units of their own within any large telco. Where do SMEs fit in?

For a minority of telcos, the best procedure is still to simply subdivide their SME clients: the firm of financial consultants gets assigned to the corporate-sector unit and the one-person bakery gets assigned to the mass-retail unit. For these telcos, the cost of setting up a separate organizational unit for SMEs would be too high, and the addition of a further organizational boundary might prove too disruptive.

But our experience suggests that most large telcos should establish a separate organizational unit to serve SMEs. Only in that way can they give these

clients the dedicated service they merit and thereby reinforce their allegiance. The unit's specific character is likely to vary from one telco to another according to such factors as corporate structure and country-specific channel structure.

One of the primary tasks of a unit dedicated to serving SMEs is to act as a single point of contact for the indirect sales channels to ensure efficient sales and service of telecom products. Such a hassle-free arrangement can endear a telco to its partners and encourage them to recommend the telco to their SME customers. The unit should also be responsible for addressing any potential conflicts between the indirect and direct channels and for selecting and providing incentives to partner companies. The unit's other main task is to determine, or at least advise on, the service bundles to be offered to SMEs. When those bundles contain products provided by different departments within the telco—such as fixed-line and mobile services—the dedicated unit coordinates delivery to customers.

Adaptability: Ensuring Effective Delivery of Services

One sobering lesson of our work with telcos and SMEs is that SMEs favor effective telcos even more than they favor generous telcos. Good execution outweighs good deals. So any telco hoping to secure its SME client base should review its current customer-satisfaction level honestly and apply appropriate remedies where necessary. Here are some of the challenges a telco may encounter and the steps it should take to address them.

Failings of the Sales Force. Salespeople may repeatedly fail to realize their promise for various reasons.

- *Challenge:* The sales force is insufficiently performance-oriented and insufficiently focused on revenue-driving activities.

Response: Monitor each salesperson's performance and revise incentives to align them with strategic goals. Free up salespeople from back-office tasks.

- *Challenge:* The sales force waits for customers instead of taking the initiative and targeting them, and it spends too much time on customers with low revenue potential.

Response: Systematically analyze targets on the basis of their potential, rather than their current, telecom usage. Generate leads and triggers, and train the sales force to operate under such guidance.

- *Challenge:* The sales force sells incomplete solutions owing to unfamiliarity with the expanding product portfolio. Salespeople are constantly calling on more knowledgeable colleagues to help configure optimal solutions.

Response: Construct a set of likely *total solutions* and define specific product and service bundles for each of them. Intensify sales force training.

Shortcomings in the Indirect Channels. A telco's indirect sales channels often show symptoms of misplaced focus—and sometimes of disloyalty.

- *Challenge:* Partner companies focus on the same customers that the telco's own sales force focuses on.

Response: Revise the incentive structure and, if necessary, assign specific customers to the indirect sales channel.

- *Challenge:* Partner companies pursue one-off sales rather than generating recurring revenues.

Response: Adjust incentives to align with commercial goals, perhaps by offering partner companies a share of recurring revenues. Improve support processes for partners, perhaps by helping with customers' queries and complaints.

- *Challenge:* Partner companies recommend rival telcos when advising customers—whether because of channel conflict, product-portfolio conflict, or inadequate incentives.

Response: Restore partners' goodwill by devising an incremental rewards program (such as a gold, silver, and bronze scale) on the basis of level of sales or, better still, share of wallet. Refer clients to the partners in exchange for reciprocal treatment.

Inadequacies of the Product Portfolio. A telco sometimes fails to define, support, and price its service bundles in a way that captures and retains SME business.

- *Challenge:* The telco offers service bundles that are too narrowly defined—consisting of only stand-alone data products, for example, and excluding, say, mobile and fixed-voice services, computers, and security—thereby preventing a total solution.

Response: Tighten cooperation among the various divisions (and also involve the partner companies) in creating and supporting interdepartmental service bundles. In short, learn the logic of bundling and promote the redesigned bundles energetically.

- *Challenge:* The telco offers service bundles at prices that are discouragingly high for SMEs.

Response: Offer slimmed-down service bundles with an appealingly low overall cost. Empower the SME unit to offer simple bundles of this kind, with discounts on products from different departments within the telco.

Inefficiencies in Removing Operational Roadblocks.

Roadblocks to achieving customer satisfaction are perhaps inevitable, but often a telco will dawdle when it comes to removing them.

- *Challenge:* The telco obtains insufficient feedback from the market (for example, in analyzing lost sales and lost customers).

Response: Probe the views of SME customers more proactively. This can be done by using questionnaires and interviews rather than just by reviewing complaints.

- *Challenge:* The telco provides inadequate delivery of service bundles, perhaps because delivery is coordinated by the sales staff rather than by trained specialists.

Response: Set up a separate subunit for delivering service bundles.

- *Challenge:* The telco uses overly complex contracts or provisioning procedures that were inherited from the corporate-sector unit and are better suited to large corporate customers.

Response: Redesign operating processes to fit the SME approach to doing business.

- *Challenge:* The telco suffers from slow operational decision making owing to excessive decision-making layers within the organization.

Response: Undertake a serious review of corporate governance.

- *Challenge:* The telco provides poor *last-mile access*—that is, a lack of service capabilities for remote locations.

Response: Subsegment the market on the basis of geographical clusters and determine the more cost-effective way of providing smooth last-mile access to SME customers: either directly or through a third party.

Getting on Board

Ultimately, every telco needs to identify its own particular challenges and respond appropriately—whether with major structural changes or with a simple tweaking of existing procedures. Dramatic upgrades and extensive restructurings can be daunting and slow. Therefore, because timing is so important for capturing market opportunity, we tend to recommend a phased approach.

One important component of this phased approach is a real-time pilot. The pilot gives managers a chance to test a new *modus operandi*, enabling them to introduce and fine-tune needed improvements and—especially when positive results start flowing in—to secure crucial engagement and buy-in from stakeholders within the organization.

But a pilot presents challenges of its own. To minimize the risks and maximize the benefits to learning, telcos should conscientiously carry out the following four steps:

- Plan and script the pilot in detail, and carefully select the subsegments of the market that will be tested
- Create a mechanism for taking rapid corrective action—keeping in mind that the pilot is dealing with real-life clients
- Share best practices promptly—among managers, divisions, and partner companies
- Monitor the financial and organizational implications of each aspect of the pilot in order to establish a compelling case for action and convince the key decision makers to adopt the new procedures broadly throughout the company

Once the pilot proves successful, those running it should become enthusiastic champions of full-scale implementation. These champions will then become the trainers—drawing on their experience to coach their colleagues in the skills required by the new regime.

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The SME market offers such a large purse that telcos really have no choice but to compete for it. Prospering in this market will depend on several factors: an ability to move quickly to capture a large slice of the market during its rapid transition; finesse in choosing the right channels for approaching customers and the right service bundles to offer them; determination in initiating and strengthening a dedicated SME unit; and flexibility and self-scrutiny in dealing with partners, optimizing delivery, and pinpointing total telecom solutions.

Telcos that combine these attributes properly and use them wisely will navigate the expanding SME market with confidence and success—and take the wind out of their rivals' sails. Those that neglect to do so may lose their bearings and veer off course, or fail to set sail at all.

Stepan Breedveld
Marcos Aguiar
David Michael
Wendell Kuling

Stepan Breedveld is a vice president and director in the Amsterdam office of The Boston Consulting Group. Marcos Aguiar is a vice president and director in the firm's São Paulo office. David Michael is a vice president and director in BCG's Beijing office. Wendell Kuling is a project leader in the firm's Amsterdam office.

You may contact the authors by e-mail at:

breedveld.stepan@bcg.com

aguiar.marcos@bcg.com

michael.david@bcg.com

kuling.wendell@bcg.com

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