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Navigating industry turbulence: An interview with Erik Hoving, KPN Group

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Mr. Hoving shares his perspectives on the changes sweeping through the telecommunications, media, and technology industry and the particular challenges telecoms service providers are facing.

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Chief Strategy, Innovation, and Technology Officer, KPN Group

With 6.5 million fixed-line customers, 37 million mobile customers, and activity in the Netherlands, Germany, France, Belgium, and Spain, KPN is one of Europe's leading telecommunications providers. In addition to telephony, KPN provides Internet service to 2.5 million customers and offers business network services and data transport throughout Western Europe. KPN has also been in the digital terrestrial television game since 2004 and began offering IPTV services in 2006.

In 2008, Erik Hoving joined KPN as its Chief Technology Officer for KPN Mobile International and the Chief Executive Officer of KPN Netco Mobile International. He is currently the Chief Strategy, Innovation, and Technology Officer for the KPN Group.

McKINSEY: What are the challenges for the industry at this stage?

ERIK HOVING: On the one side, a major challenge has to do with the way our customers are engaging with the technology. Ten years ago, this industry was able to predict and manage how customers would use the technology, largely because customers didn't have much of a choice. Today, however, customers have the ability to choose how they use our products and services. The technology is much less rigid, and customers are taking advantage of the flexibility. This is having a direct impact on brand loyalty and on the overall value chain in the industry. The top worldwide brands five years ago in the telecommunications, media, and technology sector were Nokia, Vodafone, IBM, and Microsoft. Today, we're talking about Google, Apple, and Facebook. The marketplace is changing, and customer behavior and preference are driving this change. On the other side, sector leaders are worrying about globalization. Our industry isn't local or even regional anymore. Our industry has become very global. Advanced LTE is the next space in the mobile industry, and this is a prime example of how technology advances are no longer solely the domain of Europe or the US. Massive R&D labs in China are bringing this technology to the world, and Vietnam and India are becoming huge contributors as well. My job doesn't have a European focus anymore. My job is worldwide. On a day-to-day basis, I speak with our technology partners in China, India, and Silicon Valley.

McKINSEY: Speaking of customer behavior and choice, demand for data over the last five years has been phenomenal, but historical telco pricing strategies have made this a difficult service to monetize. What is necessary to address this monetization challenge?

ERIK HOVING: The interesting thing is the perspective we as an industry have been taking on the data explosion. We like to talk about the differences between voice and data, but our customers don't view it that way. From their perspective, they aren't using "data" per se; they use applications that happen to require data transfer. We as an industry have been unable to explain to the customer that in order to use these wonderful applications, the speed, quality, reliability, and security of the underlying data transfer are actually critical, and communicate this value to them. Most users do not really know the difference between 2G, 3G, and 4G.

> *"What we haven't been able to do is explain to customers why they need data and thus communicate its value"*

McKINSEY: It sounds like you're describing a marketing challenge here?

ERIK HOVING: Yes. Marketing is a major challenge for the industry. The more customers understand the value of our technologies and services, the better off the industry players are. The second issue related to this big data hike is not prioritizing an increase in prices but a shift in how we think about profitability. By this, I mean changing our own equation. Instead of looking at our cost base, determining the profit we want, and then setting the consumer price, I think we should first understand what customers are willing to pay, derive the target cost structure, and then simplify our organizations and the portfolio that we offer our customers. This is a very different way of looking at the business. Customers will ultimately understand there is a difference between speed and quality of service and that if they pay more, they get better speed or quality of service. After that paradigm shift, players can start thinking about specific monetization strategies. There are multiple ways I see to create value here: in the devices, in the ability to make content mobile and easy to use for consumers, and in the ability to use the information.

McKINSEY: The talk is that structuring the new mountain of user-generated data would be an asset to software and social networking companies. Do you think there is a potential benefit for telecoms operators as well?

ERIK HOVING: I am absolutely certain that any company could use this information to better serve their customers and create more value. There are, however, two hurdles that we face as telecoms operators. The first are the legal and regulatory constraints placed on us. Unlike players such as Google, Apple, and Facebook, operators are governed by local telecoms laws that more strictly protect privacy. The second

"Customers still expect a higher level of privacy from their telecoms operators"

is the difference in the way customers value and perceive privacy between the Googles and the telcos of the world. Even if regulation were somewhat more lax, customers would still expect a higher level of privacy from their telecoms operators.

McKINSEY: How can the industry best take advantage of the convergence between devices?

ERIK HOVING: Ultimately, you have three devices: a small interactive screen, a bigger interactive screen, and a very large screen. The smallest touch screen is your smartphone, the bigger one is the tablet, and the biggest touch screen today takes the form of a TV set. I think these three will be integrated eventually with one back-end and one common application platform. All content across all three devices will be Internet-based and data-driven. For this integration to happen in the next ten years, processing power must continue to increase according to Moore's law – and become about 100 times more powerful than it is today. This is the realm of the chip industry. The other requirement is really big bit pipes. This is the major opportunity for operators, both mobile and fixed. Customers will need more bandwidth and better connectivity.

McKINSEY: Another growth opportunity many telcos are focused on is cloud. Where do you see the role of telcos in the cloud chain?

ERIK HOVING: I believe the cloud is going to become extremely important to telcos – especially to integrated access players – not only in the B2B area but also in B2C. The ease of access that comes with the cloud will become more and more important to users at home and in the office. The number-one issue here is security and safety, and I believe this is the space for the telecoms operator. I think it is only a matter of time before customers begin to realize that where their data is stored is actually relevant. For example, users will want to know the legal restrictions of their cloud services based on the host country. But even before user security issues are addressed, some basic mindset change needs to happen. The cloud is actually pretty simple, but not a lot of people understand

> *"The number-one cloud issue is security and safety, and I think this is the space for the telecoms operator"*

it. Dropbox and Amazon Cloud still elude many potential users, and it will also be the role of the telco to help customers over that barrier.

McKINSEY: We spoke earlier about generating revenues – but keeping an eye on expenses is the other side of the equation. What do telcos need to do to reach the next S-curve in cost reduction?

ERIK HOVING: Now, this is an area where fixed and mobile are not created equally. There is certainly room for improvement for fixed operators, but in the mobile area, we have to get our cost levels way, way down. When you look at the biggest drivers of network and IT costs, these are related to sites, backhaul, and energy consumption. We all talk a lot about network consolidation and network sharing. These strategies are certainly important. We have ventured into site sharing and we have done backhaul sharing in some places. I think that the biggest cost savings potential, however, is in smarter planning. I see major cost-savings opportunities, for example, in software-defined radio. In my opinion, the industry isn't fully capitalizing on the possibilities here. This can really start to happen after the introduction of LTE and its ability to transform where you can mix frequencies. When do you make upgrades? When do you roll out new infrastructure? Smarter planning reduces complexity thus reducing costs – and this is where the real savings lie.

McKINSEY: Is there a place for partnerships in this savings equation?

ERIK HOVING: There is definitely a place for partnerships, but not just in the conventional sense. The process of going through requests for information and proposals consumes so much money and time, and procurement partnerships only make things more complex. Telcos have so far cooperated in procurement partnerships to bundle and amplify their purchasing power toward suppliers. Looking forward at our challenges, I believe more in a new paradigm of technology partnerships where we collaborate with our vendors and jointly shape the business.

McKINSEY: What's your perspective on infrastructure sharing or pure outsourcing?

ERIK HOVING: In Europe, regulators have so far been constraining the value creation from network sharing. If you look at India, sharing seems to be done a bit smarter. They share networks from an operator's birth. A great example of the strength of network sharing comes from the railroad industry in 19th century America. At one time, there were multiple tracks for multiple trains between New York and Philadelphia. Many bankruptcies later, all the types of trains were traveling over one single track. This applies to telecoms networks. Why do you need four different networks in places where there is nobody? There is a huge cost advantage sharing networks in areas where you actually only need the coverage. In areas where we need a lot of capacity, we will probably think differently about network sharing. Regarding the issue of outsourcing, I think it has to do with the answer to a simple strategic question: Is there somebody else who can do a certain job better, more efficiently, and more effectively than we can? There's too much debate over the outsourcing of "critical" processes. All processes are critical. Choose your outsourcing partners carefully with a long-term view and put your full trust in them.

McKINSEY: What do you think about the type of infrastructure investments the industry needs and the role of regulators?

ERIK HOVING: Europe led the mobile telecoms world in 2000 with Nokia and Ericsson. Over the next two years,

> *"Sharing works when you only need the coverage – but not when you need the capacity"*

European regulators received EUR 200 to 250 billion from operators in licensing and other fees. This put a significant burden on the industry and Europe lost the lead in terms of quality of infrastructure to other parts of the world. As a result, South Korea, Indonesia, and Hong Kong are now the gold standard for future infrastructure in terms of high-speed networks, leveraging the latest technologies. Their societies and economies will benefit from this technology lead.

McKINSEY: If investment is absolutely necessary and European telcos are constrained in their ability to fund the investment, who pays for it?

ERIK HOVING: Well, there is the model used in Australia and Singapore, where the government pays for it. Then there is the model in Europe, where the EU has yet to make a decision and many European countries have chosen to await the outcome before taking action. In the Netherlands, however, we have decided to do some things ourselves. We use the Port of Rotterdam example. Applying today's business plans to the Port of Rotterdam 200 years ago would probably have meant that a port would never have been built. The port's total potential and ultimate value couldn't have been imagined. So, for now, the issue of infrastructure has to be taken from the national level down to the regional level. It is clear that the upgrade of access networks to fiber will be different from one region to the next.

Mr. Hoving was interviewed by Michael Gryseels, a Director in McKinsey's Brussels office.