

# Mobile Operators: Tired of Margin Pressures?

## *A cost management approach for the mobile communications industry*

*Market saturation, fierce competition and investors' tremendous expectations are putting intense pressure on mobile operators. Growth rates for mobile operators are flattening in nearly all regions globally. Combine this with fierce price wars in several markets and shrinking margins, and it is clear why margins for Western European mobile operators have dropped by more than 3 percent in recent years. Operators in Eastern Europe and Asia have suffered similar declines. A.T. Kearney's European and Global Cost Benchmarking, as a first step in a three-phased operational excellence approach, can serve as a starting point to manage costs, improve operations and develop a cost-conscious culture.*

While mobile communication markets in Europe are continuing to grow slightly, mobile operators recognize that these markets are quickly becoming more mature and saturated (*see figure 2 on page 2*). As a result, cost management has become an all-important focal point, and will become even more crucial as tougher market conditions kick in.

With this in mind, A.T. Kearney started to develop the European Cost Benchmarking (ECB) framework in 2002. The benchmarking approach, which compares costs of more than 60 operators on a yearly basis, has turned into the de facto industry standard used by nearly 90 operators during the last five years. From last year on, the operator panel has been significantly extended to include non-European participants under the name Global Cost Benchmarking (GCB).

ECB/GCB is the first part of a larger A.T. Kearney operational excellence (OPEX) approach. OPEX is a three-phased integrated cost management approach for mobile operators and begins with benchmarking costs among industry competitors to create cost transparency. In the second phase, A.T. Kearney identifies root causes for high costs and quantifies the savings potential. Finally, an efficiency and cost improvement program, which forms the basis for the creation of a new more cost-conscious culture, is set up.

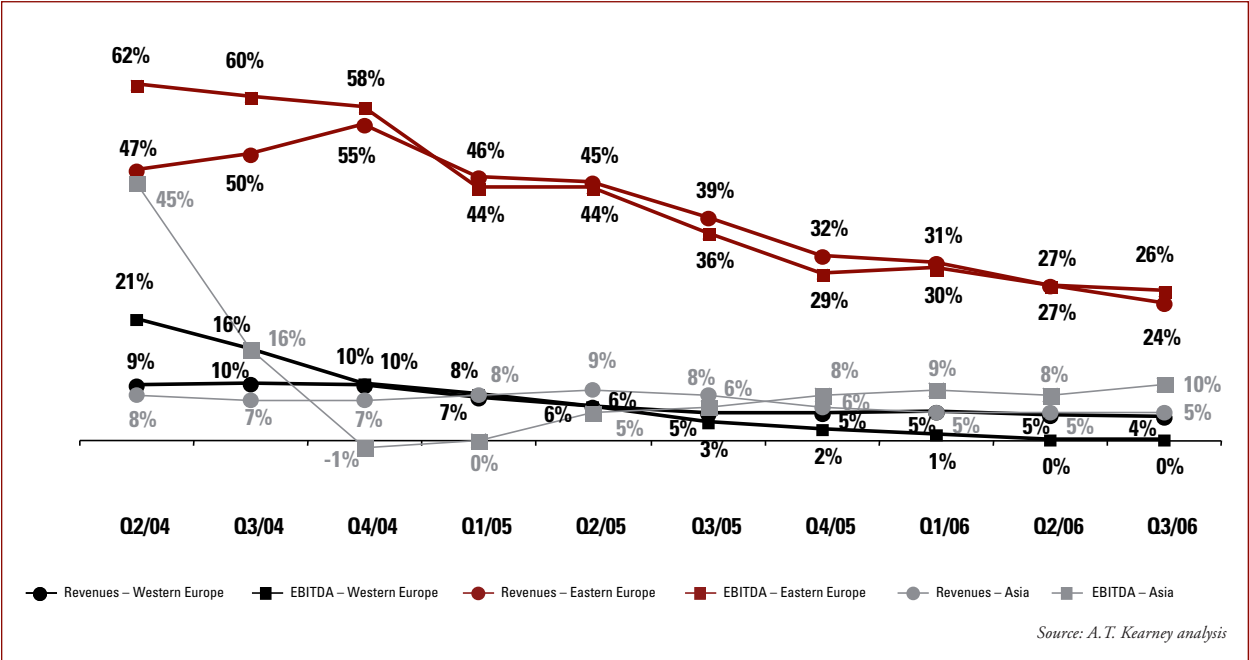
Results in recent years demonstrate that on average ECB/GCB and OPEX can identify a 15 to 20 percent efficiency gap in operational costs, and 30 to 60 percent of these gaps can then be converted into savings, usually realized within two years.

The following is a discussion of the three phases of OPEX. Each



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Figure 1: Wireless market growth in Western and Eastern Europe and Asia



phase can be implemented as a stand-alone project or integrated as part of an overall efficiency improvement program.

Phase One: Create Cost Transparency

Cost transparency is achieved by benchmarking operators from different European countries and selected international markets. The main focus is to measure the operational efficiency of process-related indirect costs. To obtain a complete picture, we also analyze revenue figures, direct costs, capital expenditures (CAPEX) and selected key performance indicators.

To ensure that participating operators are indeed comparable, and thus provide companies with the best possible information, the ECB/GCB methodology includes the following:

**Cost segmentation.** We first segment each operator’s raw cost data into predefined segments using an activity-based costing approach. Raw cost data is allocated to activities and cost types in accordance with the ECB/GCB framework and consolidated into a standardized questionnaire. This is done with a sophisticated cost allocation tool, either on site by the A.T. Kearney team or by the operator with remote support from A.T. Kearney.

The process must be performed diligently to ensure comparable data comparisons across operators and thus gain maximum value from the benchmarking.

**Cost harmonization.** Cost data is harmonized across operators (to allow for proper comparisons) by adjusting country-specific factors such as personnel cost indices and purchasing power parity. For selected countries, we do a line-by-line harmonization of external services costs that takes into account country-specific supplier market conditions.

**Cost normalization.** Different benchmarking indicators are then obtained by normalizing the cost

data. For this purpose, the harmonized data is divided by the relevant cost driver. We use a detailed correlation analysis to constantly evaluate and confirm the relevance of the selected cost drivers. The final ECB/GCB report contains a number of additional analyses using alternative drivers to view the operator's cost performance from all angles.

**Cost comparison.** The analyses not only include the entire available operator panel, but also clusters of operators with similar structural characteristics. For example, we analyze operators of

comparable network density and size, prepaid ratio, number of customers and market share—or a differentiation by eastern or western origin is made. For process-related indirect costs, we use these clusters or panels to determine cost performance gaps. A performance gap is defined in this context as the delta between actual cost position and reference value (average cost position minus one-half a standard deviation).

**Cost documentation.** Benchmarking results are documented in a final report that provides top management with a comprehensive summary and

detailed “area books” for those with functional responsibilities. The report includes a cost analyses per activity, a process cost dashboard (for example, a CEO dashboard), and operational efficiency key performance indicators that help explain a certain cost performance (see figure 2).

All operator-specific requirements are accounted for through additional individual analyses with a number of adjusted cost drivers and clusters. Throughout the process, we ensure the highest level of confidentiality. Every operator re-

Figure 2: Total Company Performance Gap Overview by Activity (indirect costs)



ceives its own data (undisguised) while all other data is anonymous and only available to ECB/GCB participants.

ECB/GCB is a useful tool for every operator to assess its cost position compared to other operators. It also proves valuable in the second phase to determine and realize savings potential.

### Phase Two: Identify Root Causes for Higher Costs and Quantify Savings Potential

Benchmarking the indirect pro-

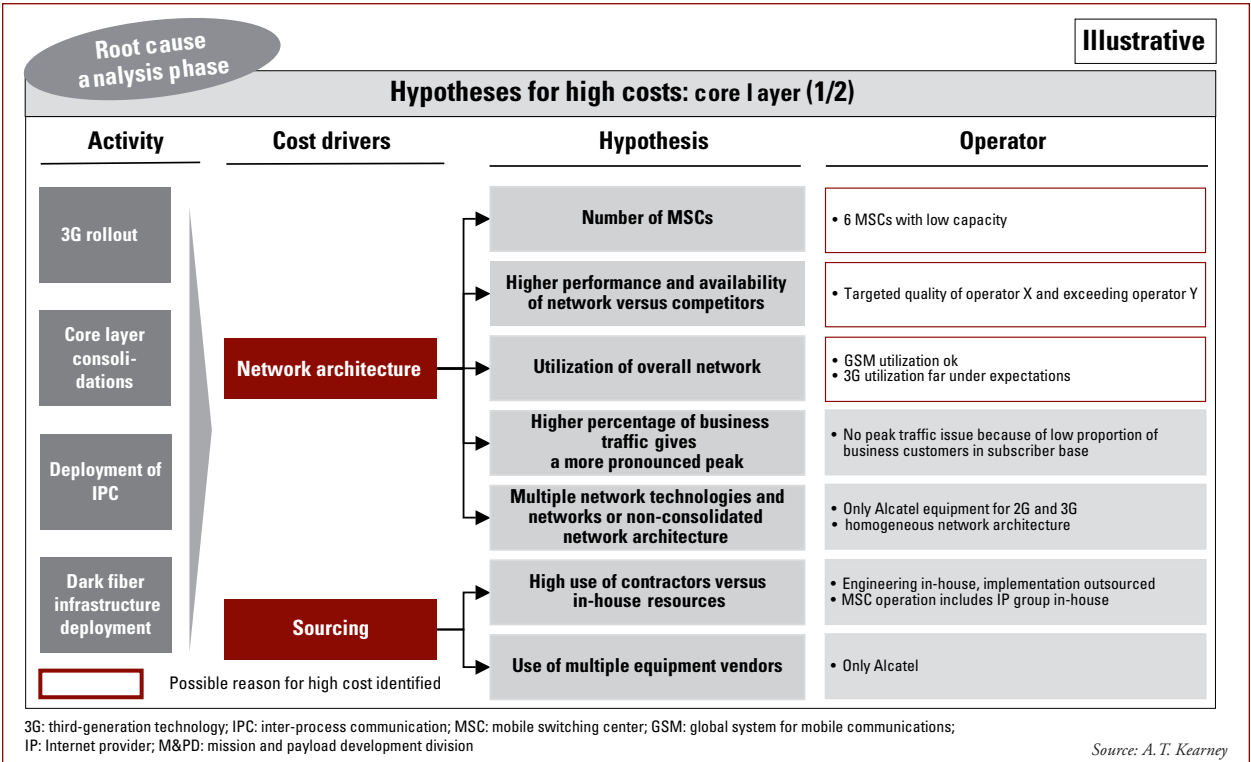
cess-related cost is only the first step toward achieving a sustainable efficiency improvement. Performance gaps indicate potential areas for improvement but do not yet constitute actual savings potentials.

In phase two, we thoroughly analyze significant cost gaps to derive the savings potential—which can range from 30 percent to 60 percent of the initial cost performance gaps depending on the operator and the country. Our OPEX approach identifies the root causes for above-average costs and then quantifies

the savings potential as follows:

The root cause analysis starts with functional workshops where we work with the company to review the ECB/GCB results and develop initial hypotheses concerning performance gaps. These are followed by more in-depth workshops to identify root causes of the gaps and quantify the savings potential. We use detailed hypotheses trees based on our experience with efficiency improvement programs in the mobile communications industry (*see figure 3*). Workshop teams

**Figure 3:** Hypothesis tree for root cause analysis



are made up of specialists from the relevant areas of the operator's organization and experts from A.T. Kearney. In addition, our central benchmarking team conducts specialized analyses of all cost gaps. We differentiate between addressable and non addressable root causes, and then quantify the key deliverables.

In the next step, the quantification of potential savings, we conduct workshops to calculate business cases for selected initiatives and interview experts to assess the ease of implementation. Based on this information, the initiatives

are prioritized according to their business impact and the ease of implementation within a given time frame.

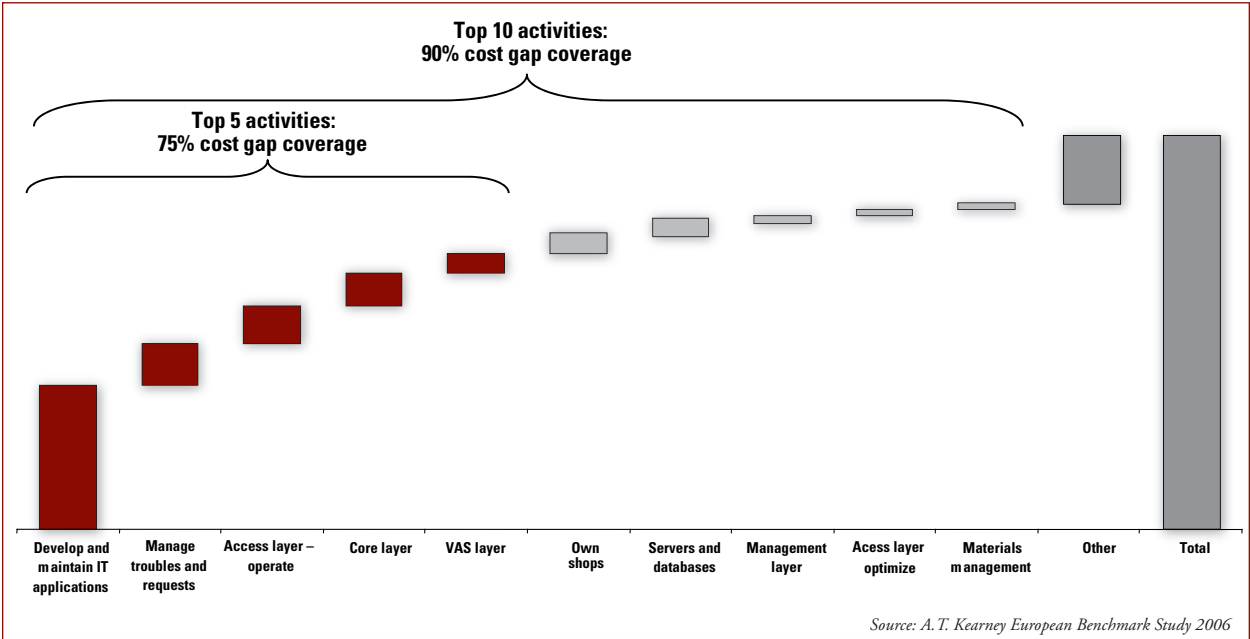
Case Study.

As an example, we recently analyzed the cost performance—between actual and budgeted costs—of a market-follower operator in a Central European country. In a phase one benchmark, we identified major cost performance gaps compared to a broad range of operators in six core areas: network, IT, customer service, sales, marketing and support and overhead. The company priori-

tized the top 10 areas with the highest cost gaps, covering nearly 90 percent of the total (see figure 4).

In the second phase, root causes were identified and quantified for each of the 10 selected areas. For nine of the 10 areas, we identified root causes and developed more than 120 cost savings initiatives to deal with roughly half of these performance gaps. The initiatives ranged from highly strategic measures, such as cleaning up the product portfolio to focus on value-added services and improve own-shop efficiencies and IT demand management, to operational mea-

Figure 4: Phase Two cost gap assessment



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asures such as cancelling preventive maintenance of fire extinguishing systems in BTS sites.

The suggested prioritization was then discussed with the company's management team and initiatives were prioritized based on the eventual set up of an efficiency improvement program. More than 90 percent of the measures proposed have been implemented leading to savings of nearly 60 percent of the original cost performance gap identified. This is a perfect example of a realization rate at the upper level of the range from 30 to 60 percent.

### Phase Three: Design and Implement an Efficiency Improvement Program

In the third and final phase of the OPEX approach, we design and implement a detailed efficiency improvement program. The savings potential of all sub-areas are aggregated to savings initiatives, which are synergistic with respect to their savings levers and the team members who work on them. The goal is to gather a manageable number of key initiatives that identify savings levers with the highest impact and that are feasible to implement.

### Case Study.

For example, in our work for a

major Western European incumbent operator, we set up an efficiency program in the areas of network, IT and billing. After performing phases one and two (benchmarking, verifying cost gaps and potential savings), we established a joint project office to define work streams and kick-start the respective implementation phases. The result was a well defined savings program that led to significant improvements to operations, more savings and reduced capital expenditures, and with only minor CAPEX investments required for realizing certain measures.

Also in phase three, we developed a detailed communications plan so that different layers of management and employees become more aware of costs and therefore it is easier to get firm wide buy-in to efficiency improvement measures.

Implementation is assured on the one hand by forming a cross-functional team including the strategy and finance departments as well as line managers from the different areas. In these teams, members outline the savings potential and plan and control the implementation. On the other hand, regular status meetings with the program leader, the steering committee and the board will ensure a successful implementation and savings capture. This implementation support ensured a high-level of savings realization—for

this operator of more than 50% of the original cost performance gaps identified.

### Long-Term Goal: Develop a Cost-Conscious Culture

After completing the ECB/GCB benchmarking and implementing the efficiency improvement program, the next step is to establish a cost-conscious culture. This sets the stage for sustaining significant cost reductions over a longer period of time.

Creating a cost-conscious culture requires a change in the mindset of shareholders, management and employees. Costs must be transparent, especially in areas with higher costs in order to justify these costs. Preferably, higher cost areas contain investments that will generate higher revenues and thus create value for the firm.

In areas where there are significant gaps in cost performance, operators should rethink their current value proposition: As cost-conscious operators, do they want to provide the current level of service only at a lower cost? Or should they eliminate an activity altogether because its value-add is insignificant to customers?

An excellent way to set and track certain targets is to compare exemplary cost structures and performance patterns with the current cost

situation. The dashboards in figure 5 illustrate how premium-branded and priced operators can have higher costs, especially in areas that are visible to customers. Meanwhile, low-cost, no-frills operators must be cost efficient in nearly all areas (see figure 5).

### Case Study.

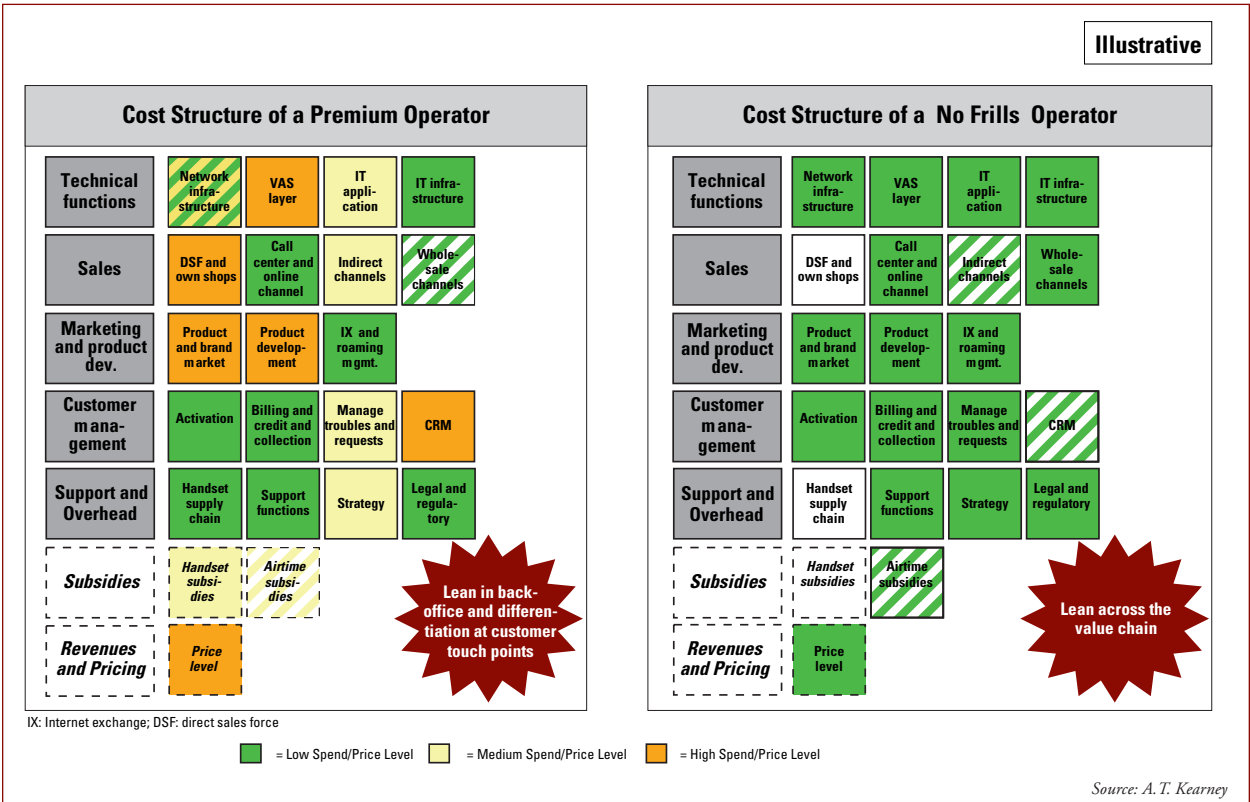
A good example of a cost-conscious culture is that of a long-term participant in ECB, a market-leading

incumbent mobile operator in a mature Central European market. This operator used ECB/GCB to benchmark its costs back in 2002, finding it had only an average cost position. Since then, it has consistently improved its cost position to a best-in-class position, where it is today (see figure 6 on page 8).

The major reason for this successful cost management was the total transparency of cost throughout the whole company. Year by

year, cost gaps were verified, savings derived and translated into clear implementation measures. In parallel, the company set up a clear communications plan for the entire organization and even for shareholders and financial markets. Furthermore, a dedicated controller was assigned to each area to monitor the implementation of efficiency improvements and for continuous cost consciousness.

Figure 5: Aligning cost structures and strategic positioning



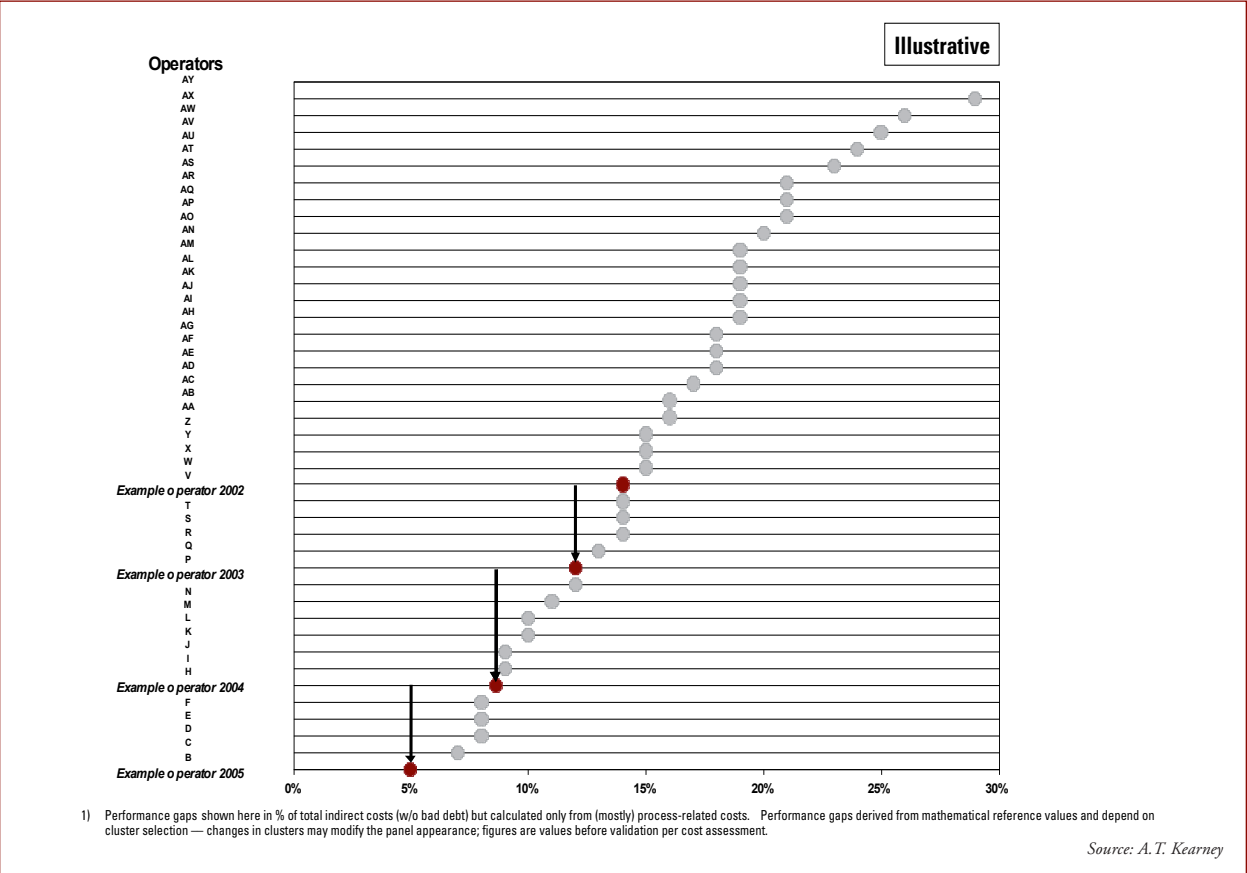
## Become More Cost-Efficient

Mobile operators that have employed ECB/GCB and OPEX, a focused framework for increasing cost efficiency, are achieving operational

excellence. The framework enables full cost transparency, verification of cost gaps and identification of savings potential. Indeed, in the past four years, several of the nearly 90 mobile

operators that have participated in ECB and GCB have reduced indirect costs by 20 percent or more.

Figure 6: Cost positioning and performance gaps 2002–2005



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A.T. Kearney is a global strategic management consulting firm known for helping clients gain lasting results through a unique combination of strategic insight and collaborative working style. The firm was established in 1926 to provide management advice concerning issues on the CEO's agenda. Today, we serve the largest global clients in all major industries. A.T. Kearney's offices are located in major business centers in 33 countries.

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