B2B 2015: The future role of telcos in ICT markets

The convergence of telecoms and IT has opened the door for significant B2B activity in the ICT industry. Understanding the markets and the trends that shape them will help telcos take full advantage of the market share and revenue opportunities.

In a dynamic industry like business-to-business tele-communications, four years can seem like a lifetime. Because the pace of change is so fast, even looking just a few years down the road is of strategic importance. Assessing the possible roles for telcos in the industry of the (near) future can provide leaders with valuable insights on how to position for success. To that end, McKinsey has undertaken an initiative to explore current trends in telecoms and identify the forces that will shape the market in the years to 2015.

The fusion of IT and telecoms

The evolution and convergence of technologies have blurred the lines that once separated telecoms players from the world of information technology, and the two sectors are on a collision course.

Many telcos are actively trying to make use of their existing scale and IT savvy to move beyond basic voice and data services and begin selling IT services. A number of telcos have recently acquired IT companies in order to drive growth in ICT services and related network areas. Examples of this "border crossing" are KPN's 2007 acquisition of Getronics and NTT's recent acquisition of Dimension Data. The same trend has been observed in emerging markets, as shown by the partnership of Telmex with Hildebrando and Telkom

Indonesia's acquisition of the IT player Sigma. Telecoms equipment players are also following suit and actively venturing into the IT space, as illustrated by Cisco's move into the server market.

However, the convergence taking place is not a one-way street. Many modern IT services such as cloud computing require communication products as integral parts of the offering. Also, a number of IT players are recognizing they have the ability to make inroads into the telecoms space. This is often accomplished by designing substitutes for traditionally delivered telecoms services, such as over-the-top application collaboration and IP-based communication applications.
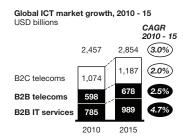
Supply-side changes are being mirrored on the demand side, with more companies expanding the role of the chief information officer (CIO) to include decisions regarding both IT and telecoms. Further evidence of these changes can be seen in the clear trend toward consolidating IT and telecoms suppliers. CIOs must expand their perspectives regarding enterprise-level ICT, as the boundaries between voice and data, mobile and fixed, telecoms and IT begin to disappear.

Emerging markets – B2B growth engines

Emerging markets have recently been the focus of B2B growth, outpacing their developed market counterparts. Between 2005 and 2010, the Latin American B2B telecoms market grew at an annual rate of 12.5 percent, while in Eastern Europe markets grew at 8.4 percent. In even greater contrast, growth rates in developed economies like North America (+2.9 percent) and Western

The B2B space is expected to continue to grow at attractive rates, surpassing B2C for the first time, especially in IT services

Global ICT market growth, 2010 - 15
USD billions

	2010	2015	CAGR 2010 - 15
	2,457	2,854	3.0%
B2C telecoms	1,074	1,187	2.0%
B2B telecoms	**598**	**678**	**2.5%**
B2B IT services	**785**	**989**	**4.7%**

	North America			Latin America			Western Europe			Eastern Europe			Middle East and Africa			Asia-Pacific		
USD billions	2010	2015	CAGR 2010 - 15															
B2C telecoms	221	229	0.7%	77	85	2.0%	263	263	0%	67	76	2.6%	116	147	4.8%	329	387	3.3%
B2B telecoms	162	172	1.2%	58	69	3.8%	131	134	0.6%	48	57	3.5%	72	91	4.8%	128	155	3.8%
B2B IT services	322	411	5.0%	29	49	11.0%	232	270	3.1%	11	14	4.7%	15	19	5.4%	175	225	5.1%
Total	705	812	2.9%	164	203	4.4%	626	667	1.3%	126	147	3.2%	203	257	4.8%	632	767	3.9%

Note: Figures may not equal the sum stated due to rounding
SOURCE: Yankee, March 2011; Gartner Worldwide ICT spending, Q1 2011; McKinsey

Europe (+1.8 percent) were much lower. Spurred on by the opportunity to capture some of the high growth, emerging market telcos are moving to establish themselves as credible ICT players. A survey of 30 Brazilian CIOs revealed that telcos are beginning to be seen as credible providers of ICT services in market segments such as data centers, WAN, LAN, call centers, and, to a lesser extent, desktop management.

The continued convergence of IT and traditional telecoms markets and the opportunities it creates will cause telco B2B offerings to grow at attractive rates in the coming years, with B2B growth surpassing B2C growth rates for the first time ever (Exhibit 1). Globally, the growth of combined B2B telecoms and IT services will increase at nearly 4 percent annually from 2010 to 2015, eclipsing the expected expansion of the telecoms B2C market of 2 percent per year during the same period. Much of the momentum for this move ahead comes from IT services, which are expected to grow at almost 5 percent per year from 2010 to 2015 (Exhibit 2).

While IT services offer attractive growth opportunities to a mature telecoms industry, they come with reduced margins. EBITDA margins for typical telecoms services can exceed 35 to 40 percent, whereas the EBITDA margin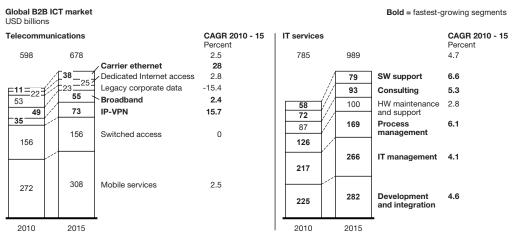s for IT services are commonly much lower, ranging from 5 to 25 percent. However, EBIT is more appropriate as a profitability metric for IT services, acknowledging their lower capex requirements compared to telecoms services. The EBIT margins of pure IT services are typically around 5 to 10 percent, while EBIT margins for ICT services frequently amount to between 10 to 20 percent.

Telcos must determine the appropriate focus of resources to manage margins and capture growth, and emerging market operators have key advantages over their developed market counterparts when moving into ICT:

High growth rates. The steep ICT growth trajectory in emerging markets makes them very attractive. Emerging market customers often have a lack of legacy IT compared to those in developed markets, and surveys regularly show that customers are prepared to move directly toward the latest generation of technology and services, potentially leaving out entire generations of technology that more developed markets are transitioning through. For this reason, advanced ICT services will play an even more important role in enabling emerging market operators to grow and tap into new revenue pools.

Open market structure. Secondly, due to their early stage of market development, market structures in emerging economies are more open. Emerging markets

02 Telecoms growth will be data-driven, and IT will grow at attractive rates in most areas

Global B2B ICT market
USD billions

Bold = fastest-growing segments

Telecommunications

2010	2015	Segment	CAGR 2010 - 15 Percent
598	678		2.5
		Carrier ethernet	**28**
38	25	Dedicated Internet access	2.8
11 / 22	23	Legacy corporate data	-15.4
53	55	**Broadband**	**2.4**
49	73	**IP-VPN**	**15.7**
35			
156	156	Switched access	0
272	308	Mobile services	2.5

IT services

2010	2015	Segment	CAGR 2010 - 15 Percent
785	989		4.7
	79	**SW support**	**6.6**
	93	**Consulting**	**5.3**
58	100	HW maintenance and support	2.8
72	169	**Process management**	**6.1**
87			
126	266	**IT management**	**4.1**
217			
225	282	**Development and integration**	**4.6**

typically show higher fragmentation than developed markets with a more limited range of services available (except for multinationals often served with customized solutions supplied by extranational vendors). This open market structure means that telcos expanding into ICT will typically face fewer conflicts with channels and partners and have more opportunities to create win-win situations. One disadvantage of the early stage of market development, however, is that there are likely to be fewer established companies to acquire to drive growth.

Six B2B trends and their telco implications

To better understand how telcos can position themselves to capture the B2B growth opportunity, McKinsey has conducted a survey of the forces shaping the market. We identified six trends that are defining the telco business-to-business arena through 2015, a number of which are already a reality in developed and some emerging markets.

Ubiquitous Internet-based connectivity will drive growth rates of up to 33 percent each year for services such as managed Internet protocol, private branch exchange systems, and voice over Internet protocol – where telcos already have a natural advantage. Operationally, the shift to IP has a number of implications. More sophisticated network design and integration skills are needed to provide and service advanced IP-based products, which often call for some customization in order to make them work effectively with customers' ICT systems. Software capabilities will become more important in the future, with service setup and integration depending less upon wiring and more upon programming. Additionally, the requirements for field technicians will change significantly and field force skill profiles must be adjusted accordingly. Finally, telcos will need to carefully manage the migration to IP-based solutions to avoid cannibalizing traditional high-margin telecoms revenues and diluting unit margins and cash flows.

Unified communications and cross-platform integration are expected to grow at almost 20 percent annually in the coming years, exceeding spend on stand-alone communications services by 2012. Examples of these services include desktop videoconferencing and applications that can be used seamlessly across devices such as PCs, smartphones, and tablets. Telcos providing these services have an opportunity to reduce cost and complexity for their customers. However, some recent large deals have been problematic and even unprofitable, so strong mechanisms will be required to manage the contractual and commercial risks.

Big things come in small packages:
The B2B cloud opportunity

Of all the ICT trends, the one with the greatest potential influence on the future market is cloud computing – which is gaining increasing relevance and acceptance for large and small enterprises in developed and emerging markets. The adoption patterns (and opportunities) differ significantly between SMBs and large enterprises.

SMBs are mostly looking at enterprise class features and mainstream computing services to ease the way they consume IT and reduce investment requirements. Horizontal services such as e-mail, backup, disaster recovery, and security are typically at the top of the adoption pecking order; however, software as a service (SaaS) can enable small enterprises to access and benefit from software previously only affordable for large enterprises. For example, Salesforce.com's success made high-end CLM capabilities available to a large number of companies that had previously not used such software.

Large enterprise adoption of cloud is more segmented with a range of adoption cases. For example, "divisional IT" is the adoption strategy for large enterprises to free IT department management bandwidth. Smaller divisions or departments are provided with a standard, externally managed cloud offering, and the IT department only manages the portfolio of SaaS applications made available. "Load balancing" is a data traffic regulating technique that utilizes the public cloud in ways that manage overflow to allow for testing, minimize the impact of peak network demand, and maximize

data center capacity. Finally, "new business models" result when cloud computing (the public cloud in particular) is fully leveraged. This is especially beneficial when collaboration needs to happen across enterprise silos and organizational boundaries, with cloud used to set up marketplaces and exchange information across a fragmented supply chain and with a broad network of distributors.

The SMB opportunity

The high growth rates of the emerging market SMB segment means that there are structurally fewer "entrenched" solutions invested in and more frequent natural transition or service switching points at which new services and service models can be adopted. Also, in emerging markets, the low investment cloud pricing model is attractive to finance constrained emerging market businesses, creating a potentially high latent demand for the services.

In SaaS, telcos can operate as a channel and enabler, marketing and potentially bundling a range of SaaS offers with core telecoms products such as data connectivity. Experience shows that the more products from the same operator customers hold, the more loyal they are to that operator. Early indications are that this holds true for cloud computing despite the convenience and flexibility the "as-a-service" pricing model offers. In addition to reduced revenue erosion in core products, one telco moving quickly into this space has seen that churn for core products is 50 percent lower for SaaS customers than for the customer base as a whole.

Cloud computing is growing rapidly with spending in cloud infrastructure expected to increase by 30 percent each year through 2014. Cloud computing broadly has three service models (known collectively as "X" as a service – XaaS): software as a service offers finished applications to customers; platform as a service provides software integration and application development capabilities; and infrastructure as a service helps customers with infrastructure management, data storage, and computing power. Bridging the gap between the public

and private cloud space, virtual private clouds used by large enterprises are expected to become a major market. A virtual private cloud allows a company to utilize a secure, private space on shared infrastructure and is targeted to provide the security of a fully private cloud with the economics and flexibility of a public cloud. Research predicts that these virtual private networks in IT infrastructure could account for 30 to 35 percent of total cloud revenue in 2015. Expertise in incident management, security, and disaster recovery is a poten-

There are potential winning plays for telcos in ICT

	Transformational ICT outsourcing for large enterprises			Cloud services for SMBs

System integration
Enterprise software
Middleware
Computing services
Hardware
Network
	Winning play 1:
	Network-intensive outsourcing
	
	• Multiyear outsourcing deals with a significant network component
	• Reduced cost and complexity through IP and unified communications
	• Integration of private and public clouds, with emphasis on security and disaster recovery
		Winning play 2:
		Provisioning of standard platforms in an on-demand mode
		
		• Provision of standard platforms and applications in an on-demand mode
		• Emphasis on
		  - End-to-end incident management and SLAs
		  - Security and disaster recovery
			Winning play 3:
			End-user-managed complexity
			
			• Support for an array of end-user devices and applications
			• On-site field services as differentiator vs. offshore attackers
			• Partnerships with offshore providers for complementary skills and footprints
				Winning play 4:
				XaaS for SMBs
				
				• Leveraging the strong SMB footprint in voice and data (and in some cases in desktops) to expand into applications for up-/cross-selling
				• Partnering with software players for complementary skills

tial asset for telcos, but they will need to act quickly or find themselves excluded from this space by the global IT giants.

A new wave of mobile services such as machine-to-machine (M2M) applications represents an attractive area of opportunity for B2B services. M2M subscriptions are expected to make up 10 percent of all European mobile subscriptions as early as 2013. M2M plays can include remote healthcare services, smart metering for utilities, and vehicle asset tracking for logistics and field service providers. Telecoms players can create more value by leveraging their network assets, large customer bases, and distributed field forces. Success here will require excellence in partnering capabilities, with many of the aptitudes telcos will need to secure lying far outside their core businesses. Telcos will also need to adopt a culture of innovation to move them from simply passive infrastructure providers to platform and solutions providers.

Selective "consumerization" is the convergence of business and consumer handset and PC markets; a development that could change the handset market and revolutionize the corporate desktop environment. User demand for more attractive devices is driving a proliferation of smartphone and tablet devices being supported by corporate IT departments. "Bring your own computer" programs, such as those that have been launched by Citrix and Intel, encourage employees to, as the name suggests, use the same computer for both personal use and work, injecting consumer buying factors into the traditionally rather conservative and TCO-driven corporate PC landscape.

The "applications revolution" describes the growing trend for a plethora of small applications sourced from different developers and channels to be used on a range of devices. Of the players in this sphere, telcos are the specialists in supporting these multi-OS/multiple-device environments. Click-to-buy app stores are increasing in popularity, with business needs being served both by categories with general application stores such as Apple's and dedicated business app stores such as that of the Australian carrier Optus. App stores can round out telcos' portfolios and support a "one-stop shop" value proposition – telcos can deliver on all of their business customers' needs for network-enabled services. Software players, however, are already making inroads to owning the customer relationship, so this is not an open-ended opportunity.

All six trends present operators with a number of potential opportunities and threats. Identifying the correct approach will mean the difference between capturing the growth potential from these opportunities versus suffering the potential threat that they also represent to the traditional telecoms business.

Positioning telcos for the B2B future

B2B ICT markets will grow attractively in the coming years, and telcos are in a good position to shape them. A number of possible strategies could pay off for telcos seeking to grow in this space (see table on previous page). Broadly speaking, telcos can map their strategies along the two halves of their B2B client base.

In the corporate market, telcos should look to leverage their network capabilities, their experience in supporting complex and diverse arrays of end-user devices, and their ability to manage the end-to-end performance of network-centric ICT services to establish strong value propositions. In the SMB market, telcos' established customer relationships and strong channel presence can be the platform from which to build successful XaaS offerings.

Experience shows that moving into ICT can bring significant risks. For example, one operator in the Asia-Pacific region acquired an IT player with a broad offering including systems integration, but found that benefiting from becoming an integrated IT and telecoms player was more difficult than expected – the bulk of the IT and telecoms services were simply too different to enable commercial or operational synergies to be realized. A Western European operator faced difficulties of a different nature, underestimating the cost of delivering large contracts, which led to large write-offs.

Delivering on these strategies will require telcos to transform their commercial, technical, and operational capabilities. Commercially, sales teams need to expand their capabilities to recognize customer needs in new product areas and effectively communicate the new and often more complex value proposition of the new products. The trend to solution selling and requirement for solution sales capabilities will accelerate further, with communications becoming just one element of comprehensive, integrated solutions. Skills, systems, and assets need to evolve technically as the prerequisite to enable the efficient and scalable delivery of the new service.

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Telecoms "business as usual" is being replaced by a "new normal" with a broader and more complex playing field that will offer significant promise to telcos prepared to meet its challenges. Telcos and IT organizations are vying for control of their new ICT intersection. Telcos in emerging markets, however, are positioned especially well to reap the benefits in the B2B realm if they can be mindful of the trends, understand their unique assets, and move quickly.

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