

## MVNO: Is the Future Still Rosy?

By David Grigg

The beat goes on. MVNOs (mobile virtual network operators) receive plenty of positive buzz. More new MVNOs are announced every month. Predictions remain bullish. Market research firms continue to forecast a major shift of new wireless subscribers away from the traditional carriers and into the MVNO channel. Vendors and

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consulting service providers for the wireless industry salivate at the prospect of new customers from the MVNO community. The hype has taken on a life of its own.

MVNO conferences have sprung up all over the U.S., where attendees hear about how easy and profitable it is to become a player in the U.S. wireless market. The future looks as if it is all upside. Wireless carriers are deluged with inquires from MVNO wannabes. For every new big-name MVNO the likes of ESPN Mobile, Time Warner/Cox cable, or Sony BMG, 30 to 40 or more smaller-sized hopefuls are kicking the tires.

Is all this hype deserved or is this just a reincarnation of the dot.com era? Will the MVNO bubble eventually burst? Many MVNOs are still in their nascent stage, so it is a bit premature to come to any sweeping verdict, but there are already some trends worth noting.

Consider, for example, the 5.2 million net subscriber additions in the fourth quarter of 2005 reported by Verizon, T-Mobile, and Cingular. Most MVNOs decline to publicly divulge the size of their subscriber base or provide details about their growth. But by extrapolating the most optimistic numbers available from all the MVNOs, one thing is very clear – as a channel, U.S. MVNOs have a way to go before realizing their potential, especially when compared to MNOs (mobile network operators).

### **Tougher than expected for some**

Some MVNO executives privately express their disappointment in their ability to meet their growth projections; they have found it harder than expected to sell a wireless phone in today's market. With more competition coming from new MVNOs and from new carrier offerings, it is not likely to get any easier. The low hanging fruit has been picked. The higher hanging fruit is harder to reach and more costly to harvest.

The other complaint frequently expressed by MVNO executives is the high cost of

distribution. Prepaid recharge transaction fees alone can reach 20%. Combined with the hefty handset subsidies that are required to be competitive, the numerous slices taken by all the parties in the supply chain leave thin margins for MVNOs.

So is this reason for concern? By themselves, these trends alone don't translate into a channel downturn; as noted earlier, there's no shortage of new entrants into the market. Rather it puts more pressure on market research to reliably predict growth potential, and on a business model that works if growth falls short of its target.

### **HMVNOs - the latest threat?**

Wireless carriers are learning from MVNOs. Constant pressure to show increased growth is forcing MNOs to expand their sales efforts by targeting marginal markets that have traditionally been either too difficult or too expensive to pursue directly. Rather than crack these markets through existing internal sales channels and infrastructure, some carriers are moving to adopt the practices

of MVNOs, where a small unit within the carrier acts much like an autonomous MVNO to enable a more nimble, cost-effective response to penetrating marginal markets. In its fondness for acronyms, the telecom industry has dubbed this a HMVNO, or Hybrid MVNO, where carrier combines their branding with MVNO-type infrastructure from a MVNE to form a new type of entity. If this trend continues,





business metric that bears careful attention.

**Net subs & ARPU vs. gross margins**

Due to the pressures of Wall Street, wireless carriers need to focus on optimizing subscriber growth and ARPU, Average Revenue Per Unit. But herein lies a trap for MVNOs. Regardless of the industry, for a wholesaler to have any chance at being profitable and cash flow positive, the focus on growth and ARPU can't trump the attention paid to optimizing gross margins and managing costs. Yes, there are economies of scale that kick in after attaining a certain size, but minimizing costs - stay-

MVNOs will have to stay nimble and reinvent themselves to keep the carriers from encroaching on what has, until now, been their turf.

**Survival of the fittest**

If you think being a highly funded MVNO with national name brand recognition guarantees survival, I have one name for you - WorldCom Wireless. Even the biggest players can't ignore basic fundamentals forever. It's clear controlling costs is essential, but along with performing accurate market research, what can a MVNO do to avoid falling by the wayside? As a starting point, there are numerous reports that are essential to keeping one's finger on the pulse of their business and enable effective responses to evolving market conditions. Let's look at one

ing lean and mean - definitely improves a MVNO's chance of hanging around regardless of future market conditions.

A MVNO that is able to calculate and report gross margins for each mobile number has a strategic advantage over those that can only report margins at a summary level. In addition to being an excellent revenue assurance tool, sorting such granular reports by margin separates the most profitable subscribers from the least profitable and enables the MVNO to redirect its sales efforts accordingly.

**Limited exit strategies**

What if the pundits predicting shakeouts or channel downturns are proved correct? If success ultimately proves elusive, as some experts say, what options are available to MVNOs? There has

always been value in a wireless subscriber, so unless debt is sky high, the value of a MNVOs should never go completely away. If you should someday find yourself struggling to grow and stay cash flow positive, you will undoubtedly find several competitors ready to pay for your subscriber base, but don't expect to be able to create much of a bidding war. Based on the recent sale of one MVNO, you'll do well to command \$100 per sub on the open market.

Since acquisition costs are typically the biggest drain on capital, perhaps the only other viable exit strategy is to curtail investing in acquiring new subscribers and milk your subscriber base for profits until churn takes its ultimate toll. This is a slow death knell, but you'll hopefully be pulling out some cash as you fade away into the sunset.

Knowing MVNOs face all these challenges, what can we conclude about their future? Despite the buzz, building a successful MVNO is certainly not as easy as it appears on the surface. Competition is heating up and if costs can't be tightly controlled there well may be a shakeout at some point in the future. That however, doesn't mean there won't be numerous successful survivors. MVNOs can make a sound business case providing (1) retail prices don't erode too much from current levels, (2) the cost of acquiring a subscriber is manageable, (3)



wholesale pricing continues to be attractive, and (4) they can scale to a decent size. Some of these factors are clearly outside a MVNO's control, but those that do their homework, plan accordingly, and can scale by nimbly responding to evolving market conditions, have the best chance of persevering and outliving their competitors.

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