

Will Prepaid Service Be the Next Wireless Frontier?

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Profits and growth are slowing for the U.S. wireless industry, but new customers for prepaid services could be the key to a revival.

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U.S. wireless companies are facing difficult times. Although market penetration in the U.S. reached 50 percent of the nation's population this year, double what it was just four years ago, growth is now slowing considerably. In fact, Booz Allen Hamilton and industry analysts estimate that at best the market will top off at about 60 percent in 2005. This means new profitable customers, let alone high value ones, are becoming extremely hard to find.

To snatch up remaining customers, wireless carriers have resorted to such cutthroat tactics as giving away minutes and offering steep discounts on handsets. As a result, the average monthly bill for cell phone service has dropped about 8 percent since 2000, to \$61 from \$66. This implies that carriers are not only slashing prices for new customers, but also for existing subscribers — individuals willing to pay more for

wireless service.

The critical challenge carriers face today is how to capture an incremental customer more profitably without cannibalizing existing subscriber revenue. To accomplish this, wireless companies have to explore unconventional ways to compete for subscriber dollars. One of the more intriguing and potentially lucrative target markets is prepaid wireless, a large untapped segment that could drive the next wave of customer acquisition without compromising sales growth. With this service, people pay up front for mobile usage by, for instance, purchasing a phone card or remitting a monthly fee in advance.

Because this market sector is typically viewed as populated by only non-credit worthy and risky customers, few U.S. wireless companies have paid much attention to developing prepaid wireless strategies. However, close examination of the economics of this segment

shows that it can be an avenue for wireless companies to improve profitability and avoid the pain of jeopardizing revenue in order to increase subscriber volume.

A Fresh Perspective

The first step in seizing the undeveloped opportunities in the prepaid cellular market is to stop viewing its customers as undesirable. Carriers can target a much larger, as well as a more diverse and attractive, set of customers, for which the prepaid plan structure is inherently appealing. They include:

- **Occasional users.** Most likely, these customers already have a cell phone but are unhappy about being locked in to a contract that requires them to pay for upward of 300 minutes per month, which is usually much more time than they need. In fact, an estimated 67 percent of U.S. subscribers use fewer than 180 minutes per month.

- **Teenagers and young adults.** Since most teens and young adults don't have the budget for a postpaid plan, many of them have to piggyback their parents' plans as additional users. From a perspective of customer loyalty and lifetime value, targeting individuals between 16 and 24 for prepaid programs could be lucrative for wireless companies, because many will switch over to a postpaid account later in

control employee spending on work-related cell phone use. In addition, prepaid plans help small businesses avoid wasting time with billing hassles, which is the No. 1 source of wireless customer dissatisfaction. More than 96 percent of all U.S. companies are small businesses.

- **Transient travelers.** A businessperson based in Atlanta who has a local plan and does not want to pay exorbitant roaming fees could

“Potential users of prepaid wireless service are largely untapped segments that could drive the next wave of customer acquisition without compromising sales growth.”

life. Young people also tend to like to experiment with new technology, so they might purchase higher-margin value-added services like e-mail, location-based promotions (such as guides that list the nearest restaurants), and Web browsing. This demographic constitutes 14 percent of the overall population and is growing 70 percent faster than other segments.

- **Hispanics.** Because members of Hispanic households tend to share infrastructure (houses, cars, telephones, etc.), they often prefer prepaid phone cards to avoid keeping track of direct-dial charges for each person. And, compared with other cultures, Hispanic cultures are characterized by a preference for cash-based financial transactions.

- **Small-business owners.** Prepaid programs provide a simple method for small businesses to con-

purchase a prepaid calling plan and rent a handset upon arrival in New York. This would increase calling flexibility at a more reasonable cost. There are 700 million air travelers within North America annually.

Managing Costs, Maximizing Value

Identifying these customers is only the beginning. It's also essential that carriers squeeze all the value they can from prepaid offerings by controlling costs and creating revenue with better services. Doing this requires continuous and innovative management, but it can pay off handsomely, frequently translating into increased earnings, as has been the case in Europe, where prepaid programs are prevalent. For example, Vodafone U.K. increased its prepaid customers from 54 percent of its subscriber base in 1999 to 68

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percent in 2001. During that period, the carrier's EBIDTA margins rose from 31 percent to 35 percent.

There are five key tactics that carriers should consider adopting to

tion channels, such as supermarkets, convenience stores, vending machines, ATMs, and gas stations, to provide prepaid cards and phones. By decreasing the overall

higher margin services, such as mobile e-mail, and specialized short-message content, such as sports scores and financial data, has proven to be popular with prepaid customers, as much or more so than with traditional plan subscribers. However, carriers need to introduce these services gradually to avoid building additional costs into the system as they attempt to generate higher revenues.

3. **Focus on customer retention.** Prepaid customers have very little brand loyalty to their carriers — churn can be as high as 6 percent per month — because wireless companies prefer to avoid contact with these customers to minimize handling costs. But a few low-cost, high-touch strategies could result in

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maximize the value from prepaid plans:

1. **Control acquisition costs.** Since the revenue collected from prepaid customers over the life of their relationship with a wireless company is generally lower than that of postpaid customers, it's important for carriers to reduce expenses linked to prepaid programs. To do this, they should reduce handset subsidies, which are given to postpaid subscribers in exchange for a one-year contract, and instead offer low-cost refurbished phones. Carriers can also cut expenses by installing automated interactive voice response systems for call activation, and by making greater use of third-party distribu-

acquisition cost for prepaid customers by 50 percent, a carrier can recoup costs from prepaid customers within one month instead of about three months.

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2. **Offer value-added services.** Prepaid plans in the U.S. have predominantly been basic voice offerings. In Europe, the introduction of

greater prepaid customer retention. Among them: welcome calls, services for roamers, product promotion through text-based messages on the

cell phone, handset renewal offers, newsletters, and mailings with discount vouchers.

4. Offer innovative pricing plans. Traditional prepaid pricing

flexible payment strategies, such as paying via the Internet, many prepaid customers could gradually be enticed to increase their cell phone usage, and become more familiar

Importantly, though, financial improvements cannot be guaranteed just by increasing the prepaid customer base because other variables — infrastructure costs, overhead, and organizational efficiency, to name a few — affect carrier performance. However, if a carrier pursues a focused strategy based on the multiple levers of value maximization, tight cost management, and a consistent approach to convert the prepaid customers into a postpaid subscriber, the economics of the prepaid customer can be extremely attractive. +

“It’s essential that carriers squeeze all the value they can from prepaid offerings by controlling costs and creating revenue with better services.”

plans were so tightly structured that people who wanted more minutes had no incentive to increase usage. Carriers can earn extra revenue by such offerings as additional minutes per month at a lower rate, rewarding customers with reduced prices for subsequent months based on high usage in prior periods, lower rates for nighttime calls, and discounts when services are added to existing basic prepaid packages.

5. Turn prepaid customers into postpaid subscribers. The prepaid strategy needs to be seen as one among a carrier’s mix of offerings, and not a completely different service, as it is mostly viewed today. If a carrier provides value-added features, varied pricing plans, and even

with all the carrier’s services. Eventually, that could transform more and more prepaid customers into postpaid subscribers.

A Focused Strategy

The most significant aspect of this fresh view of the wireless market is that it reveals a strong two-pronged approach to overcoming slowing growth. First, a prepaid customer acquisition strategy for wireless carriers can target previously neglected consumer segments to drive increases in market share. Second, by focusing on reducing the costs associated with the prepaid service, wireless carriers can rapidly improve financial performance associated with this offering.

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