

## Blueprint for Broadband Success

### A Three Phased Strategy for Building Cable Operators' Competitive Advantage and Enterprise Value – Part One

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Cable operators today are in the position to gain new revenue streams, retain subscribers, and elevate competitive position in an increasingly challenging market. Offering advanced services with the triple play of digital video, high-speed Internet access, and voice over IP phone service can increase average revenue per subscriber, create new growth opportunities, and establish a framework for competitive differentiation.

Cable operators face increasingly complex network and plant requirements, regulatory imperatives, growing competitive pressures from satellite providers and RBOCs, and increased levels of customer expectations. Achieving long term market success for today's cable operators requires a proven path. This article outlines three steps to address current pressures and provide a foundation for growth and potential acquisitions. The most critical factor in the enduring suc-

cess of the cable operator is the commitment to the long-term execution of a strategic plan. This article outlines a blueprint comprised of three phases — **Strengthen, Extend, Expand** — to assist the cable operator to excel across every facet of the business development.

#### Phase One: Strengthen

An investment of time and capital is necessary to deliver high quality broadband services over complex networks. During the strengthen phase, the cable operator performs a situation assessment to gain a comprehensive understanding of its customers, capabilities, and the competition. The cable operator then uses that knowledge to improve its infrastructure quality and customer experience to levels that can support the developments of phases two and three. It is critical that, during the strengthen phase, the physical plant (the primary asset for

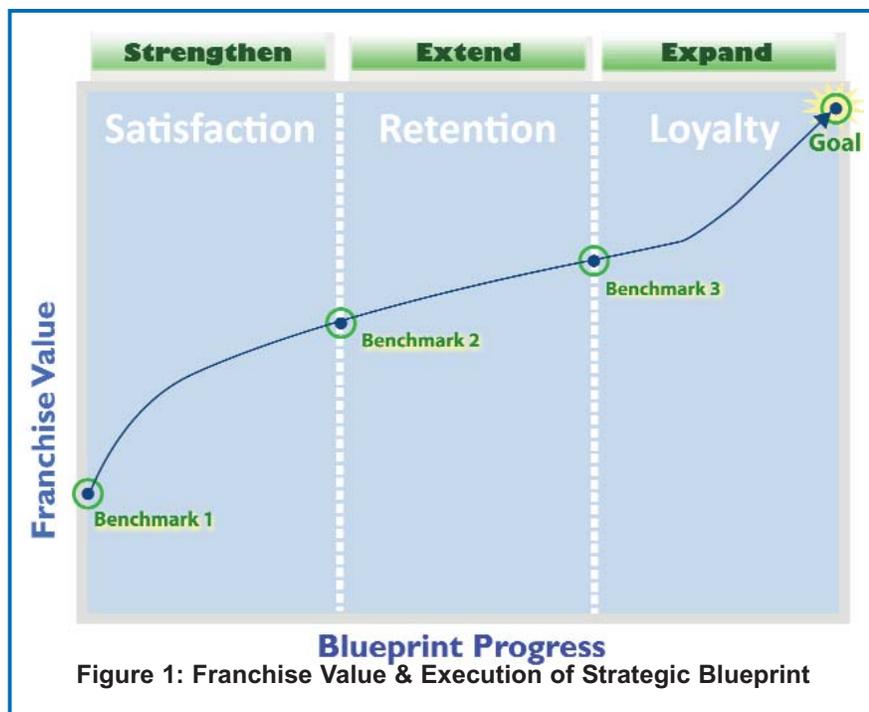
an cable operator) be built up to a quality level that will enable the cable operator to generate new revenue streams and sustain high quality customer experience in the subsequent phases.

#### Phase Two: Extend

After the cable operator has ensured the strength of its foundation, it can move on to significantly increase revenues and reap the returns from investments made during the strengthen phase — extending its competitive position through a superior subscriber experience. Enhancing the overall customer experience with new services can increase subscriber retention levels, number of users, total revenues, and average revenue per subscriber. Deploying new services methodically creates a seamless transition. The extend phase advances the cable operator from the above average status achieved during the strengthen phase to a benchmark level of performance — resulting in a competitive advantage and setting the stage for the expand phase.

#### Phase Three: Expand

During the expand phase the cable operator focuses on the value benefit the investments of the previous phases and reaches a level of world-class performance across all facets of the business. After phases one and two, the cable operator has established efficient and well-run technical assets, loyal customers, delivery of the services customers demand, increased average revenue, and increased margin per user. Now, economies of scale and stronger customer loyalty allow the cable operator to provide world-class service at a decreased cost. The cable operator can reinvest those savings in the business, increase its value through market share expansion, and take advantage of the expanding commercial market.



The resulting operational performance strongly positions cable operator executives and owners for future M&A negotiations (where access to affordable growth capital will be driven by proven performance). Franchise valuations for cable operators are inextricably tied to discounted forward cash flows, revenue per subscriber, and, increasingly, to customer satisfaction and retention levels.<sup>1</sup> This article outlines the current competitive environment facing cable operators and a strategic approach that will maximize key valuation metrics.

## **The 2008 Market Landscape for Cable Operators**

Cable operators face an array of market forces, including: an increasingly complex physical and network infrastructure environment, competitive pressures from telecommunications and satellite companies, and increasingly sophisticated subscriber expectations.

## **Increasingly Complex Infrastructure and Network Environment**

Over the past fifty years, cable evolved from a one-way, limited channel provider to high levels of channel availability. Today it is a complex system including video on demand, pay per view, and HDTV.

During the first four decades of market development, the relatively slow customer adoption rates resulted in an industry with longer than average technology development lifecycles. The gradual pace of change allowed most operators to respond to changing technology with stability and without substantial strain on existing resources or capital, to accept the multitude of signals, modulate and put those signals onto channels, and provide reliable delivery to subscribers' homes. Cable operators remained focused on broadcast video and efficiently managed resources, knowledge development, and customer needs

When the opportunities to provide high-speed Internet services over cable systems began to take hold in the late 1990's, the pace quickened. The time-to-market requirements for implementing new technologies and services became compressed. Cable systems became two-way networks with an entirely new set of data streams generated in subscribers'

homes and transmitted to the internet via the head end. Operators wishing to remain competitive faced new investments in capital equipment and increased delivery pipe size.<sup>2</sup>

As consumers realized that broadband was more efficient than dial up and could provide new types of multi-media content, operators faced a simultaneous increase in network users and bandwidth usage per user. These factors drove increased demand for bandwidth and high speed data (HSD) services. According to the SNL Kagan, in 2007 growth in high speed data subscribers as a percentage of all basic cable subscribers across industry have surpassed the 50% threshold, up from just 11% only six years ago.<sup>3</sup>

The R&D and operating costs to provide superior service in this rapidly changing environment are significant and leave little room for error. Outsourcing partner can share some of the burden with the MSO, especially in areas such as diagnostics and provisioning. Providers such as IBBS can provide MSOs with a competitive edge in this dynamic and challenging environment.

## **Managing Multiple Devices**

Managing the increased complexity of physical infrastructure involving multiple devices is a growing challenge for cable operators. What began in the customer's home as a simple cable set-top box has advanced to include a cable modem and a router connected to multiple computers. The addition of voice over IP (VoIP) brings yet another device over the cable system for telephone service. Cable operators have had to quickly learn how to manage complex two-way networks with multiple computers, routers, and telephones. In order to fully support these complex networks, a technically trained staff is required; however, with a set amount of financial resources obtaining the level of expertise necessary is difficult.

Market change will continue to accelerate with converters being placed in the home due to the digital conversion required by the FCC in 2009. These will bring about additional challenges to network operations. Cable operators will again need to increase resources for expertise, knowledge, and computing capability in order to remain competitive in the evolving market. Partnering with a

solutions provider of managed network services, diagnostics and provisioning, such as IBBS, can provide a competitive edge in a rapidly changing market environment, as many MSOs have already discovered.

## **Delivering and Managing a Changing Services Mix**

Many customers find it challenging to add new customers and services while sustaining an acceptable user experience.

Without the proper knowledge, support, and infrastructure to manage the rapid rates of adoption and deployment, MSOs can find themselves in a vulnerable position.

Cable operators that cannot meet rising consumer demands for expanded and integrated multi-modal service options (web, call center, and email) run the risk of experiencing unacceptable service levels, prompting customers to take their business for TV, telephone, and Internet elsewhere. According to a 2007 survey of over 4,700 cable and telecommunication consumers, Forrester Research found that a majority of service providers are not delivering a level of customer care that would encourage subscribers to recommend their service. Data suggests that an increase in the number of services purchased from a single provider does not necessarily translate into increased levels of satisfaction, but can actually weaken the customer's perception of quality care.<sup>4</sup> In order to avoid churn in the competitive state of the market today and the numerous options heavily marketed to consumers, cable operators will need to carefully monitor the quality of their customer care across the services they provide.

Additionally, the current delivery, management, and billing of services are often "silo-based" and provide limited integration between services. This model restricts the overall potential increase in market adoption of triple play services from a single provider. It is costly to the provider and disruptive to the customer who desires one-stop service and billing.

Working toward the long term goal of creating a convergent multi-service environment built on a foundation of network infrastructure and quality customer experience will maximize the value of triple play and enable the cable operator to provide superior service to its customers.

## Subscriber Expectations Increasing

Along with increased usage, content rich applications have led to substantial strain on the network. Users are no longer simply downloading from the Internet, but uploading rich multi-media content from the home to the Internet. The user expects to be able to upload content with the same relative efficiency as downloading, but it is the uploading experience that is most constraining and challenging for the broadband system. In order to enable these activities with the required speed demanded by users, many operators will find it necessary to provide “synchronous” upload and download bandwidth.

## Growing Demand for Bandwidth

Network constraints and the demand for bandwidth intensify as subscribers develop a seemingly insatiable need for dynamic Internet experiences. In order to appease customers who are frustrated by what they perceive as slow service, cable operators are being put in the position of having to make an investment to provide higher performing networks without taking part in the new revenue streams generated by the consumption of rich content.<sup>5</sup>

This “expectation inversion” means that the customer gets the benefit of a higher performing network, but the service provider absorbs the increased costs without the benefit of additional revenues.

In contrast, the content providers and aggregators continue to benefit in a proportional relationship to the usage. Ironically, by attempting to satisfy users’ desire for faster service with increased bandwidth, the cable operator can unwittingly undermine its own video business. The improvement of the delivery mechanism gives users increased access to free, ad-supported TV online and fewer reasons to watch TV.

Cable operators must explore ways to strike relationships with internet content providers to facilitate premium access to its customers.<sup>6</sup> As consumers gain increasing awareness of new internet options for high definition content delivery, there is also a growing risk of subscriber attrition that must be met head on by cable operators.<sup>7</sup>

## Changing Competitive Dynamic Requires Triple-Play Service

The reconsolidation of RBOCs is a competitive force that has several significant implications for the cable operators. Competitive network delivered services are a business based on economies of scale, which places the cable operators at a relative disadvantage. Cable operators face several competitive pressures in competing with RBOCs. The first challenge is economics. RBOCs are able to deliver at lower costs as a function of their size. The resources available to RBOCs allow them the opportunity to build out new technology such as fiber to the home. Cable operators also face limitations when it comes to marketing resources. Whereas RBOCs can create marketing programs which are easily reproduced across their service areas to increase brand recognition, the relative limited scope of the MSOs does not allow for such programs. Lastly, the RBOCs position in Washington is proving much stronger due to their ability to send numerous lobbyists to influence the FCC and regulatory committees. The number of lobbyists and the ensuing unfavorable state of the FCC toward cable operators puts the cable operators at a clear disadvantage.

Cable operators also face competitive challenges from satellite. As video service providers, the satellite companies already have nationwide coverage, which means that their acquisition costs compared with cable operators are exceedingly low. The sheer volume of their subscribers also brings with it the ability to purchase and provide equipment and programming at steep discounts. Satellite providers also share the RBOC’s capability to create national brand identity through marketing and sales strategies, which puts fragmented cable operators in a challenging position.

From a marketing and regulatory standpoint, RBOCs and satellite providers seemingly have the upper hand, but cable operators are fighting back and capitalizing in kind on opportunities to capture increased market share with expanded service offerings. Cable VoIP continues to see growth from 2.6 million in 2005 to over 13 million in 2007. IBBS proprietary research indicates that over 90% of MSOs of all sizes expected to enter the VoIP marketplace

by 2009.<sup>8</sup> The strength of cable operators’ triple play offerings has led to several telecommunication and satellite company partnerships to counter this MSO threat.

## Phase One: Strengthen the Foundation for Growth

Ensuring Better Network Quality without Sacrificing Customer Experience

To succeed against these challenges and competitive dynamics, cable operators must strategically strengthen the foundation of their operations. In phase one, the cable operator gains a comprehensive understanding of what they have from a plant infrastructure and resource capability perspective. Once the cable operator has identified its internal weaknesses, it can take steps to eliminate and counteract them. Building better overall network quality will provide revenue-generating services without sacrificing a great customer experience. The operator must identify what needs to be done to improve quality and reliability – and what the competition is doing in order to increase their competitive edge. Business capabilities should be strengthened at the core base services of video and data before offering advanced services. This phase requires commitment to a Total Quality Management philosophy and results in an above average performance and increased credibility with customers.

## Putting Customers First

In the strengthen phase, cable operators apply their market knowledge to create packages providing optimized value to customers and maximized revenue for the operator. The cost of losing a subscriber has implications in terms of revenue, acquisition costs and valuation. Since it is almost always more costly to acquire new customers than it is to retain them, to reduce churn, cable operators must learn subscribers’ motivations for leaving or staying.

## Moving to Triple Play

Moving to triple play services strengthens cable operators’ hold on customers and reduces the risk of customers turning to an alternative service provider. When a customer is simply receiving video services, it is simple for them to switch providers, but with each new service

added to the customer's subscription, the probability of leaving decreases. Triple play service attracts phone customers with the lower costs available from cable providers. Research has indicated price remains the most prevalent driver for consumer switching of voice services. An added benefit for the cable operator is the fact each customer taken from the phone company diminishes its resources available to build fiber networks, marketing and regulatory initiatives. Triple play service also solidifies the cable operators' position relative to satellite providers. Broadband users not only get high-speed Internet service, but an email address that provides a lasting online identity. The idea of losing that identity and having to reestablish an alternate address reduces the likelihood of switching providers.

## Coping with Triple Play Challenges

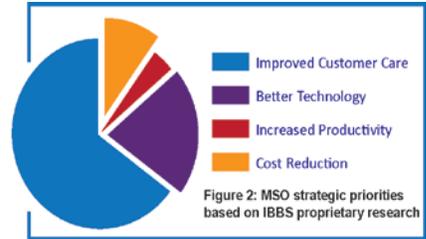
Attracting and retaining customers with triple play services can be challenging. Research indicates that improved customer care is a top strategic priority for cable operators. The services and content customers demand — and the resulting in-home requirements — lead to an increasingly complex network environment.

Many cable operators have limited technical resources to manage these complex services. Providing a reliable level of triple play quality of service (QOS) demands a wide range of subject matter experts in high demand across

the market including:

- CMTS Engineers
- RF Engineers
- In-home Network Experts
- IP Engineers
- VoIP Engineers
- Web Service/SOA Integration Experts

Building such a team in-house is challenging for cable operators of all sizes. For mid-size cable operators, hiring and retaining this talent is especially difficult. Another challenge to deploying triple play is the cost of building an integrated back office capability. This financial requirement is another driver for out-sourcing this capability to service providers such as IBBS. Plant sensitivity is a cause for concern when implementing triple play services. These services are very sensitive to real-time interference and a minor malfunction in the plant can cause a noticeable defect in the service from the customer's perspective. The plant needs to be maintained and monitored on a regular basis to ensure the reliable delivery of services. Finally, the addition of voice to the cable operator's services presents major challenge for the focus on customer satisfaction. In contrast to the telephone companies, which are backed by years of experience, the cable operators' employees lack the telecommunications knowledge and experience to efficiently and accurately address many of the issues that may arise with a customer's phone service. Cable operators also lack the appropriate tools to identify the



issues and accompanying variables in order to correct problems with phone service. According to various market studies, over 70% of phone customers who churn, do so within the first 60 days of service. Implementation of VoIP diagnostic tools could result in reduction in churn.

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