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Bundles and Range Strategies: The Case of Telecom Operators

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Abstract: Against a background of competition and the generalisation of IP that characterises the field of electronic communications, the concept of the "bundle" has resulted in the emergence of "triple play", and even "quadruple play." This paper offers an overview of the growth of this phenomenon by introducing a distinction between the basic components of multiplay strategies and the diverse range of functions that can be linked to these strategies.

Key words: Bundle, range strategy, triple play, quadruple play.

■ Bundle development in a context of fierce competition and "IP-isation"

Telecommunication operators are currently experiencing a dramatic change in their market, with competition growing increasingly fierce on the one hand and a technological shift marked by the generalisation of IP and the growth of very high speed networks on the other. The decline in the value of the traditional markets for fixed telephony is continuing as a result of tougher competition, but primarily due to substitution by voice over IP and mobile services. The broadband market, which has facilitated the emergence of new players (internet access providers) is booming, but is characterised by competition that can sometimes be very fierce, which has a negative influence on profit margins and has obliged players to increasingly invest in infrastructures. Lastly, the pay TV market is approaching saturation in some countries, audiences are increasingly fragmented and the launch of new forms of access such as ADSL and digital terrestrial television could weaken the position of the sector's traditional players. In this context, the objectives of bundle strategies in the electronic sector are classic, namely to increase ARPU, to ensure consumer loyalty and to expand subscriber bases by introducing a differentiating factor.

The influence of national contexts

The competitive context of each market is a key factor in the commercial strategy pursued by operators. Regulators are sensitive to the risks that can be linked to the launch of a bundle by a player that uses its dominant position in a service to finance its move into a new market. That has nevertheless not prevented the growth of bundles, a phenomenon that can even be seen in highly competitive markets where the largest number of bundles are to be found. In the USA, RBOCs rushed to offer consumers long distance-local flat rate bundles after the Telecom Act, and are now using bundles as a weapon against cable operators by marketing triple and quadruple play offerings.

In France and Japan, very fierce competition in the broadband market has turned these countries into highly advanced markets in the coupling of ADSL access services, IP telephony and television. On the other hand, in markets that are not very competitive but still enjoy a steady growth rate, incumbents are not showing the same eagerness to enhance their offering by launching voice over IP, for example. This is the case of Telefonica in Spain, for instance, which only offers Voice over IP in the corporate market.

However, given that competition in this sector is bound to become widespread, it is very likely that multiplay offerings will become more common.

Two bundle strategies

Bundles cover a range of relatively different realities, which we propose to distinguish between by identifying:

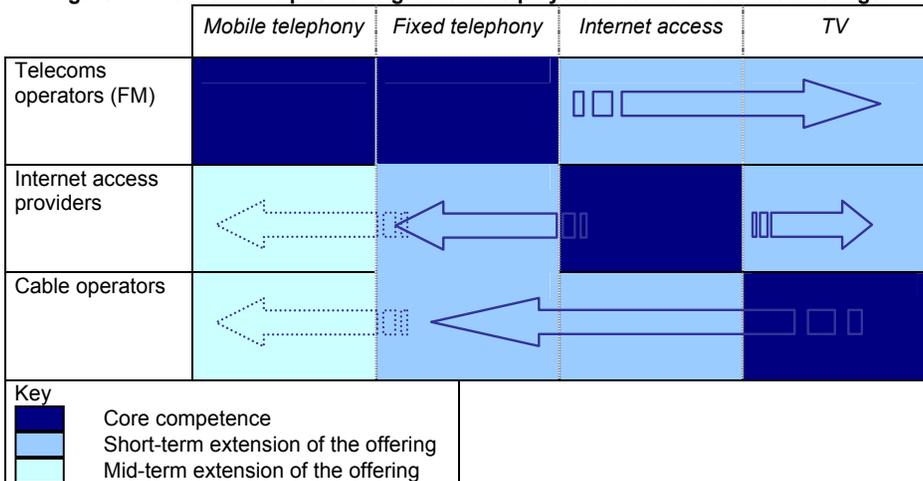
- The horizontal bundle, double, triple or quadruple play, aimed at linking relevant services from different markets such as internet access, TV and fixed telephony or mobile services. These bundles are part of a broad range strategy.
- The vertical bundle consists of linking additional functions to a reference service such as internet access, television or telephony. These bundles are part of a deep range strategy.

■ Broad range bundles

Triple-play heading towards generalisation, quadruple play in sight

Although this does not eliminate the risk of foreclosure, bundles in the communication sector are remarkable in that they force players in relevant markets, which are in principle different and separate, to compete against each other. As we have seen, on the side of traditional telephone operators are internet access providers, cable operators and now mobile operators. This group also includes virtual operators and distributors that initially specialised in one market and are now oriented towards bundle offerings, either to compensate for revenue losses in their initial core business (the resale of minutes of telephony), or in response to competitors offering multiplay.

Figure 1 - Trends in the positioning of various players in terms of service offerings



Source: IDATE

Each player has thus sought to position itself in new markets: internet access, voice over IP, then TV over IP for incumbent operators, voice and TV over IP for access providers, and voice and internet access for cable operators. As a result, fixed and mobile telecommunications, access providers and cable operators are likely to find themselves competing head-on in the three dimensions of quadruple play: fixed and mobile telephony, internet access and television in the consumer market.

An operator's strategy depends on several factors, but especially on its positioning in the market and its marketing objectives. Regardless of the type of player in question, however, the orientation towards triple play is a major market trend. Almost all players have already chosen, or plan to offer triple play, whether this be to attack the market with an innovative offering, or in response to commercial launches by their competitors.

VOD or television: different visions of video integration in bundles

The basic components of the triple play offerings of any group of operators are likely to be fairly different. This is true of the telephony service, which can be offered on an analogue or an IP basis, and at special prices for international calls, as well as those to mobiles. This is also the case for internet connections depending on connection speeds and prices. However, the options tend to vary the most for the video component. Depending on market conditions, triple play operators will either offer existing bouquets traditionally distributed by satellite, or make up their own bouquet by integrating "traditional" television channels from free digital terrestrial television or pay TV. In some cases, when access to television channels is difficult and controlled by a powerful player that possesses its own distribution system (UK), operators may focus on launching a video on demand service.

Are we heading towards quadruple play?

Always looking for marketing differentiation, operators are now adding mobile services to their triple play offerings. The USA is a pioneer in this respect, with incumbent operators like SBC, Verizon, BellSouth, Qwest and Sprint launching quadruple play offerings back in 2005. These offerings are marketed under the name of the operator or in partnership with mobile or satellite operators for television.

Incumbent operators are obviously in a better position to offer quadruple play since they usually have a mobile operator as a subsidiary. However, cable operators are also in the running and most U.S. cable operators have plans in this field, in partnership with mobile operators.

However, the quadruple play offering is still in its infancy. The first offerings are still often made under different brand names and offer a low

level of functional integration. As a result, operators rarely offer unified services related to quadruple play such as unified messaging. This depth of range should increase with the diffusion of offerings and greater market maturity.

Several technological orientations for quadruple play

Quadruple play, based on the addition of mobile services, can cover a large number of scenarios.

The most classic model is that of adding cellular services to the triple play offering; this is the most widespread form of quadruple play, which may or may not bear the brand name of the cellular operator. Operators can also sign MVNO agreements with the latter in order to distribute services under its own brand name (this is one possibility envisaged by Free in France).

However, mobile services can also be offered in the framework of FMC services (fixed-mobile convergence), integrating an element of interoperability between several basic multiplay components. BT was a pioneer in this field with its development of an offering called "BT Fusion." This offering is aimed at providing wireless telephone communications, which either use ADSL networks via a wireless connection or cellular networks if the user is not near a point of access.

The innovative nature of this offering lies in the fact that it relies on a single terminal for both mobile and fixed communications, which switches network automatically according to the geographical location of the subscriber. Access points for IP communications are either a base station in the subscriber's home, or public hotspots. The advantages of this service for users include a single terminal that reduces costs (notable of mobile calls) and a single bill for the two services.

In France, Neuf Telecom has also launched a consumer service with a hybrid GSM/WiFi terminal under the "TWIN" brand name. Orange and Free also have plans in this field for the third quarter of 2006. It is worth noting that the Free offering should not only use the subscriber's personal DSL connection, but will use the connections of all Free subscribers. The network is thus created by Free subscribers and could be extended to Wi-Max.

Positioning of operators in quadruple play

| Country | Operator | Voice | Internet access | Television | Mobile services |
|----------------|------------------------|-------|----------------------------|----------------------------------|-----------------------------------|
| France | France Telecom | ■ | ■ | ■ | ■ |
| | Alice (TI) | ■ | ■ | ■ | □ |
| | Free | ■ | ■ | ■ | ■ (wifi) |
| | Noos | ■ | ■ | ■ | |
| | Neuf Telecom | ■ | ■ | ■ | ■ (MVNO+wifi) |
| Germany | Deutsche Telekom | ■ | ■ | VOD | ■ |
| United Kingdom | BT | ■ | ■ | VOD | ■ FMC+MVNO |
| | Carphone Warehouse | ■ | ■ | | □ |
| | NTL UK | ■ | ■ | ■ | |
| Italy | Alice (TI) | ■ | ■ | ■ | ■ |
| | Tiscali | ■ | ■ | □ | |
| | Fastweb | ■ | ■ | ■ | |
| Spain | Telefonica | ■ | ■ | ■ + VOD | ■ |
| | Ono | ■ | ■ | ■ | |
| Japan | Yahoo! BB (FTTH) | ■ | ■ | ■ | ■ (Vodafone KK) |
| | NTT (FTTH) | ■ | ■ + third party ISPs | Not live | ■ |
| | KDDI | ■ | ■ | ■ | ■ |
| | Plala | ■ | ■ | ■ | |
| USA | ATT (SBC) | ■ | ■ | ■ + VOD (Dish Network) | ■ (Cingular ATT) |
| | Verizon | ■ | ■ | ■ + VOD (DirecTV or FIOS TV) | ■ (Verizon Wireless) |
| | BellSouth | ■ | ■ | ■ (DirecTV) | ■ (Cingular Wireless, subsidiary) |
| | Qwest | ■ | ■ | ■ (Partnership with DirecTV) | ■ |
| | Embarq (Sprint-Nextel) | ■ | ■ | ■ + VOD (Dish Network or Embarq) | ■ (Sprint PCS or Nextel) |
| | Comcast | ■ | ■ | ■ + VOD | □ |
| | Time Warner Cable | ■ | ■ | ■ + VOD | □ (Sprint) |
| | Cox Communication | ■ | ■ | ■ + VOD | □ (Sprint) |
| | Cable Vision | ■ | ■ | ■ + VOD | □ (Sprint) |

■ Proposed by the operator □ Planned

Mobile "pure players" seem to be threatened by multi-play developments. The latter could give rise to strategic alliances and a new cycle of mergers-acquisitions, even if other options are envisaged. As a result, some mobile operators are offering specific prices for mobile calls made from home ("homezoning"). This mainly pricing offering marketed by Vodafone in Germany, for example, is not a bundle as such, but it acts as a substitute, competing with double-play offerings and discouraging the transfer of traffic to VoIP.

Similarly, backed by the bandwidth speeds that their 3G and HSDPA networks can offer, they may be tempted to compete with ADSL, to offer occasional and mobile internet users performing connections.

■ ... but market demand remains concentrated on double play for the moment

Although the first quadruple play offerings are still in their infancy, triple play offerings are still not very stable in terms of their content and remain in the minority. For U.S. cable operators, the dominant form of double play includes television and broadband, although the popularity of VoIP is growing. For ADSL providers, double play is based on telephony and broadband. It is worth noting that in terms of ARPU, the positioning of cable operators is clearly more beneficial, with additional revenues from voice being fairly low for access providers.

It should also be noted that all telephone lines are not eligible for ADSL or ADSL2+ at a bandwidth capacity that enables the distribution of television programmes. This limitation will become an even more important factor when high definition television becomes standard. It is this very perspective that has made triple play a key argument for promoting investments in optical access networks in Asia and the USA, with Europe to follow.

Furthermore, consumers may react more slowly in cases where they already have a contract with a specialised operator (as is the case with a pay-TV subscription). This reaction can also vary. Not all consumers are necessarily convinced that a single bill is an advantage. As far as quadruple play is concerned, it will be interesting to see whether the highly personal dimension of subscriptions and the mobile terminal does not prove a barrier to the generalisation of a multiplay subscription on a household level.

■ Deep range bundles

Deep range strategies

In the search for avenues of growth, operators have long since associated deep range services with a reference service such as internet access, voice or television. Each type of operator has consequently worked on its range of services based on its core competence: convenience services (such as caller id display or call waiting) for telephony operators, and channel bouquets, premium channels, PPV, VoD and digital recording for cable and DBS operators. As for internet access providers, they can find ways of differentiating their offering and boosting its profitability thanks to access related services (anti-virus, messaging services, security services, storage services, portals and related services, etc.)

Fairly logically, we can see that operators have a past to contend with. They generally have a range that is deep in terms of their core competence, and fairly restricted in the new areas of triple play. Cable operators, on the other hand, have long-since offered a wide range of television services, but their offering of pay services related to access or voice over IP is relatively limited. Incumbent operators, by contrast, have developed a large range of pay services related to access, but few services in the TV and voice over IP markets.

Moreover, operators are tending to integrate a growing number of services in their base offering. This is notably the case with services related to voice over IP, which are most often included in the subscription. This trend is also true of services related to internet access. The integration of "free" services in the base offering consequently represents a way of offering a differentiated range.

What are the trends towards deepening ranges?

While operators are generally tending to enlarge their range of services, the situation varies to a greater degree when it comes to the deepening of ranges around a basic service such as voice, internet access or TV. Several factors influence range deepening including:

- Primarily, the quest for complementary revenues based on a highly competitive basic service; as a result an operator can advertise an attractive flagship offering, in access for example, and capture additional revenues. As a reference, convenience services for dial-up voice can still generate significant revenues for incumbents.

- Related services that also enable players to differentiate their offering from that of their competitors, especially in markets such as internet access where the basic offering is essentially characterised by a bandwidth capacity and is therefore not differentiated. This is the case with BT, for example, which links the services of the Yahoo! portal to its offering and thus positions itself differently to other ISPs.

- Along the same lines, related services enable players to build specific offerings for certain client segments. For example, in association with internet access, Telefonica's "Disney" pack combines cartoons, parental control software and educational games; it is aimed at children. In mass markets such as voice, TV and now internet access, the growth of a segmented offering will be crucial to winning market share and to targeting different types of customers effectively. The launch of targeted bundles of services is a key component of this strategy.

- The addition of premium services also contributes to the image of the operator's brand. As a result, some high value-added services contribute to the operator's image as an innovator. This is the case with video telephony, for example, which has notably been developed by France Telecom and Telecom Italia.

- Lastly, new services are appearing and naturally enhancing the service range. For example, the fact that voice over IP is linked to a PC significantly improves the outlook for offering communication management services and it is certain that new services will emerge.

All of these factors are going to encourage operators to develop a deeper range, especially in a fiercely competitive context. However, other factors should slow range deepening including:

- Primarily, the trend towards integrating services in the basic offering to maintain ARPU. In the field of access, ISPs unanimously agree that the basic offering tends to integrate additional services such as anti-virus; moreover their offerings already include services related to messaging (email addresses, etc.). In the competitive TV market, bouquets tend to be enhanced in order to avoid decreases in prices. Lastly, alternative voice over

IP operators generally offer free call management services, and it will be relatively difficult to make clients pay for these services.

- The launch of new related service also involves management costs and risks in terms of quality of service. The costs generated by these new services need to be offset by these revenues, which is not necessarily always the case. As a result, some operators may prefer to stick with a standard offering.

- Expanding the range also means looking for partners, notably in the world of TV. This can prove difficult, especially for small ISPs that have little bargaining power compared to the majors.

- Lastly, some operators may chose to market a very simple offering that is very transparent and enables consumers to find a suitable offering fast and easily. The complexity of the options on offer can constitute a barrier to purchasing, especially for new subscribers. Some players may choose to remain positioned in very basic offerings to make their offering very transparent, notably compared to incumbents, which generally market a relatively complex offering.

These factors tend to reduce the range of services on offer, although it is possible to identify the following trends by type of player:

- Incumbents have R&D resources that enable them to develop innovative services: video telephony, converging services with mobile terminals. They position themselves more in terms of deepening their range based on access, and should continue to deepen their range to differentiate themselves from new entrants.

- Cable operators are traditionally positioned in the TV market with offerings in basic services, premium services, thematic bouquets, individual channels and VOD. They have proved slow to deepen their range in internet access and telephony, but will be obliged to develop services in the future by the competition.

- Lastly, ISPs have developed specific strategies; an operator like Free, for example, offers few services related to access, several paying services related to voice and a large range of bouquets and optional channels for television.

From a market dynamics point of view, the features distinguishing telephone operators from internet access providers should nevertheless tend to fade away. Similarly, the frontiers between cable operators, which have seen major consolidation in their sector and have often made major

investments to update their networks, and telecom operators with optical infrastructures, should become less and less visible. Players will nevertheless continue to differ in terms of their financial power, their competitive advantages and the market sectors that they primarily target.

■ By way of conclusion

How profitable are bundle offerings?

Policies for price reductions on bundles vary significantly: some players, notably U.S. RBOCs, offer a marginal reduction, with the main advantage for users being a single bill. Other operators go as far as to offer a 30% reduction on a triple play offering, with the "average" price reduction being around 10%. On the other hand, price reductions are also aimed at orienting consumers towards a product in the range and two reduction strategies are offered: on the one hand some operators offer bigger reductions on top-of-the-range offerings to encourage customers to subscribe to their greater added-value offerings; other operators, on the contrary, offer attractive reductions on entry range offerings in order to maximise their appeal, with the long-term objective of converting these subscribers to other services. Lastly, let us mention the case of Carphone Warehouse, which offers free internet access to its dial-up voice subscribers.

Although the launch of bundle offerings may boost revenues per subscriber, it can also squeeze profit margins, especially if operators have to buy high added-value contents. However, the amortisement of the acquisition cost of subscribers over several services, significant savings in terms of technology and organisation and client retention should boost operators' margins. It is consequently extremely difficult to assess the overall profitability of bundles. Some experts remain sceptical of the potential of bundle offerings to generate a real increase in profits and it will undoubtedly be necessary to wait for feedback based on the experiences of various players before making any concrete judgements. There would seem to be a few encouraging examples in the USA, where the bundling strategy enabled the major local telephony operators (SBC and Verizon), that had been suffering from a significant decrease in lines and traffic, to boost their turnover in the fixed market in 2004.

Variety and transparency in multiplay offerings

The bundle is a key aspect of the range strategy and will undoubtedly condition operators' success. Growth in the broadband market, the diversification and intensification of usages and the growth of new services (fixed-mobile convergence services, unified messaging, video conferencing, HD TV, interactive TV etc.) represent a wealth of opportunities for bundles.

Sticking to marketing strategy components and thus not dealing with complex execution problems, several risks and critical points can nevertheless be identified:

In markets where all players are positioned in triple, or even quadruple play, the offering runs the risk of becoming commonplace and a loss of references for consumers is to be feared.

Operators therefore face the challenge of creating an original range of services, with strategic choices in terms of the depth and width of the offering. To date players have primarily developed their range according to their core competence; they now have to do the same for the new markets in which they are positioning themselves, and to offer consumers a range of harmonised services. Operators will notably have to trade off between the richness of their range and its transparency: too large and complex a range could repel potential subscribers, whereas a simple and transparent range is necessarily limited in scope.

In markets that are approaching saturation in some cases, bundles of services also need to evolve to address specific client segments. The challenge will then consist of identifying market segments and also of designing specific offerings for each segment.

The reactivity of players may be limited by hesitation on the part of regulators, especially as the same authorities do not always regulate all of the components of multiplay.

Competition in multiplay is not limited to that which characterises the different players in access (telcos, cable operators and access providers). It can be extended to all players in a value chain that is becoming increasingly complex and includes the internet giants, eCommerce and software players.

Annex

Typology of bundle strategies

| | <i>Main objective of the bundle strategy</i> | <i>Positioning of operator</i> | <i>Nature of dominant bundle offering</i> | <i>Operators pursuing this strategy</i> |
|---|--|--------------------------------|--|---|
| 1 | To win loyalty | Incumbent facing challenge | Deep and wide range | France Telecom |
| 2 | Boost broadband demand | Incumbent in dominant position | Relatively narrow range | Telefonica, Deutsche Telekom |
| 3 | Win market share | Challenger, new entrant | Low cost bundle | Free, Fastweb |
| 4 | Increase ARPU | New entrant | Bundle oriented towards value added services | Tiscali |
| 5 | To target new market segments | Cable operator | Wide range | UPC, Time Warner Cable, Comcast, Telewest |
| 6 | To win loyalty and attract new clients | RBOCs | Quadruple Play | SBC, Verizon |