

Telecom, Media & High Tech Extranet

Virtually mobile: What drives MVNO success

By: Jukka Lehtikoinen /// Pierre Pont /// Yannick Sent



Once the domain of new mobile attackers, mobile virtual networks now draw a diverse set of players. No matter which player, success hinges on addressing key questions and taking decisive action.

Largely a 21st century phenomenon, mobile virtual network operators (MVNOs) have already evolved through three waves of development. The first took place in the early 2000s, when mobile penetration ran below 80 percent and voice was the only real offering. Retailers and companies with strong brands sought new incremental revenue opportunities and prepaid plans tended to dominate. Players traded on their retail presence and brands, offered basic products, and took advantage of their low-cost positioning. The second wave happened during the second half of the 2000s with higher voice penetration and with the appearance of 3G technology and mobile data applications. MVNOs were new companies striving to create small pockets in the market, attempting to differentiate themselves from mobile network operators (MNOs) by offering low-cost foreign calls, data, or subscriber identity modules (SIMs) in subsidized markets.

The latest wave in the mobile virtual network evolution has attracted large players with even bigger market share ambitions (e.g., over 5 percent).

The MVNO space has evolved to include large players with big market share ambitions

particular has evolved into one of the most mature regions for MVNOs, with Germany, Denmark, Norway, and Switzerland leading the way (Exhibit 1).

Many emerging markets will offer major growth opportunities in the near future. For example, analysts predict MVNO subscribers and revenues will grow at roughly 60 percent annually in Thai-

land from 2010 to 2015, and both indicators will exceed 40 percent a year in Hungary, Mexico, and Slovakia during the same period. As a result, the MVNO share in emerging markets will rise into the 1 to 2 percent range, with outliers like Oman reaching nearly 20 percent.

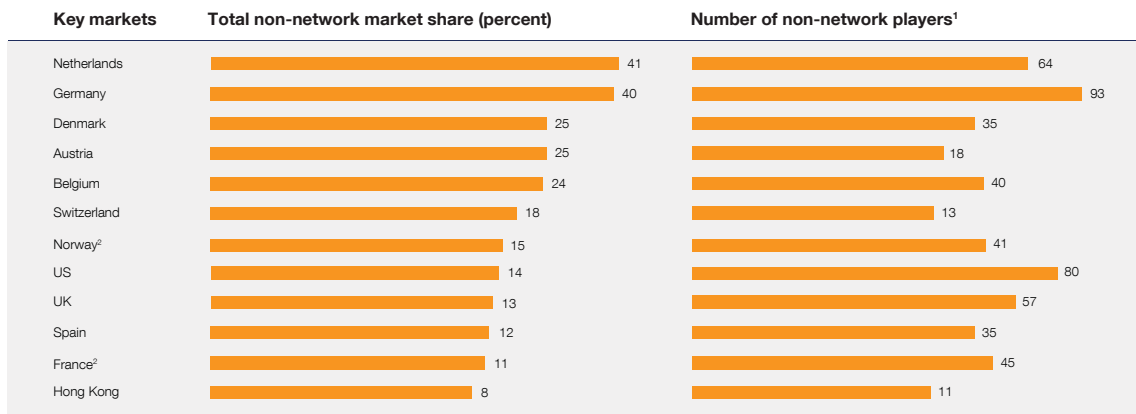
The keys to MVNO success

Based on extensive market research and its experience working on a variety of MVNO launches and MNO wholesale strategies, McKinsey has identified five key success factors for MVNOs.

Exploit brands and market segmentation. Companies that launch successful MVNOs often make use of existing marketing assets like media and telecoms brands, customer databases, and channel infrastructure. They strive to create a unique brand positioning and value proposition in order to attract target clusters such as specific ethnic groups or demographic cohorts like millennials. This typically means identifying emerging niche markets that lie beyond the reach of traditional marketing approaches or are too costly to serve or address using a conventional business model. To attract these niches, companies should set aggressive segment-targeted pricing strategies and develop specific distribution tactics that might involve sales kiosks or point-of-sale (POS) displays in gas stations or local stores.

Build MNO relationships. Forging a win-win agreement with an MNO will play a key part in any MVNO's success. A good contract with a network operator that is easy to renegotiate if it becomes necessary to switch network hosts is essential. The mobile player needs to ensure that the final contract is adaptable enough to meet

MVNOs in developed markets control between approximately 10 and 40% of the mobile business



¹ Data as of YE 2013 or 2012 based on latest availability in the country

² Excluding the second brands affiliated to telecoms operators

SOURCE: Pyramid; press clippings; McKinsey

Exhibit 1

new requirements, such as the need to accommodate data offerings. Based on forecasted traffic patterns and offerings, the MVNO needs to develop a detailed understanding of the impact any wholesale-level variables could have on its business plans. What's more, any wholesale rate agreement should have built-in protections against price-cutting actions by the host network. For instance, MVNOs need to develop agreements that guarantee that the effective wholesale rate will be lower than the agreed-on rate or the host's retail rate minus a given percentage. Doing so will prevent the host network from reducing its own customer-facing prices below those it negotiated with the MVNO.

One MVNO made sure its target segments were not on its MNO partner's radar screen as future opportunities and ensured that any cannibalization risk between the offerings of the two operators was low. It also confirmed that the profit pools associated with targeted segments were sizable enough to accommodate strong MVNO growth while also benefiting the MNO, which could not capture these customers by itself. Be-

yond this, the company successfully modeled the data requirements for its content-rich proposition.

A close relationship with the MNO is important for an MVNO's commercial viability

the company did thanks to its up-front analysis and careful execution.

Strive for marketing excellence. Successful MVNOs develop clear value propositions that they customize to meet the needs of target customer segments. In some cases, players integrate audiovisual content into marketing campaigns to boost their impact.

One European virtual network operator made sure it had a cheap and transparent pricing strategy with no monthly subscription, fixed voice and SMS prices, and an extremely easy-to-use sign-

Consequently, the virtual operator was able to structure the contract through a "take or pay" approach that rewarded it with lower fees overall if it reached its targets – which

up system. The MVNO's clean value proposition of good customer service, a simple electronic payment system, and only the services that its target customers deem relevant has enabled it to win business in highly competitive markets.

Another MVNO has made innovative use of social networks to power its unique business model. Its hybrid pay-as-you-go and contract model currently targets young, tech-savvy, and digitally knowledgeable customers, although the company aspires to attract a broader audience of value seekers in the future. The operator's core values and business model literally make customers part of the business. Unlike conventional mobile phone operators, its service users can choose to participate in certain aspects of the company's operations, such as sales, customer service, and marketing. In return, users receive remuneration. In December 2012, the MVNO estimated that it would pay just under GBP 3 million to its customers. Because of this customer assistance, the company needs only 28 full-time employees to handle over one million customers.

Focus on sales and customer excellence. Excellent players carefully manage multichannel distribution strategies with an eye toward formulating a targeted go-to-market strategy. To do this, they typically seek answers to questions regarding four specific elements of the MVNO business.

The first element is the virtual network's channel architecture. What is the optimal channel mix for today and in the future (e.g., number of distributors, direct versus indirect POS, or owned versus franchised outlets)? How can the MVNO increase its "capillarity" in the most effective way? What are the key alternative channels it should develop? Should MVNOs consider partnerships with fast-moving consumer goods players or banks? How can an operator apply micromarket activities to push sales in low-performing sub-regions?

Another aspect of the MVNO business relates to the incentives an operator uses. Do the incentives entice different channel participants, such as

distributors and direct and indirect POS players, while also ensuring an optimal payout to channel partners? How does the virtual operator ensure high customer satisfaction and create a system that competitors cannot easily copy?

Then, there are the underlying processes, tools, and IT stacks used to optimize the operator's sales performance from acquisition to retention. What are the ideal enablers for the performance of POS displays, third-party distributors, and other channels? How can the MVNO effectively cross- and upsell products, such as value-added services and top-ups through its digital channel and e-sales approach (e.g., "next product to buy") and analytics?

Finally, a virtual network operator has to ask itself questions about the implications of the chosen channel strategy on its organization. For example, should it create its own sales force to control the POS push, and if so, how?

Pursue operational excellence. Winning MVNOs minimize costs by selecting the right mobile virtual network enablers to assist with key operations, such as billing and administration. Enablers can be critical – especially for small, new MVNOs – making it easier for them to roll out their businesses without excessive up-front investments. Consequently, MVNOs need to determine which services to retain in-house and which to outsource. Successful MVNOs also work hard to master the elements of an effective business rollout. Unlike a mobile network operator, 75 to 85 percent of an MVNO's cost structure involves variable charges like wholesale airtime costs and customer acquisition expenses. As a result, MVNOs need to keep exceptionally close control over their variable costs, while actively limiting fixed costs as much as possible. Experience suggests that to achieve commercial viability, an MVNO needs to develop a business model that minimizes customer acquisition and retention costs as well as fixed outlays. Successful MVNOs often use existing distribution assets and channels to reduce these costs.

Each model has clear and unique implications for the top and bottom lines and associated margins

	Branded reseller (prepaid)	Service provider (prepaid/postpaid)	Light MVNO (prepaid/postpaid)
Subscriber ownership	MNO	MVNO	MVNO
EBITDA margin Percentage of revenues	< 10	10 - 15	15 - 20
Peak project funding USD millions	4 - 6	8 - 12	15 - 20
Capex USD millions	2	3 - 5	15 - 20

Depending on the MVNO operational model and the segment of the target market selected, investment payback can usually be expected in 4 to 6 years

Exhibit 2

MVNO model choice drives operational needs

MVNOs can choose from four models, presented below in the order from least to greatest risk and value potential.

Branded reseller. Using this model, an MVNO can potentially offer its own value-added services (VAS), but otherwise holds no assets in the partnership with the MNO. Specifically, they get no ownership of the client, the infrastructure, or the SIMs. This model also does not give the MVNO the ability to set prices. The branded reseller model enables the MVNO to reap the benefits of operating under its own brand (or co-branded with the MNO). The branded reseller is responsible for the costs of branding, sales, and distribution and shares revenues with the partner MNO.

Service provider. While still having no ownership of the infrastructure, MVNOs under the service provider model do get to own the customer care and billing platforms. The MVNO has the potential to own the SIM, and it can set prices indepen-

dently of the prices set by the MNO. The brand – as under the reseller model – may be independent or co-branded. In this model, the MVNO can own clients so its revenues may come directly from outbound traffic. It is responsible for wholesale access rate structures as well as the costs associated with the IT platforms it owns (on top of the same branding, sales, and distribution costs MVNOs pay under the reseller model).

Light MVNO. This model does not give network infrastructure ownership to MVNOs either, but it does give them ownership of the client and the intelligent network platform – and even partial ownership of the VAS platform. The light MVNO's revenues come from both inbound and outbound traffic, and here, the MVNO is responsible for the same costs paid under the service provider model – e.g., rate structures, IT platforms, branding, sales, and distribution.

Full MVNO. It is also possible for the MVNO to operate like an MNO in virtually all ways except for ownership of the radio access network. At this end of the spectrum, the full MVNO gets the benefits

associated with owning the network-switching infrastructure and also incurs the costs of these network elements.

Given this wide range, companies must understand that their choice of MVNO model will have a major influence on determining the required levels of operational excellence. Margins, project funding,

MVNO model choice determines revenue potential, margins, and expenses

and capital expenditures will vary significantly depending on which MVNO model a company chooses. A branded reseller's margin on earnings before interest, taxes, depreciation and amortization (EBITDA), for example, would typically be less than 10 percent; a service provider's will be from 10 to 15 percent; and a light MVNO's from 15 to 20 percent (Exhibit 2). Based on a case-study analysis, McKinsey has estimated ranges of the top- and bottom-line implications of different MVNO plays.

Successful MVNOs usually seek a cost-efficient operational model, which is generally from 30 to 50 percent below an MNO's cost to serve average customers. Compared with an MNO, an MVNO can own the low-cost play position, but leaders need to recognize that as they take more control from the mobile operator, they need to capture a higher market share to make it all work. Only a light or full MVNO can offer the range of services and differentiators required to gain significant market share and associated revenues. Therefore, the decision maker's calculus must include considerations of both risk/reward and of the potential to capture the necessary market share.

The successful MVNO launch

Once leaders have determined the MVNO model appropriate to their needs, the next critical challenge involves the launch itself. McKinsey's experience and research concerning successful MVNO

launches worldwide suggest a number of elements that companies should keep in mind.

Launch date. The prospective MVNO must establish and communicate a clear target date for the launch (based on global best practices that the company adjusts to the local environment). Companies often find it helpful to "backward plan" in order to define the launch's critical path and key milestones as well as the last date on which leaders can make decisions without delaying the launch.

Decision making and ownership. Launch success will largely depend on the company's ability to assemble a multifunctional task force of high-caliber, full-time launch owners who are fully responsible for results. This also includes establishing rapid decision making processes and pre-agreed escalation procedures. Direct and frequent CEO involvement can help an MVNO realize a strong launch, as can focusing on what really matters for the launch, especially from the customer's perspective.

Customer experience levels. A successful MVNO will define desired customer experience levels across all of the operator's customer touch points. These include the company's SIM activation kit, call center, advertising, offering structure, POS, and merchandising. To ensure uniform customer experience, companies need to establish consistent value proposition definitions (e.g., simplicity, transparency, and premium or "no frills" offers) and apply them across the board. Additionally, they should assess their core operational performance thresholds in order to avoid customer dissatisfaction.

Contract details. The MVNO also needs to focus on the details of the contract. The critical negotiating areas for an MVNO are the wholesale rates and the telecoms service agreement, which defines the interfaces and services provided by the host network to the MVNO. Prior to negotiations, the virtual network player should already have a business model supported by extensive risk analysis that identifies the range of wholesale rates it needs to earn a reasonable rate of return. It should use this range to analyze proposals during

negotiations. Beyond this, MVNO should also work out estimates of target-host network traffic costs before negotiating with the MNO.

McKinsey's experience in the industry suggests that launching an MVNO can take up to a year, depending on the length of negotiations with the host MNO and the involvement of an MVNE. The launch itself involves business planning and building, which must proceed hand in hand. Typical business plan elements will focus on licensing and preparation and include defining target customer segments and securing a positive wholesale agreement based on forecasted usage patterns. The hopeful MVNO then specifies the offer and distribution architecture, selects the technical infrastructure that makes the most sense, and prepares to implement the contract.

At the same time that the company acts on these final planning elements, the business-building aspects of the launch and implementation should take shape. Steps include recruiting channel partners and implementing the overall technical system, including the creation of interfaces with the host's network. The company then designs

and rolls out overall processes. The final two business-building steps, executed by handpicked staff, involve building the project, making sure the permanent organization has the right capabilities, and ensuring that the required levels of transparency and consequence management exist.



The MVNO play is becoming increasingly attractive to growing numbers of leading companies worldwide. Cable companies see the potential in fixed-mobile convergence, while some retailers are moving into the MVNO space to increase their share of wallet and basket size. Several models exist, and hopeful MVNO players will choose the one that best serves their end goal. Whether completely new to operating a mobile virtual network or looking to apply MVNO expertise to new markets, all players need to work through a variety of decisions that range from operational elements to the best go-to-market and negotiation strategies. Depending on its current situation, business model chosen, and market aspirations, a company's MVNO play can be a strong source of growth with margins of up to 20 percent.



Jukka Lehikoinen

is a Knowledge Expert in McKinsey's Helsinki office.
jukka_lehikoinen@mckinsey.com



Pierre Pont

is an Associate Principal in McKinsey's London office.
pierre_pont@mckinsey.com



Yannick Sent

is a Knowledge Expert in McKinsey's Paris office.
yannick_sent@mckinsey.com