For many operators, simplification is more important than digital transformation

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In its annual results for FY2017/2018, the Irish operator eir gave further information about the strategic direction followed since the takeover by Xavier Niel's NJJ in April 2018. This strategy provides a counterpoint to the familiar digital transformation narratives of many other operators. This comment explains the logic of this alternative blueprint for operator business transformation.

A strategy driven by physical network capex, not by digital transformation

eir's strategy balances cost savings with new investments.

Major cost savings

- Simplify products
- Cut staff numbers by 25%
- Move headquarters
- Cut spend on external advisors
- Cut media buying

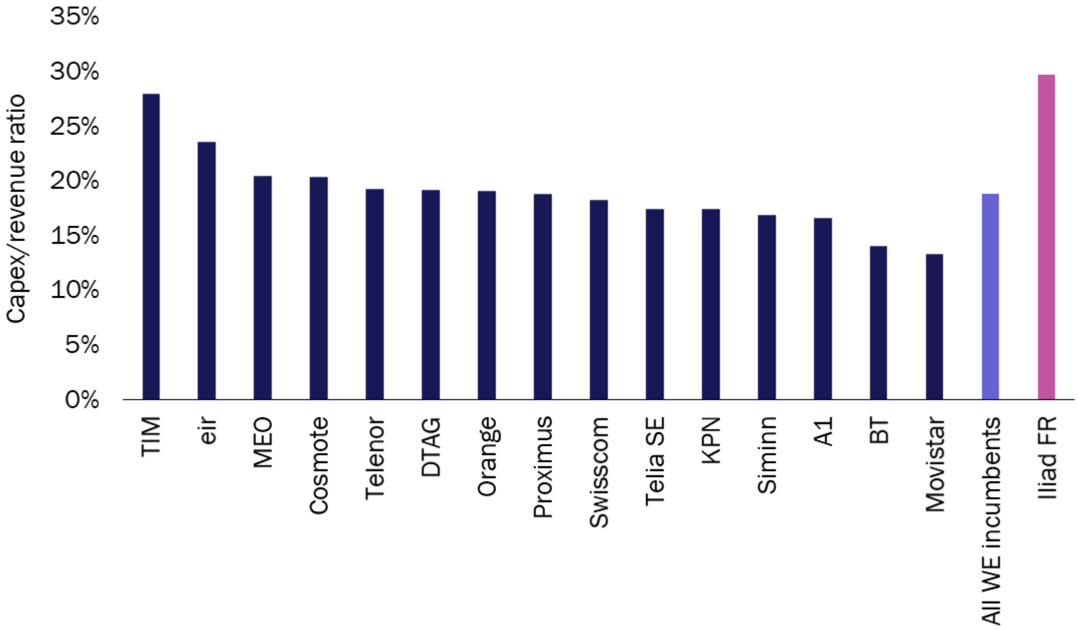
Major investments

- FTTH overbuild of the current FTTC footprint
- Hundreds of new mobile sites
- New IT stack for a smaller product set

The level of cost savings is such that eir expects to achieve improved cash generation.

Figure 1 shows that eir already has the second highest capex/revenue ratio among Western European (WE) incumbent operators after TIM. Next year, eir expects that the capex/revenue ratio will be slightly lower at between 21% and 23%. This is still high compared to that of the rest of the peer group, but European incumbents' capex has been rising for several years. eir's FTTx investment has been hovering at around 40% of the total group capex for a while, and the operator now has a very ambitious plan to go from 11% to 72% FTTH coverage in 5 years.

Figure 1: Capex/revenue ratio for European incumbents, FY2017/2018



Source: Analysys Mason

Figure 1 also shows the capex/revenue ratio for the French operations of Iliad, Niel's main business and a minority shareholder in eir. Iliad has always been intensely capex-driven. It has found opportunities for disruptive market entries, has kept its portfolio ultra-simple and has driven owner-economics through the operating model as it has scaled up. Owning an incumbent is different, but the same priorities are visible at eir: heavy capex, simplified service offerings, a focus on opex reduction and competitiveness in terms of network quality and price. (Having enjoyed many years of success, Iliad has not found life particularly easy in France in the past 9 months: revenue growth in fixed and mobile has dried up. This drove the operator to do something that it has not done for over a decade: put prices up and add a discount layer.)

None of the usual digital buzzwords (such as customer experience/NPS, new digital services, agility and service platforms) get a mention in the latest eir investor presentation. 'Digital transformation' is conspicuous by its absence. Indeed, it is hard to find any other operator that did not make some sort of a nod towards digital transformation in its investor slideware at the end of the last financial year.

Simplification is more immediately important in cost transformation than digitalisation is

Radical cost transformation is a key strategic aim of many operators. Simplification of the product portfolio is one way to achieve this, and M&A is another. Arguably the majority of operators, particularly competitors and smaller national operators, regard digital transformation as one of a number of ways to control costs, rather than a means to achieve some radical transformation of the nature of their business.

Some operators' interest in digital transformation can be whittled down to the following question. How many people in vans and people in call centres does it allow us to get rid of? However, this question forms the basis of a broader strategy to radically alter the size and structure of the workforce, and, as it turns out, digital transformation currently only plays a small role in this scheme.

As well as eir, BT, Telenor and Telstra have recently announced significant job-cut plans. Three of these operators make the connection between product simplification and employment cost savings.

- For eir, "simpler processes mean fewer administrators/managers, and more doers", and therefore the staff number has been cut by 25%. eir has also made it clear that it will be investing less in content and production.
- Telstra plans to reduce its number of basic service plans from 1800 to 20. It will "eliminate 2–4 layers of management" and is targeting 8000 posts, resulting in a "25% reduction in executives and middle management" due to "radically simplified operations and new ways of working".
- Telenor speaks of "clear priorities to deliver on [its] digital transformation agenda, to continue to seek efficiency gains and revenue growth, while simplifying portfolio and way of work". It cut 8% of its workforce in 2017 and will cut a further 6000 employees (about 21% of the workforce) over the next 3 years.
- BT plans to make a gross reduction of 13 000 employees (12% of the workforce) in mainly back-office and middle-management roles over the next 3 years, but instead of emphasising product simplification, it stresses that it will be "launching new converged product offerings to deliver differentiated customer experiences".

None of this means, however, that typical 'analogue' jobs (the kind that digital transformation is meant to sweep away) are necessarily always the ones that will go first. For eir and BT, network engineers for capex projects are ringfenced. BT actually took on 6000 new network engineers. At eir there are around 1100 network engineers, meaning that the reduction in the number of non-network positions is 35%. Both eir and BT also took on call-centre staff. Telstra looks more 'digital' and has taken on 1500 staff in software and cybersecurity, but has cut 9000 others. It says that "in the future, our workforce will be a smaller, knowledge-based one".

Various aspects of digital transformation are inescapable. For example, digital engagement with customers is what consumers and businesses will expect, and it represents an opportunity to cut costs. Beyond that, being perceived as 'digital' may be little more than a signal to investors ("we're engaged in the current best practice") and to the labour market ("consider us as well as tech businesses").

Many smaller operators such as eir struggle to scale their own digital services, and their platforms will exert little gravitational pull. The nature of platform business models is that most will fail. Most operators are lessening their involvement in the video value chain as the popularity of traditional TV declines and the provision of on-demand services becomes dominated by a few international players. Hence adopting a very connectivity-focused model now could prove to be the right decision in the future. What eir can be, however, is a big-hitter locally in connectivity. For eir, FTTH-focused investment could dislodge the cable incumbent that is weighed down by legacy video service baggage.

A handful of operators, at most, have the capability to transform into platform-oriented web-scale or tech businesses that are less shackled to physical access networks, should they really wish to. That capability depends on scale within geo-political and linguistic boundaries and on the power of the organisation to attract talent. For the remaining operators, including all competitor and smaller national operators, digital transformation is just one facet of business transformation, and maybe not even a strategically important one. These operators, which account for over two thirds of global telecoms revenue, would be largely wasting their efforts by attempting to change their business. For them, being digital means selectively applying best practice, but 'digital transformation' is a mix of hyperbole and virtue-signalling.

A new report, *The financial impact of digital transformation: evidence and analysis*, assesses the impact of digital transformation initiatives on operator productivity.

