Technology, Media & Telecommunications Practice

The future of telcos: Mapping the routes to renewed success

For all their efforts to reignite growth, telcos have yet to overcome their fundamental challenges. Doing so is still feasible, but the viable paths will require unprecedented transformation.

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In recent years, telcos have repeatedly attempted to turn around their flagging fortunes by embracing agile ways of working, core-adjacent businesses or services, advanced network technologies, and assorted productivity improvements. Yet these piecemeal efforts have not been sufficient to turn the tide. The challenges the industry faces are fundamental and arguably existential, including massive capital requirements and complex underlying issues. And responses to our recent survey of 60 telco CEOs and other top executives from around the globe show that executives are well aware of these daunting obstacles.

Nevertheless, based on our research and experience in the market, including interviews with telco leaders, we see a few viable options for putting the industry on firmer footing. Telcos can reinvent the integrated business and operating model, move away from the integrated approach by delayering or separating into multiple focused entities, or transform into a utility-like organization with greater emphasis on sustainability, efficiency and more government support.

Fundamental challenges

The massive capital required to develop and maintain increasingly sophisticated telecom networks has certainly taken its toll: the industry has seen its return on invested capital (ROIC) and shareholder returns steadily decline, even as tech companies have harnessed telecom infrastructure to generate unprecedented value creation through the broadband and smartphone revolutions.

However, that investment burden is only one piece of a broader, more complex set of issues that telcos must address head-on in bold, creative ways if they hope to lay the foundation for a more sustainable, long-term future. Those issues can be grouped into three main categories, each offering potential, though often difficult, solutions:

1. *The industry's legacy business models may not produce sufficient profitability and returns to sustain the required levels of capital investments.* Overcoming this may require telcos to embrace new models and extensive, unprecedented collaboration within and beyond the industry to enable alternative revenue sources. For example, streaming or other over-the-top (OTT) providers could pay for use of excess connectivity, or telcos could offer new B2B API-enabled products.

2. *The evolving industry structure and innovations raise the prospect of even tougher competition*. New technologies such as e-SIM will likely reduce barriers to entry; some airlines are already marketing e-SIM packages to travelers who previously would have had to leverage roaming or temporary local offers. Similarly, the emergence of wholesale-only, specialized players in fiber allows new players like utilities and retailers to develop their own telco offerings. Tech champions are likely to launch their own connectivity services while aggressive mobile virtual network operators (MVNOs) and secondary or digital attacker brands are also rolling out in major markets. Some telcos are likely to respond by engaging in at-scale M&A, and major market consolidation may—finally—occur.

3. *Macroeconomic uncertainty may drive a growing wave of regulatory interventions.* Amid challenging economic conditions for consumers, customer-focused regulators in certain geographies may lower or put downward pressure on telcos' average revenue per user. This has already been the case in parts of the EU, where policy makers have implemented rules on price increases. The evolution of existing policies, such as data protection frameworks in emerging markets, will continue to shape the industry, in many cases dictating how telcos leverage customer data (for instance, with proactive outreach and marketing). Addressing this will require stronger and more concerted industry-wide efforts to increase the visibility of the challenges and potential risks of persistent inadequate returns on invested capital.

To gain a better understanding of how the telco industry views its challenges and potential solutions, we surveyed 60 telco CEOs and other top executives from around the globe.[1] Their responses reveal what leaders consider their most pressing concerns: profitability, competition from new business models, and regulatory constraints (Exhibit 1). These concerns inform the three potential paths to renewal that this article will examine.

Given the financial struggles of the past decade and a half, it's easy to see why profitability tops the list of executives' concerns. Investor sentiment has been so negative that even among the telcos that managed to grow their economic profit from 2017 through 2022, half saw no increase in their market value. Worldwide, the only carriers that enjoyed a significant market bump were a relatively small, select group of carriers that grew both their top and bottom lines more than the industry average. In North America and Western Europe, they amounted to just over 10 percent of all operators.

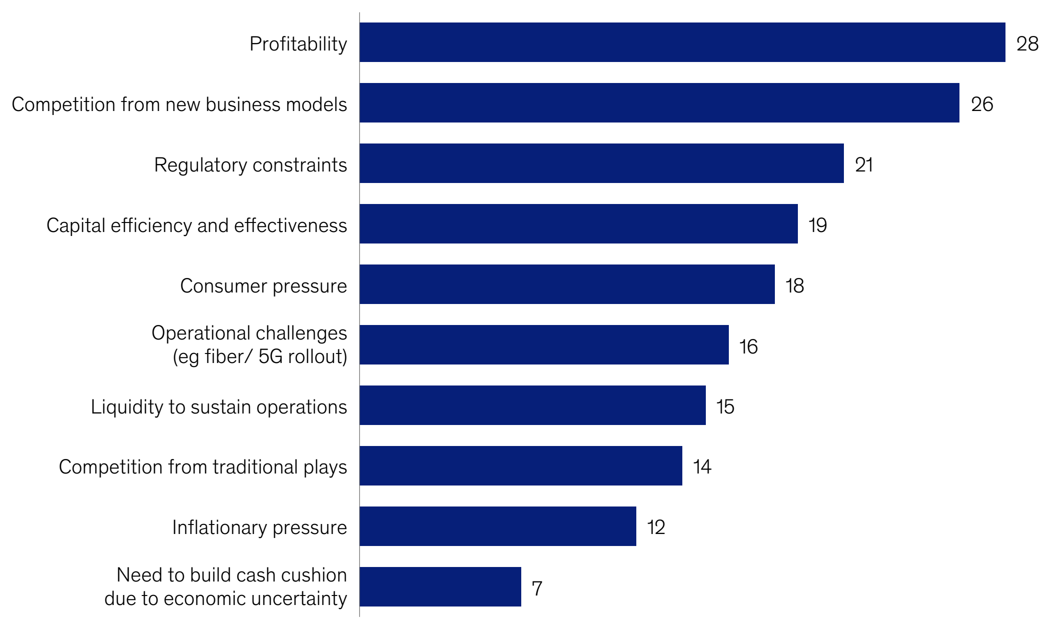
The sector's ongoing capital expenditure (capex) requirements are one of the key drivers of market wariness. While annual revenue growth has stagnated to around 2 percent worldwide—up barely 1 percent in North America, and down by the same figure in Europe—telcos' invested capital growth has outpaced it. And as industry invested capital has soared by around $300 billion since 2018, telcos' ROIC has slowly but steadily declined in North America and Europe, falling roughly 10 to 15 percent from 2018 to 2022.

[1] McKinsey Global Telco Executive Survey, February 2024.

Exhibit 1

Telco leaders identify profitability, new business models, and regulation as the most pressing issues for the future.

Number of telco C-suite executives citing issue as one of their top 3 concerns[1]



[1]Q: *How would you rank your current most pressing urgencies?*
Source: McKinsey Global Telco Executive Survey, Feb 2024 (n = 60)

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Industry leaders don't expect the investment burden to be lifted anytime soon. Around two-thirds of survey respondents predict their capital outlays will accelerate over the next three to five years, but less than a third say they anticipate a similar boost in revenues during the same period. Even so, more than 90 percent of telco CEOs and other leaders agree, at least to some extent, that the industry will continue to be a major source of innovation and economic growth in the coming years, with many saying the sector's enabling role will become even greater than it has been. As one CEO of a global integrated telco told us, "Telecom is the centerpiece of our era now. All innovations need strong telecom infrastructure."

Of course, that optimism about telcos' future importance doesn't necessarily translate to a bullish view of their own success. Only about half of those surveyed predict the industry's current dynamics will improve in the next decade. One executive was skeptical of the sector's ability to embrace fundamental change: "There is not enough impulse in the industry to change the business model. Companies are concentrating on restructuring rather than innovation." Whether or not that is an accurate assessment of the industry's capacity for change, there is no denying that the industry still has an opportunity to radically remake its business.

Three main options for a stronger future

Based on our research and experience in the market, including interviews with telco leaders, we have identified three viable paths for the industry to reach renewed success.

Reinventing the integrated telco business and operating model

If the entire model an industry has long relied upon for consistent growth and profitability is no longer up to the task, then it makes sense to try to come up with something better. As telcos set out to do just that, there are two main approaches they can leverage: boosting efficiency and effectiveness, and pursuing growth at scale.

Boost efficiency and effectiveness. Telco survey respondents cited digital technologies, organizational rethinking, and investment sharing as the most important levers for future value creation (Exhibit 2). We agree that the sector's best opportunities to turn things around with their current core business revolve around those areas.

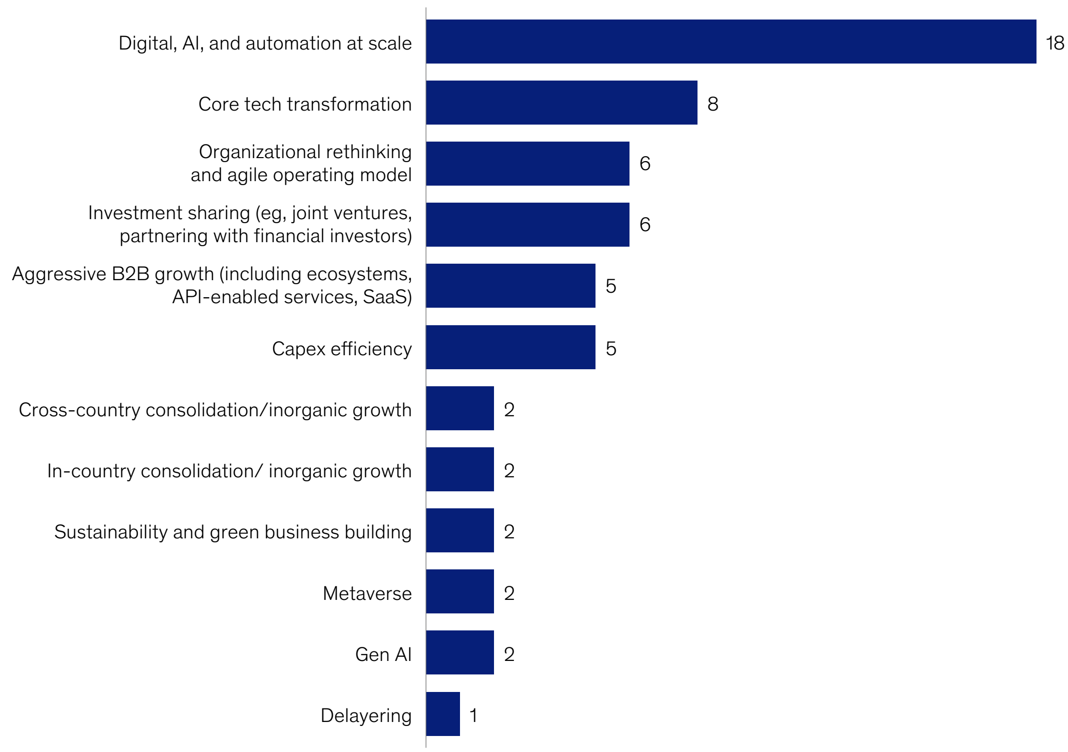
— *Redesigning the operating model.* Telcos can begin to lay a new, streamlined foundation for success with a comprehensive, digital-driven redesign of the entire operating model. In such an overhaul of the organization, telco leaders should act as if they are starting entirely from scratch, devising an enterprise unencumbered by current constraints while making clear that the transformation is one of their top priorities. To succeed, this shift has to have an impact on all key functions, from customer care, marketing and sales, and customer value management to finance, accounting, and strategy.

  Digital, AI/generative AI (gen AI), data, and automation need to be at the center of virtually all business activities, enabling a flexible and resilient organization that can benefit all stakeholders, including customers, employees, and investors. These tools can drive the transformation of telcos into truly customer-centric enterprises, where personalization and a product- and channel-agnostic perspective are the order of the day. For example, telcos can leverage granular user data to make individualized plan and device recommendations, promos, and other outreach. Or carriers' service teams can use AI technology to troubleshoot and resolve potential technical problems before customers have even noticed them. If telcos can eventually pull off such an ambitious shift, to the point that virtually all customer interactions are personalized, the rewards can be sizable. Previous McKinsey research has shown that holistic transformation

Exhibit 2

Critical levers for value creation include digital technologies, organizational transformation, investment sharing/capex efficiency, and B2B growth.

Share of telco C-suite executives citing lever as most important for future value creation,[1] %



[1]Q: *How would you rank the top 3 levers you are trying to deploy for value creation?*
Source: McKinsey Global Telco Executive Survey, Feb 2024 (n = 60)

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can increase incremental revenue by up to 8 percent a year, reduce the cost to serve by 10 to 15 percent, and drive up customer satisfaction scores by 20 to 40 points.[2]

— *Investment sharing.* On the capital side, telcos can use a collaborative model to reduce the toll that network and infrastructure investments have taken on ROIC. Several approaches have already shown promise, starting with basic network sharing between operators. Network sharing has taken off in the past several years, as telcos realized just how costly it would be to build 5G infrastructure. In the 2010s, the number of network-sharing deals announced globally skyrocketed, reaching nearly 500 by 2020. The appeal is easy to see; depending on the specific type of network sharing (passive, active, and so on), these partnerships can save 10 to 25 percent in operating expenses and 15 to 40 percent in capital expenses. Fully a quarter to a third of EU wireless subscribers now have their calls, texts, and data transmitted on actively shared networks.

[2] Duarte Begonha, Jacopo Ghidoni, and Olli Salo, with Annalisa Gradogna, “Model makeover: Turning a telco into a customer-centric techco,” McKinsey, May 28, 2024.

Other approaches include establishing a new independent entity to share and lessen the necessary capex or attracting third-party investment in new wholesale opportunities. In Malaysia, for instance, the government has created a separate wholesale network operator to design, build, operate, and maintain the country's sole 5G network, from which different carriers share capacity. Malaysian telecom regulators estimate that it would cost individual telcos 30 to 60 percent more to develop their own 5G infrastructure than it will through the wholesale network operator. This entity is not allowed to sell its own retail services and is required to provide equal and transparent access and pricing to all mobile operators in the country. For their part, the carriers are not allowed to develop or market their own existing 5G spectrum.[3]

Another example is in Italy, where an energy incumbent and a state-owned investment fund established the Open Fiber joint venture to develop an independent, wholesale fiber-to-the-home (FTTH) network. A clear mission, dedicated project financing, independent and wholesale-only positioning, and effective reuse of existing infrastructure (including the shareholder's) enabled a much faster rollout and lower capital spending than other operators could pull off; by 2023, after just seven years in existence, the new player had gained access to almost 15 million households (in both urban and rural locales) through contracts with more than 300 players and almost three million active customers.

The idea of partnering with energy companies or other enterprises with their own complementary, widespread physical infrastructure to quicken the pace and reduce the cost of network build-out is gaining momentum in the industry. Many telcos and other telecom players have joined forces with utility companies to tap their existing poles and fiber ducts for their 5G and fiber deployments. In 2021, US wireless infrastructure provider SBA Communications spent nearly $1 billion for the rights to attach wireless antennas on PG&E's thousands of transmission towers. The goal is to speed the transition from the traditional tower-based, macro site network that isn't scalable for 5G to one that uses small cells.

Yet another potential avenue for telcos looking to reduce the cost of infrastructure is to work with their peers in the satellite sector. Though regulation, costs, and manufacturing capacity are still issues, recent advances in low-earth-orbit (LEO) satellite technology allow for lower latency and higher speeds than their geostationary predecessors. Combined with the fact that such solutions can be set up faster than traditional fiber, it's no wonder that growing numbers of telcos are considering partnering with LEO providers to help plug holes and improve service in their coverage maps, especially in remote, low-density rural areas where dead zones are more prevalent. This could be particularly attractive in certain parts of the world, such as Africa, India, Latin America, and Central Asia, where internet access is more the exception than the rule; even today, fully 43 percent of the world's households lack web access.

Pursue growth at scale. Instead of focusing primarily on maximizing the earnings potential of their existing portfolio, telcos can also try to expand their business by tapping new revenue sources altogether. Going "beyond the core" with B2C or B2B products also can help sustain the core connectivity business, as cross-selling additional services to existing customers can deepen customer engagement and reduce churn. Telcos have historically struggled with their core-adjacent efforts, but that hasn't dulled their allure. The variety of opportunities are in the following areas:

— *B2C opportunities.* On the direct-to-consumer side, areas that have proved fruitful include fintech, home security, gaming, travel, and advertising. In 2020, for instance, Spain telco Movistar, in a joint venture with security services company Prosegur, launched a home security product that was able to gain 400,000-plus customers in its first year of

[3] "DNB: A financially sustainable 5G catalyst that benefits consumers and businesses," *The Edge Malaysia,* December 26, 2022.

operation.[4] In 2023, UK media and telecom operator Sky debuted a home insurance product to be paired with smart-home technology,[5] while in 2024, Italian operator Wind Tre launched an insurance product paired with traditional connectivity services. Telcos such as Docomo already make around 20 percent or more of their revenues from beyond the core products.

— *B2B opportunities.* In the B2B space, the industry is hoping that network application programming interfaces (APIs) can significantly improve its 5G monetization efforts. If developed successfully, APIs could be critical tools for enterprises to create compelling new applications that depend on 5G features such as speed on demand, low latency connections, speed tiering, and edge compute discovery. These could range from more immediate use cases such as credit card fraud prevention and glitch-free videoconferencing to future advances like remotely operated equipment and semi-autonomous vehicles in production environments. Previous McKinsey research estimated that the network API market could unlock around $100 billion to $300 billion in connectivity- and edge-computing-related revenue for telcos, as well as an addition $10 billion to $30 billion from APIs themselves, over the next five to seven years.[6]

  For telcos to get their fair share of that opportunity, they will have to develop a supply of fully interoperable APIs that work seamlessly across global networks. And only by collaborating at an unprecedented level—both among themselves and with a range of third parties, including vendors, system integrators, and enterprise developers—can they have a chance to do so. "Partner relationships are still somewhat transactional and need to be developed to be more strategic and deeper," noted the CEO of one global operator. In September, there was an encouraging sign on this front, as some of the sector's biggest carriers (including Deutsche Telekom, AT&T, Orange, Singtel, Telstra, and Verizon) announced a joint venture with equipment giant Ericsson to collaborate and sell interoperable network APIs globally to a wide range of developer platforms.[7]

— *Green energy.* The ongoing secular shift to green energy presents another opportunity for renewing telcos' growth. By investing in its own net-zero goals as well as new sustainability offerings and businesses, the industry can improve not just its top and bottom lines, but also its appeal to stakeholders including investors, government, customers, and talent. In a market with more than $50 trillion of assets under management by environmental, social, and governance (ESG) investors, telcos entering this dynamic arena could be rewarded with higher valuations as well as outside investment. At the same time, with 30 to 50 percent of industry corporate profits potentially affected by stronger environmental regulation, telcos have ample motivation to focus more on green solutions. Customers across industries are already showing a willingness to pay a premium (15 to 30 percent) for sustainably produced goods and services, while young talent is increasingly drawn to employers with a real demonstrated commitment to ESG.

An additional attraction to telcos is the $9 trillion to $12 trillion of value expected to be created in the green energy transition.[8] Telcos are well placed to play a big role in this evolving economy, given their core connectivity assets, wealth of proprietary consumer data, vast retail distribution footprint, field technician workforce, and existing

[4] Lars Engel Nielsen, Thomas Joseph, João Leonardo, and Benedict Vanderspar, "Thinking like a 'ServCo': How telcos can drive B2C growth," McKinsey, November 15, 2022.
[5] Avi Ben-Hutta, "Sky introduces smart home insurance," Coverager, May 2, 2023.
[6] Cristina Dexeus, Ferry Grijpink, Francesco Libera, and Andrea Travasoni, "What it will take for telcos to unlock value from network APIs," McKinsey, February 21, 2024.
[7] "How Ericsson is redefining digitalization through a groundbreaking new partnership," Ericsson, September 12, 2024.
[8] "Playing offense to create value in the net-zero transition," McKinsey, April 13, 2022.

customer relationships and presence in their homes. Promising areas ripe for telcos include 5G sustainability applications, net-zero home solutions, and green cloud services. Some early mover telcos have already struck partnerships with energy companies to market integrated solar distributed generation (DG) products that customers can operate, monitor, and maintain on their own. Over the long term, these types of services have the potential to spur organic, incremental growth while reducing churn, saving energy operating expenses, and burnishing telcos' green credentials and branding. The broader ambition is that such a product can serve as a linchpin for a variety of additional smart-home services carriers can offer, from home security and electric vehicle charging to health monitoring and entertainment.

Delayering: Separation into multiple independent and agile entities

The economic and financial challenges that telcos have faced of late have proved so formidable that many industry participants believe only a dramatic transformation can turn things around. In this view, the only way to become a more efficient, effective enterprise or drive significant new growth and keep up with today's rapid pace of disruption and innovation is to break up the traditional integrated telco model completely.

By delayering (separating the single company into various dynamic, independent units), the thinking goes, telcos can finally unleash their hidden strengths that have been buried in massive, overly complex and bureaucratic organizations.[9] Many investors are well aware of the underappreciated value in the industry. In recent years, they have snapped up tens of thousands of towers annually to create highly focused companies that have grown faster and been valued notably higher than their former parents.

There are different ways to go about this type of transformation. The most common is to delink the services side of a telco, or "ServCo," from the infrastructure or network side, often referred to as the "NetCo" or "InfraCo," which can become a carrier-neutral wholesale access provider that suddenly has a much bigger potential customer base of other operators.[10] The groupings can be based on various factors, such as customers, products, business models, investment horizons, capital allocation, or even skills and capabilities.

One operator based in the Middle East and North Africa, e& (formerly Etisalat), took its own distinct approach[11]: it gave birth to five new verticals, including two different geographic traditional telcos (one for the United Arab Emirates and another for all its other international markets), a consumer digital unit (fintech and content OTT services, for instance), and an enterprise digital unit (cloud, AI, cybersecurity), as well as a capital investments group for venture capital and private-equity funding. The company has already had more success attracting relevant talent because of each entity's specific culture and career tracks. Also, its tailored operating models optimize management's focus and decision making, and the specialization and transparency attract more investor interest.

How to do it. Regardless of which specific delayering model a telco chooses, some common elements are essential to achieving success:

— Create independent units with a single-minded focus on pure-play growth, each putting its customers at the center.

— Have new entities closely collaborate where appropriate and legal (for example, by sharing data or best practices/governance) to capture as many ecosystem benefits as possible.

— Enable full performance transparency with three to four targeted, differentiated key performance indicators and no hidden cross-subsidies.

[9] Kim Baroudy, Cristina Dexeus, and Andrea Travasoni, "Delayering: An organizational overhaul for growing Europe's telcos," McKinsey, February 23, 2023.
[10] "Can telcos create more value by breaking up?" McKinsey, January 22, 2020.
[11] "e& Group CEO: Transforming from a telco to a techco," McKinsey, December 9, 2022.

— Create distinct talent and people offerings with unique schemes for attraction, progression, retention, and incentivization.

— Articulate clearer stories to investors in order to attract different investor profiles, allow for a longer investment horizon, and as a result, potentially enjoy higher valuation multiples than a traditional telco would achieve.

— Open opportunities for M&A, joint ventures, and partnerships that may not otherwise exist, given interconnections between units.

The pros and cons. The payoffs of delayering can vary. The models for such an overhaul have their own value propositions and financial implications, with different growth and margin expectations and, consequently, different market multiples.

Turkcell, Turkey's leading mobile carrier, with $4 billion in revenues and operations spanning Eastern Europe, keyed in on the B2C and B2B models when it delayered in 2018. In this case, that meant spinning off its portfolio of digital services into stand-alone platforms, ranging from messaging, entertainment, and fintech to cloud and other enterprise offerings. By fiscal year 2021, it had already generated $150 million in separate revenues from these newly independent units, accounting for 8 percent of the enterprise's total.[12]

That kind of impact is impressive, but delayering is by no means a silver bullet. Pulling off such a radical transformation takes total commitment (from board and top management on down), time (up to two to three years typically), and significant capital (upwards of $1 billion in some previous cases). Some telcos believe a better investment of time, capital, and attention would be directed toward developing new products or capabilities. Others think delayering detracts from the ability to differentiate the company in a crowded marketplace with assets like the network experience or 5G features, such as traffic prioritization. Without having a NetCo as its corporate cousin, for instance, a ServCo risks losing preferential treatment through levers such as price differentiation or cross-subsidization and control of product development that depend on complex network integration. Conversely, the NetCo, once it is disintermediated by the ServCo, can face new obstacles to optimizing its investments. Without access to its direct customer relationships, the provider has much less insight into the best way to approach critical issues like deployment, densification, and maintenance.

Also, at a time when the industry is taking great pains to be more customer centric, presenting a seamless and personalized omnichannel experience, some telcos worry that delayering will inhibit their ability to offer effective, cross-entity product bundling, accelerated cross-sell, and one-stop-shop customer service. Another concern rests on the prospects for data aggregation and monetization across a delayered organization's entities, particularly with stronger data protection regimes like the EU's General Data Protection Regulation (GDPR) becoming more ubiquitous. Still, many in the industry remain convinced that ultimately the long-term benefits of delayering will outweigh the transitional challenges.

Shifting to a utility-like business and operating model

Regardless of telco leaders' optimism or pessimism about their sector's prospects, there appears to be a broad consensus on at least one fundamental shift on the horizon. Close to three-quarters of those we surveyed say their organization would benefit from changing its archetype in the next five to ten years. Of these respondents, the largest share identifies a turn away from the traditional integrated telco model as their most likely and advantageous path (Exhibit 3).

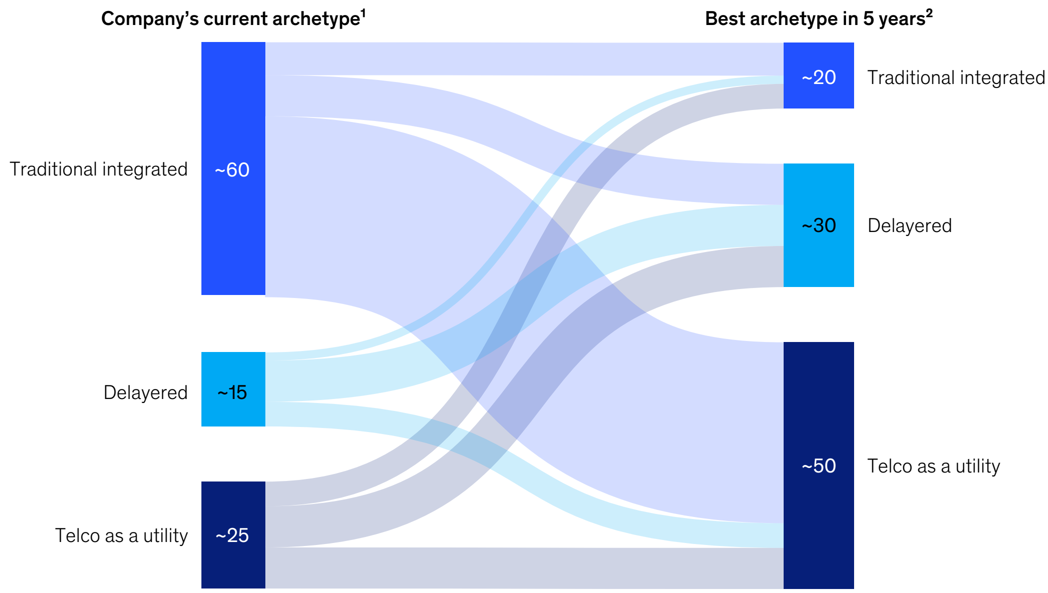
This view says a lot about the current state of the telco business. While close to a third of those surveyed say a delayered archetype is the most suitable over the next decade, more than half

[12] "How telcos can succeed in launching new businesses beyond connectivity," McKinsey, February 25, 2022.

Exhibit 3

Most leaders see shifting away from the traditional telco model as the optimal path forward for the industry.

Current telco archetype vs expected best future archetype, % of respondents



[1]Q: *Which telco archetype is your company currently?*
[2]Q: *Which telco archetype will be best positioned for the next 5–10 years?*
Source: McKinsey Global Telco Executive Survey, Feb 2024 (n = 60)

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say the best fit will be a more radical departure from today's predominant model: a shift to a utility model.

That may sound like an admission that reigniting sustained growth is unattainable, and in some ways, it is. According to many leaders, if the telco market is ultimately not going to grow faster than GDP, the sensible approach is to make a virtue of the sector's limitations. In other words, instead of simply *partnering with* utilities to help lower crippling infrastructure costs, they might as well take it one step further, to all but *becoming* one.

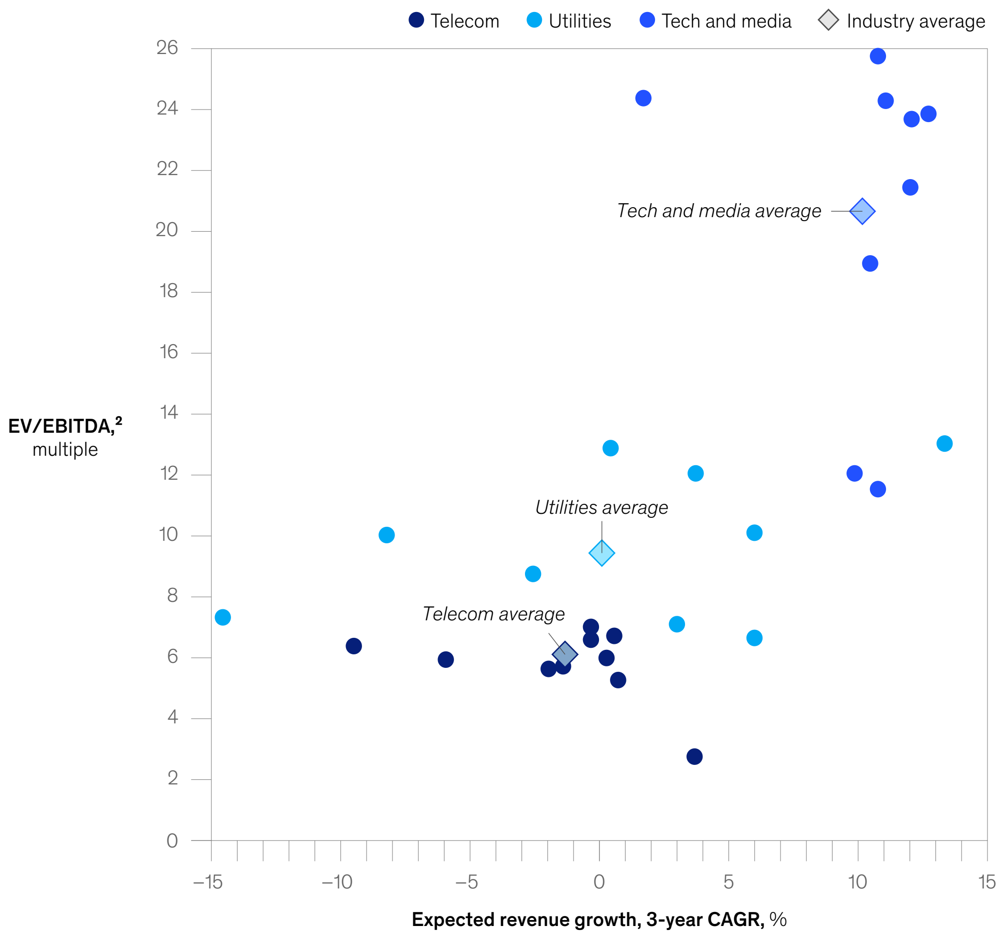
A long-standing image of utilities is that they are stodgy, but in recent years, investors have viewed them more favorably than telcos. In terms of enterprise value to EBITDA ratios and expected revenue growth, investors rate utilities somewhere between high-growth tech and media companies and slow-to-no-growth telcos (Exhibit 4). To a certain extent, telco investors have already indicated that they prefer the less ambitious approach. Our analysis shows they value low-risk, reliable cash flows more than potential future earnings growth, even for carriers with justifiably high expectations.

In addition, telcos and utilities attract comparable investor bases, with both boasting relatively high proportions of government and corporate ownership. Telcos and utilities also have more concentrated ownership than tech and media companies: in each industry, the top 20 investors account for more than two-thirds of shares.

Exhibit 4

Investors are more bullish about the long-term prospects of tech/media and utilities than of telcos.

Expected enterprise valuation multiple and revenue growth, FY 2025E[1]



[1]Based on market expectation in Q3 2024.
[2]Enterprise value to earnings before interest, taxes, depreciation, and amortization.
Source: MVIP; McKinsey analysis

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It's one thing, of course, to have a financial rationale for such a significant overhaul. In practice, shifting to a utility-like model would require telcos to make a series of moves:

— Increase the emphasis on efficiency over growth. Key to this is streamlining processes to make the operations base leaner and more cost-effective while derisking the business's overall cash profile. If telcos move away from the volatility of a more traditional customer-facing and highly competitive business and embrace simpler offer and product structures, they can squarely focus on achieving long-term sustainable margins and profits. An essential part of this transformation will be to leverage gen AI in several emerging use cases in areas such as customer service and networks.

— Reduce overall capex intensity through investment sharing or optimized capex profiles. As part of this effort, telcos may want to align infrastructure investments with a national strategy and goals to prove their status as a critical asset.

— Pursue regulatory support, including government funding or subsidies (reduced spectrum prices, for instance) to help ensure and enforce sustainable telco investments in innovative infrastructure and technology while maintaining a higher ROIC. Financial support could include the setting of cost-based prices by applying the regulatory asset base (RAB) framework, valuing a carrier's network investments in much the same way that some countries use with electricity or gas providers.

Despite the complicated challenges they continue to face, telcos can shape a new era of sustained success for themselves. The industry still has an array of valuable and enviable assets at its disposal— powerful brands, large customer bases and sales channels, rich data sets, vast infrastructure, and skilled talent pools. And real valuable opportunities exist, none larger than the chance to fundamentally reinvent themselves for a rapidly shifting era, regardless of which path they ultimately choose. Yet none of that is to minimize the complexity or difficulty of undertaking these necessary transformations. Even at the outset, telcos attempting to figure out which path to pursue will be forced to make tough choices, often in rapid succession, and then continue to move fast to adjust their approach and operating model as they make their way to their desired destination.

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