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# Mallinson: Looking back on the 'noughties'

January 4, 2010 — 10:19am ET | By Keith Mallinson

With the new decade beginning, it is worth reviewing European developments in mobile services markets since the millennium. Subscriber penetration increases continued to outpace expectations, but usage growth was disappointing throughout the decade in voice and in data services--apart from SMS--until a couple of years ago. Prospects for operator revenue and earnings growth remain constrained due to perilous economics in mobile broadband with spectrum costs, weak strategic positions in mobile internet, an abundance of wireless operators and barriers to consolidation.

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### Penetration and usage

European mobile services markets matured last decade. Whereas most Europeans now have mobile phones, it is surprising how few calls they make on them.

Subscriber penetration tripled to 130 per cent in Western Europe, while usage has remained pretty frugal with average minutes of use rising less than 20 per cent to 150 per month. Whereas East European penetration averaged only 5 per cent at the beginning of the decade, it is now approaching the West European average and MoUs are 40 per cent higher. In contrast, US subscriber penetration continues to lag at 90 per cent, but with 800 MoUs. These differences are driven by high prices per minute and low or non-existent monthly minimums with the dominance of prepaid calling and with relatively high call termination charges in Europe.

Price wars have not generated sufficient additional adoption and use to maintain declining revenues. Regulated price controls on international roaming and call termination are stimulating demand somewhat, but average European prices are still much higher than in nations such as the USA and India. With the trend towards text-based communication with SMS, email and IM it seems unlikely European MoUs will ever reach anywhere near US levels.

**3G and mobile broadband**

3G was pretty disastrous for European operators until the latter part of the decade. With spectrum auctions at the beginning of the decade resembling the game of musical chairs in several major nations including Germany and the UK, the contrived scarcity forced operators to bid dangerously large sums of money. This nearly bankrupted some large operators such as KPN Telecom and the financial shock generally impeded deployment of 3G services. The first 3G phones were unattractive to consumers with poor battery performance, bulky form factors and inadequate data capabilities. Operators had to subsidize these costly devices much more than their 2G counterparts to encourage 3G adoption with use of the new spectrum and infrastructure.

Five years after the initial 3G service launches starting in 2003, 3G is a major success in its evolved form with HSPA. It is so cost-effective that decommissioning some 2G capacity is typically worthwhile for the additional capacity and cost efficiencies. And at last, all the elements in the mobile data services ecosystem are in place, as Apple and its carrier partners demonstrate with the user-friendly iPhone, App Store and HSPA networks.

Whereas auctions are the fairest way of selecting winners and losers, it makes no sense to saddle the sector with massive spectrum costs. If the objective is--as it should be--to provide deep penetration and affordable mobile broadband to people and places where there is no alternative broadband access, spectrum should be allocated on the basis of deployment and service commitments rather than maximizing payments to government.

**Monetising the mobile Internet**

Miniscule until 2005, this market segment is now growing rapidly but mobile operators have not yet figured out how to capitalize on it significantly beyond the transport charges to which most fixed network operators have been relegated. Meanwhile, Apple is cleaning up with gross profits of $400 on every iPhone bought by operators for an average of $610 last quarter and sold with subsidies to consumers at prices ranging down to nothing on some 24 month contracts. Apple's App Store including its payment system bypasses operators completely...Continued

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All is not lost, thankfully. The iPhone appeals to a high-level market segment and Apple may not easily scale down to smaller devices, lower spenders and worldwide distribution including developing nations. Consumer iPhone prices can be very low, but service charges and contract commitments are substantial. Various alternatives including RIM, Nokia's Ovi and Vodafone 360 provide enhanced services while providing operators with more control and a share of incremental revenues. Securing a strong position in the mobile Internet is a most pressing strategic goal for operators early this decade.

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**Operator competition**

Whereas efficiently functioning markets are illustrated by new entrants and consolidation, there has been very little of the latter so far. Successive rounds of spectrum licensing including at 1800 MHz for 2G in the late 1990s and at 2100 MHz for 3G in the beginning of the millennium have steadily increased competitive pressure. Brutal economics in mobile networks and services is taking its toll on operators. EBITDA margins have fallen sharply for many carriers in recent years, with an average of 33 per cent lately. In the UK with five network-based operators plus MVNOs, EBITDA margin percentages languish in the low twenties. CAPEX is being squeezed to European average levels approaching just 10 per cent of revenues.

The proposed merger between Orange UK and T-Mobile UK should reduce the unbearable pricing pressure for all operators in the UK and it will reduce costs for the combined entity. However, the deal's completion could be significantly delayed if the European Commission refers it back to the UK telecom regulator Ofcom. Similarly, France Telecom's Orange Switzerland and TDC's Sunrise are seeking to improve their cost structure and competitive position by merging their Swiss network operations.

I remain sceptical about how effective these joint ventures among multinational mobile operators will be. If this pattern of mergers continues across dozens of nations within Europe and elsewhere, corresponding complex and inefficient management structures will form. Parents' partners will inevitably vary from nation-to-nation, resulting in many different relationships to manage. Many possible synergies will be lost with disparate objectives, preferences and practices among parents.

Swaps such as that suggested between Vodafone Turkey and T-Mobile UK last summer make more sense. For Vodafone, this would have significantly increased share of the home market under its unitary control while reducing the number of national operators for it to manage and avoid the need to compromise on management decisions with a partner.

Unless regulators are intransigent, further consolidation is inevitable--one way or another.

*Keith Mallinson is a leading industry expert, analyst and consultant. Solving business problems in wireless and mobile communications, he founded consulting firm WiseHarbor in 2007.*

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