Telcos in a post-COVID-19 South Africa

Introduction

South Africa is currently under a national state of disaster as a result of the Covid-19 global pandemic. One of the strategic responses instituted by governments across the world has been total or partial lockdowns to advance social distancing in order to slow down the spread of the coronavirus. At its strictest level, only essential services are permitted to operate during the lockdown and working from home has been encouraged, while many people have not been able to work at all. Consequently, business operations, including that of telcos, have been disrupted amidst the economic slowdown.

This whitepaper discusses Deloitte's point of view on the potential scenarios that South African telcos may find themselves in, and how they can respond and chart a successful recovery path over the next 24 months.

Telcos and Covid-19

The most significant impact on businesses within South Africa has been the lockdown measures that have been instituted. Working and schooling from home has raised the demand for connectivity. This unprecedented reliance on connectivity for digital services and customer interactions during a period of personal income uncertainty has raised further concerns on the affordability of data in South Africa. The government has already forced telcos to reduce the costs of mobile data and to provide a small amount of free data to prepaid users. Telcos now feel the pressure of decreasing margins despite disproportionately increasing usage, which requires them to continue investing in network deployments and upgrades.

Life as we know it, is likely to be different after this pandemic and telcos need to prepare their post-covid-19 recovery path.

There are several key drivers to consider however, these are mainly informed by the following two key uncertainties:

- **The ability of the company to monetise critical infrastructure**

  This refers to the ability of the telecommunications industry to monetise its critical network infrastructure considering governmental interventions as well as B2C and B2B purchasing power and willingness to pay

- **The dominant customer interface**

  The type of interface between businesses and their customers, determined by customers' acceptance of digital platforms and self-service options driven by the ability to invest into customer interface digitisation.

Figure 1.1: Two main uncertainties impacting Telcos

These uncertainties do not exist in isolation but interact dynamically to create four possible future scenarios, as shown below:

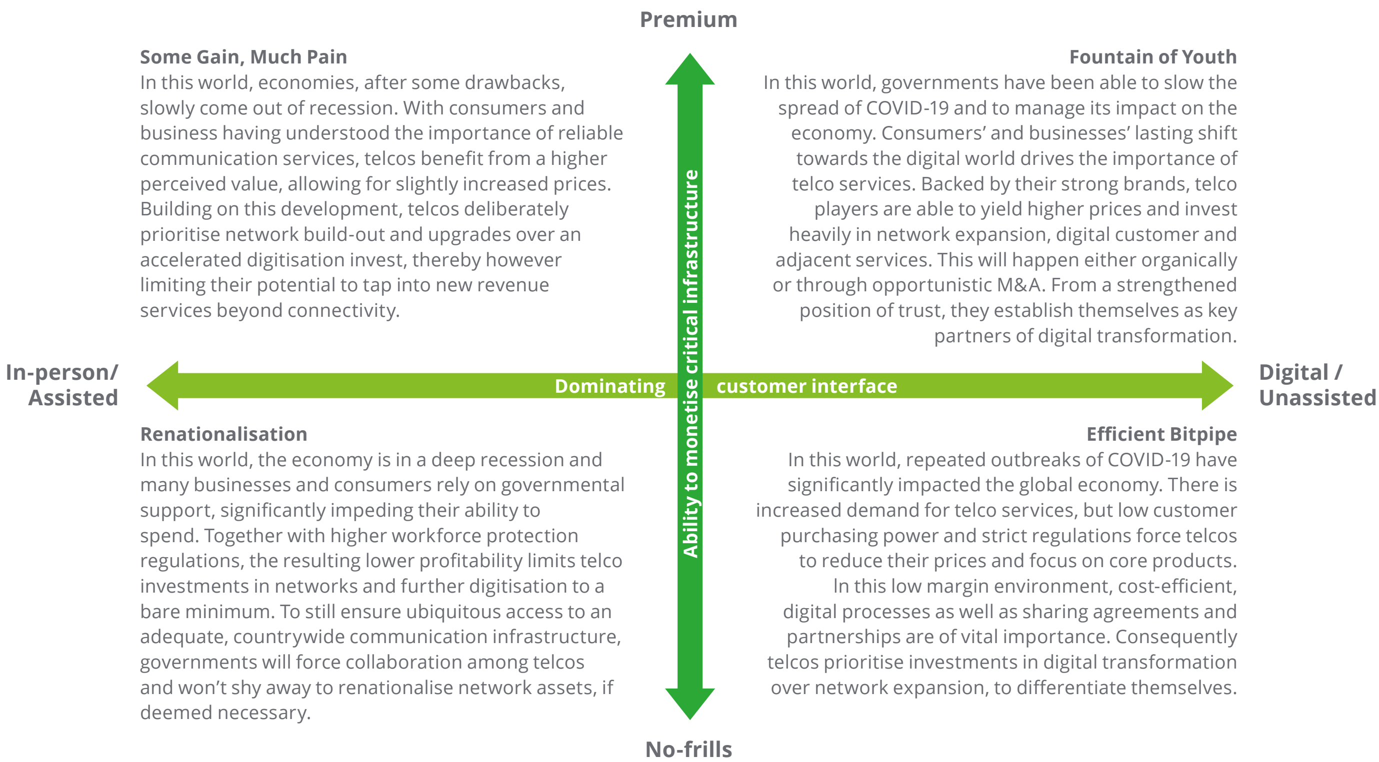

Figure 1.2: Four Telco Scenarios

Our analysis of the South African market indicates that reduced purchasing power and downwards pressure on prices will create a low margin environment. In response, telcos will focus on core products and drive digital transformation to become a low-cost operator that is as digitised as possible – prioritising customer facing processes and interactions in order to differentiate through customer experience while limiting spend.

The challenges

Telcos are experiencing exponential growth in traffic and a subscriber base that is facing tough economic conditions, leading to immense pressure on margins and cashflows. These challenges have been compounded by the effects of Covid-19 related lockdown measures.

Increased **network traffic** and a need for telcos to continue spending on critical infrastructure and digitisation	**Tough economic conditions** reducing **liquidity** and customer/client **spending power** and increased prudence around spending	**Margin** and **cashflow** pressures

Figure 1.3: Telcos are facing multiple challenges

1. Network Traffic Growth

Network traffic, especially data has been rising exponentially over the past few years. Covid-19 lockdown conditions have seen more people working and schooling from home. Entertainment has also fuelled the growth in demand. Some operators have reported almost 50% growth in mobile data traffic and more than 200% traffic in fixed data traffic over the period. As a result, investment has been triggered to implement network upgrades to expand capacity and/or shift it towards the newly created hotspots in residential areas. ICASA has acknowledged this and temporarily released additional spectrum to assist telcos in dealing with this surge.

2. Tough Economic Conditions

The South African economy has slowed down. It has dipped in-and-out of technical recession twice in the past 24 months, following two successive quarters of negative GDP growth. This has done little to contain the rising unemployment rate. Since the implementation of Covid-19 related lockdown measures, several businesses are facing financial difficulties and implemented cost containment strategies, among them salary cuts for employees as well as retrenchments. This has eroded consumer spending power and tightened discretional spending, including for telecom services.

3. Margin and Cashflow Pressure

The need for investment to meet the rising capacity requirements due to traffic growth is happening amid very tough economic conditions and has put immense pressure on Telco margins and cashflows. Operators have also responded to calls by the competition commission to reduce their data pricing.

Strategic Response Framework

Given the above challenges, telcos need to respond strategically and shape their recovery path in a way that enables them to thrive in a post-Covid-19 environment. They need to reduce their costs, establish value creating partnerships, accelerate digital transformation, optimise their networks and offer innovative products/solutions to meet their customers' evolving needs, while challenging regulatory boundaries to redefine and reinvent themselves to remain relevant. The elements we propose all interact with one another and require a holistic consideration under our Strategic Response Framework as shown below:

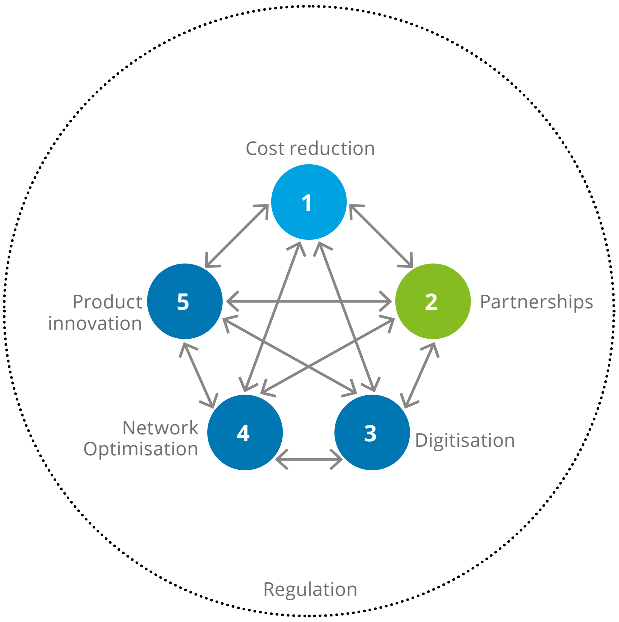

Figure 1.3: Deloitte's Telco Strategic Response Framework

1. Cost Reduction

The telecoms industry in South Africa is maturing and it is becoming more challenging to differentiate on network coverage and performance only. Price reduction is fuelling competition among players, forcing them to engage in a potentially damaging race to the bottom.

Telcos need to identify and achieve efficiencies in all areas to relieve margin pressure. This will be achieved predominantly through the automation of as many processes possible in order to save money and time. Back-end processes such as reporting and order tracking should be streamlined, and front-end activities like call-centre operations consolidated and supported by advanced technology such as AI to speed up resolution of requests. Client interactions should make use of digital channels which are more efficient, while aiming for direct customer ownership to eliminate unnecessary 3rd party interactions e.g. direct airtime distribution instead of using intermediaries. The entire value chain needs to be looked at from a fresh perspective to identify and resolve waste. This might, but not always, lead to head count reduction where applicable.

2. Partnerships

Telcos operate in a fast-changing environment and the shelf-lives of opportunities are becoming shorter, making it difficult to build internal capabilities quickly enough to exploit them. Furthermore, the R&D investments impose further pressure on margins and liquidity. Telcos can partner to accelerate their time to market opportunity and/or realise cost savings. Partnering can represent a competitive advantage and opportunities exist across many points in the value chain, including:

- Products – expanding offering portfolio through packages that have elements of partner products. As an example, partnering with video conferencing app developers to enhance video conferencing-focused packages or offering bundled B2B solutions that were previously not sold together (e.g. payments, insurance, etc.) thus winning sticky customers
- Operations – partner for value creation (e.g. partner with Netflix for more efficient data usage thus costing the customer less while reducing strain on the network), enabling convergence between network and IT technology through Global Cloud infrastructure providers as well as implementing deep network sharing with other market players
- Customers – enter new market segments through partners (e.g. partner to build healthcare and education solutions)
- Financing/investments – risk sharing arrangements with key suppliers and vendors to align investment with revenue profile e.g. data volume models with infrastructure vendors or transaction volume models with value added service suppliers.

3. Digitisation

Many companies are struggling to maintain meaningful customer relationships under lockdown conditions. Digital channels offer an affordable, lockdown-proof and effective touch point with customers. Self-service capabilities need to be expanded on to permanently convert walk in customers to digital channels. Consumers that are reluctant to embrace digital interactions are now forced to use digital channels, providing them with a user friendly, proactive and personalised experience means that most of them will opt for digital channels even after the lockdown.

Digital solutions can be leveraged to enhance operations by using AI and predictive analytics to forecast sales, website traffic, stock management and to generate insights for strategic decision-making. This can also translate to reduced cashflow pressures through more effective working capital management.

4. Network Optimisation

The national lockdown has resulted in a spike in data traffic with many South Africans relying on some form of connectivity to earn a living and to remain informed. Companies and individuals have been forced to change their ways of work in favour of remote working to survive, placing unprecedented reliance on telcos to provide affordable and reliable connectivity. Demand for video- conferencing services has grown exponentially. Telcos have contributed to the fight against COVID-19 by zero-rating access to certain university sites and granting free data to prepaid users. Telcos will need to maintain/improve networks and will therefore need to incur capex despite reducing margins and will face severe judgement on the return generated.

In order to survive, telcos need to find innovative ways to deliver stable connectivity at a lower cost. This could see a rise in shared networks (including WOAN) to optimise capex investments and preserve ROI. Innovative solutions should play a key role in addressing capacity and performance challenges:

- Small Cells – by focusing the network capacity in the specific area requiring it, small cell deployment provides a faster and cost-effective solution and allows telcos to prepare for next generation technologies such as 5G. This has applicability in private enterprise network domains and can be used to support core business operations in manufacturing, logistics and mining sectors thus, opening new revenue streams
- Analytics – telcos are custodians to a large pool of data that is useful to drive informed capex planning and predict network performance. Insights can also be monetised to 3rd parties (e.g. advertising and mall operators) who derive value from them

- Data Centre consolidation – with the convergence of IT and network services, data centres can be consolidated to reduce cost of operations. Developing experience from the internal exercise positions telcos to support similar efforts by their enterprise customers
- Network virtualisation – adoption of software defined networks allows virtual network functions to be defined flexibly and at scale, providing better alignment of the network with the evolving demands of subscribers.

5. Product Innovation

Consumers prefer value and convenience. Furthermore, customers are stickier when they purchase more than one product from a single supplier and the propensity to spend is higher within ecosystems compared to standalone offerings. An opportunity exists for telcos to leverage partnerships with complimentary players, such as OTTs, to create and offer unique packaged solutions.

The income uncertainty faced by businesses and consumers alike during the Covid-19 period is concerning. To minimise bad debts, telcos should use analytics to model a customer's lifetime value and forecast performance to determine appropriate upfront decision-making. Creative pricing models that are dynamic and personalised can act to exploit short-term opportunities at reduced risk.

Today, most SMMEs are either overserved (offered more than they need at a price they cannot afford) or underserved (offered less than what they require, at a lower price than they can afford) by telcos. An opportunity exists for operators to develop suitable plug and play solutions for e-commerce. These could include a platform business model in which SMMEs can register to sell on their products and services to a Telco's subscribers through the Telco's platform in a revenue sharing arrangement. Complementary services such as carrier billing can also be implemented to reduce transaction friction and mistrust. The country relies on SMMEs for job creation and economic growth, such initiatives are an essential corporate social responsibility for telcos.

6. Regulatory

Spectrum is a key ingredient for connectivity. As the industry prepares for 5G, the release of temporary spectrum by ICASA is an opportunity for telcos to demonstrate the economic value of affordable connectivity and influence the pricing philosophy ahead of spectrum auction. There is a case to be made for affordable spectrum and resulting implications for investment, competition and broad access to broadband services. The aim should be to work with government as a strategic partner to deliver the best possible economic outcome, while leveraging the necessary regulatory support when necessary.

Telecoms is a regulated sector in South Africa and it is important for market players to remain compliant. The dynamic and fast paced environment poses a challenge for regulators to remain current and adapt their rules accordingly. This creates an opportunity for telcos who can exploit the grey areas and profitably challenge the status quo – without breaking the law, in line with what was experienced when OTTs first emerged. This is a pre-requisite for disruption and boldness is mandatory. As a first step, operators must look at themselves differently and redefine themselves more broadly in order to begin seeing new possibilities.

Conclusion

The Telecommunications sector is facing multiple challenges, including the growth in network traffic that requires continuous investment and tough economic conditions that are eroding spending power. The pressure on margins and cashflow is immense. This has been compounded by the coronavirus pandemic. While the immediate focus will be to survive, there is a need to lift heads from the woods, think beyond the crisis and use it to position for success beyond it. Deloitte identifies two main uncertainties related to infrastructure monetisation and customer interaction as most critical. These lead to four likely scenarios, but only one is most likely. Our strategic response framework outlines six key elements that must be holistic and assist South African telcos to pick the right position for a chance to succeed in the post-Covid-19 play.

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