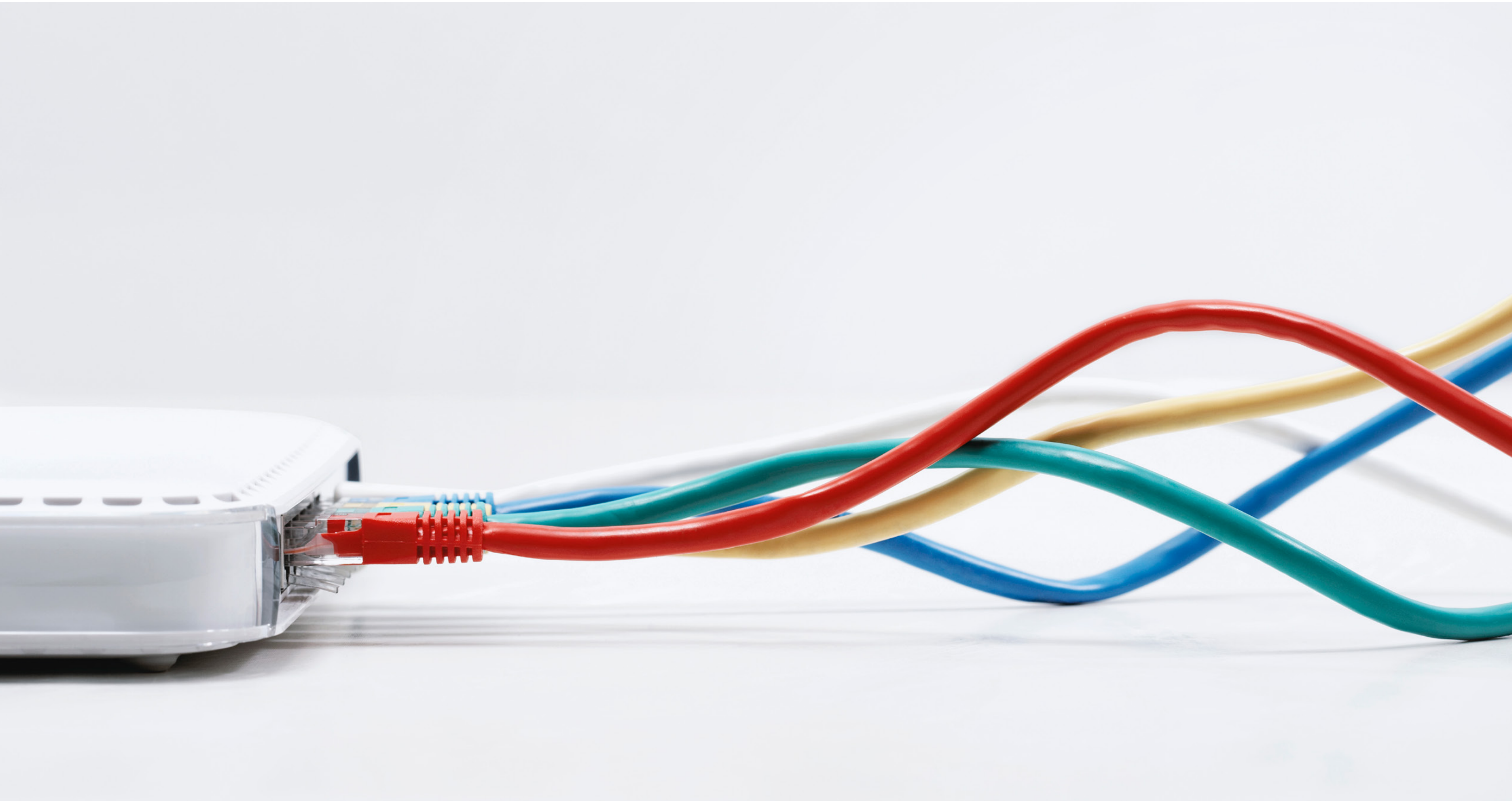
McKinsey & Company

Technology, Media & Telecommunications Practice

Maintaining a high-speed connection: A new play-book for cable growth

US cablecos have enjoyed solid growth in recent years. Continuing it will require doubling down on several key areas, even as tougher, longer-term strategic challenges loom.

by Shamik Bandyopadhyay, Jay Jubas, Mihir Vaidya, and Saf Yeboah-Amankwah



March 2020

In an age of ubiquitous streaming services, apps, and smartphones, cablecos might seem to be in a weak competitive position. Yet the industry has been on a sustained run of outperformance that many of its telecom rivals must envy.

This recent success, however, risks leaving cable players with a false sense of security just as they face heightened expectations and potential long-term challenges. But by following a new strategic game plan and grappling with some fundamental questions, the industry can have a real chance to succeed in the uncertain era that lies ahead.

Keys to cable's long-term success

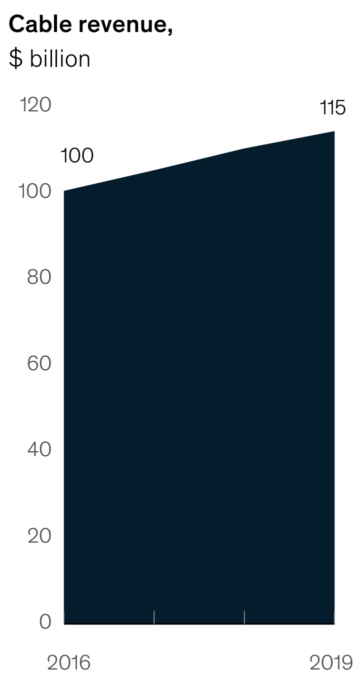
Cablecos are currently in a strong position (Exhibit 1). They remain the leading provider of broadband and TV services in the United States and account for more than 60 percent of all connected homes. Free cash flows are robust, and key industry players (Altice USA, Cable One, Charter Communications, Comcast, and Cox Communications) have averaged an impressive 25 percent return on invested capital, while the average return on invested capital of wireless and wireline operators is around 15 percent.[1]

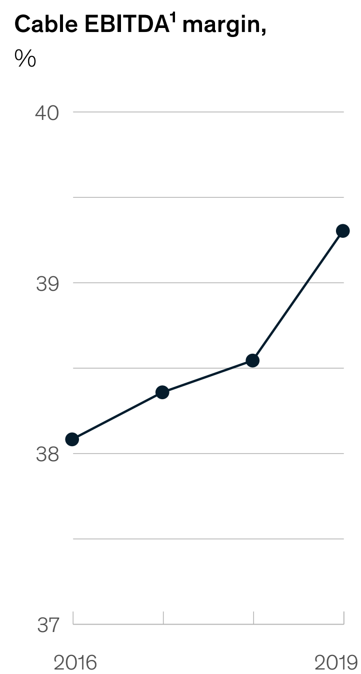
Even the cord-cutting trend of consumers ditching cable TV altogether in favor of web-based, over-the-top (OTT) alternatives, while a significant long-term threat, hasn't put a major dent in cablecos' profitability. So far, cord cutting has actually had the benefit of shedding unprofitable video subscribers, shifting the customer mix to higher-margin broadband customers.

Certain smaller cablecos have had notable success in pursuing what some have called a "postvideo"

Exhibit 1

Cable, the top provider of broadband and TV services in the United States, is enjoying solid growth that its rivals must envy.





[1] Earnings before interest, taxes, depreciation, and amortization.
Source: Company filings: includes Altice USA, Cable One, Charter Communications, and Comcast

[1] All cable-industry financial data in this article excludes Cox Communications, which, as a private company, doesn't release such information.

strategy. Cable One, for example, makes no attempt to talk subscribers out of canceling their video packages, choosing instead to offer additional OTT services, such as Amazon Prime, HBO NOW, Hulu, and Netflix, along with other high-margin broadband services. With this approach, Cable One has achieved industry-leading adjusted earnings before interest, taxes, depreciation, and amortization of 48.7 percent, with close to three-quarters of its residential customers no longer subscribing to cable-video services.

Still, the competitive landscape in video is changing rapidly, and before the recent market turmoil, bullish cable investors had already baked in most of the projected-earnings increases; as of February 2020, the consensus target stock-price upside averaged 10 percent. That is forcing companies to show continued strength and find new sources of differentiation.

In order for cablecos to drive medium-term growth and begin to position themselves for a future of regulatory uncertainties and disruptive technologies, they should seriously consider adopting three forward-looking strategies, all in tandem.

Become a digital-first enterprise

Customers are cablecos' biggest assets and offer a key lever for growth. But the industry has rarely been able to realize that potential fully. Going forward, it is unlikely to maintain its current momentum unless it learns to interact with customers in a fundamentally different way.

Although cablecos have improved their customer-satisfaction metrics in recent years, they still consistently rank among the most disliked companies in consumer surveys. Cable customers—especially younger ones—are demanding the same sort of seamless digital experiences they have come to expect from financial institutions, streaming services, and all manner of online merchants.

Consumers accustomed to digital services with precise delivery times have little patience for a cableco's six-hour window for a home visit; typically, less than 30 percent of customers can get a same-day appointment. Billing errors are another consumer sore point, with around 10 percent of the base calling every month regarding such problems. Finally, true end-to-end self-service is still more the exception than the rule. Less than half of customers attempting self-installs succeed without having to call customer care for help.

Enabling a digital-first customer experience means embedding digital in all aspects of the organization, from the back office and customer care to omni-channel sales and seamless self-install. This will help address customer irritants, improve retention, and unlock growth opportunities for offering new

Enabling a digital-first customer experience means embedding digital in all aspects of the organization, from the back office and customer care to omnichannel sales and seamless self-install.

products and services, including personalization and targeted advertising, to a more loyal customer base. Becoming a digital-first enterprise will be key to making the transition from a household-centric to a customer-centric organization.

In our experience, top executives in cable understand and support the case for "fully digital." Too often, though, execution gets bogged down. Digital goals seldom clearly link to financial metrics, subscriber metrics, incentives, and budgets. Additionally, only certain, relatively small portions of an organization (typically, IT) are quick to adopt an agile operating model, leaving many front- and back-end teams still following a more traditional, slow-moving, and hierarchical model. Last, legacy back-end IT systems often act as constraints, a problem that can be overcome in part by embracing a microservices strategy and layered architecture with APIs.

The rewards of digital transformation are worth redoubling efforts. Based on our industry experience, we believe that cablecos that transform their core operations can expect 2 to 5 percent top-line growth and significant improvements in customer satisfaction while simultaneously realizing up to 5 percent operating-expense savings, which can create the investment capacity to drive future growth.

A very similar approach has already proved fruitful for global telecom operators. One such enterprise, for example, was struggling with its digital transformation, facing worsening performance on digital key performance indicators, fragmented agile adoption, and sluggish overall execution. By adopting a CEO-level agenda for the digital transformation, with central coordination focused on cost and revenue initiatives, and aligning each agile squad to a specific tracked goal, the company was able to realize a more than $1 billion run-rate impact. In the process, it remade a wide variety of areas—acquisition, base management, customer service, network operations, and shared services.

To succeed at digital, cablecos would likely benefit by adopting a business-based transformation rather than one led by technology or IT. With such an approach, a company is more likely to prioritize quick, customer-facing wins. In the process, within the first 18 to 24 months, these successes can create the momentum necessary to complete a more complex and comprehensive digital overhaul of the business over four to five years.

For cablecos, becoming a digital-first enterprise is about much more than the operational and financial benefits of the current business. It is an imperative for finally delivering a pleasing customer experience and unlocking the margin pools up and down the stack, including in digital advertising, home-network management, and direct-to-consumer services (such as OTT streaming video).

As the cable industry makes this transition, it will need to wrangle with some difficult questions:

— How can the cable industry fully seize the potential to monetize customer data to capture a large share of the $129 billion US digital-advertising market?[2] Can it create an alternative advertising platform that better leverages the customer data? Can it tap into more personalized advertising, particularly for OTT streaming offerings?

— Should the cable industry proactively accelerate the subscriber shift to broadband? How can it leverage digital and analytics to develop a truly postvideo commercial model, including evolving the content mix to manage programming costs as video-subscriber scale declines? How does it manage video-customer churn with surgical precision to ensure it is primarily losing lower-margin rather than higher-value customers?

— As the share of broadband-only subscribers increases, how can the cable industry develop digital-centric go-to-market (GTM) and customer-care approaches that make its product offering significantly simpler to install and maintain than their current video offerings.

[2] eMarketer, emarketer.com.

Double down on B2B growth

In the past decade, the B2B market has proved to be a major success story for cablecos. They have posted around 6 percent annual growth in business customers and 8 percent annual growth in business revenues (Exhibit 2). The combined B2B revenues of all cablecos is currently about $15 billion, not far behind the $17 billion in revenue for incumbents such as CenturyLink and Verizon. While the cable industry's early inroads into the B2B market may have flown under the radar, the established leaders are taking notice and playing real defense now that it has started to capture material shares of the market.

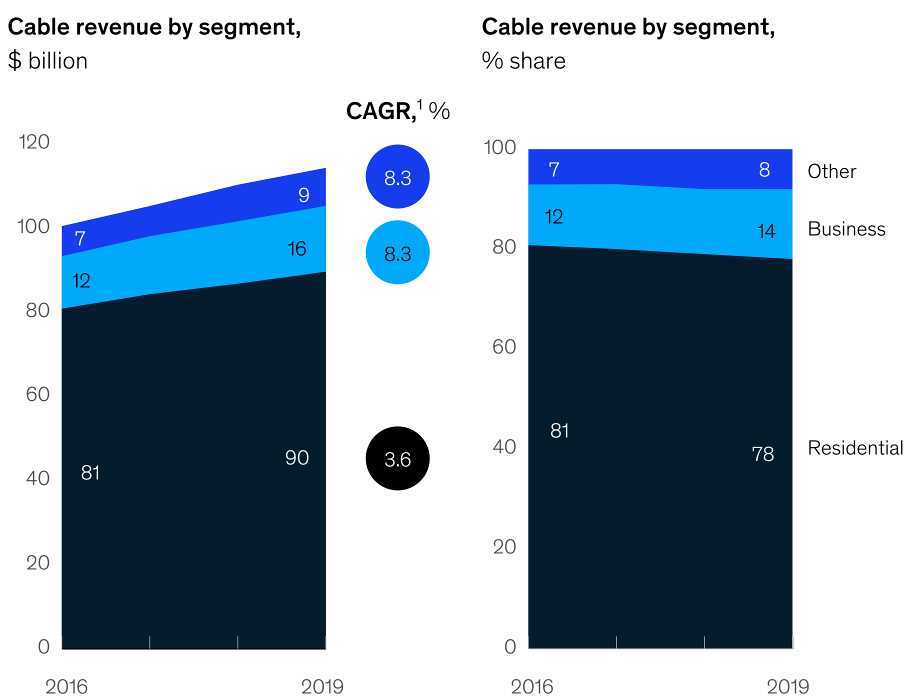
Much of the industry's B2B growth has been in the small and medium-size business segment, leaving ample room in the large enterprise market. To accelerate growth in that critical area, cablecos should focus on a few key issues:

— *Continue building a wide-ranging suite of services and software beyond mere connectivity.* These can include comprehensive cloud services, security software, and enterprise-grade productivity software. The approach should be pursued through partnerships or acquisitions, with a very high bar for end-to-end operational excellence and distinctive customer experience (including self-installation and -configuration, intuitive and proactive management, "X as a service" models, and others.)

— *Train and equip sales teams to adopt a solution and partnership mind-set, which is critical for maximizing cross-sell at a single account.* This would require more strongly leveraging sales and solutions engineers to present comprehensive offerings that include advanced connectivity (for example, software-defined networking in a wide-area network), enterprise software, and managed network services.

Exhibit 2

A key part of cable's long-term strategy is to accelerate growth in the B2B market.



[1] Compound annual growth rate.

Source: Company filings: includes Altice USA, Cable One, Charter Communications, and Comcast

One obstacle for cablecos in serving large enterprises is their limited individual geographic footprints. Cablecos have developed so-called off-net buying teams to procure out-of-footprint connectivity from other cablecos, but they still have some way to go before they can ensure a seamless experience for their enterprise clients. As cablecos start to expand into serving multinational enterprises, this challenge will be more pronounced. They will need to develop a roster of robust international, off-net partnerships with global, long-haul telcos and expand the scope of their off-net buying teams.

To expand the commercial-business segment further, the cable industry needs to address the following questions:

— Should the cable industry offer wireless service as mobile virtual-network operators as part of its commercial offerings and efforts to become a one-stop shop, especially for small and medium-size businesses? To what degree should the cable industry enable wireless operators in their 5G deployments by becoming a backhaul provider of choice for network densification? Should it stretch even further by also offering turnkey small-cell-deployment solutions leveraging its field force and rights-of-way?

— Should the cable industry create deep partnerships with IT providers to become the delivery and support platform (for example, for installation, management, and other services) for enterprise applications and cloud infrastructure services (such as X as a service)? How, and to what extent, should it try to capitalize on the edge-computing trend?

— As the cable industry explores the possibility of acquiring new wireless spectra in upcoming auctions, how should it plan to capitalize on any such moves in the commercial segment? Can it offer private networks as part of its commercial bundles—and even become the private network provider of choice?

Become a leading smart-home player

The US smart-home market continues to expand rapidly, generating $46 billion in hardware, installation, and service revenue while growing 10 percent annually (Exhibit 3).[3] Yet despite cablecos' core role in providing a critical ingredient, they aren't major players in the smart-home market. Apart from some initial forays into home security, most initiatives have been exploratory and often lacked scale.

What has been missing is a comprehensive strategy that leverages the cable industry's connectivity to millions of homes to offer smart-home services and products to its current (and prospective) customers. Cablecos already have more than 70 million unique customer relationships, growing at an annual rate of about 3 percent, and their cables pass over around 110 million homes.

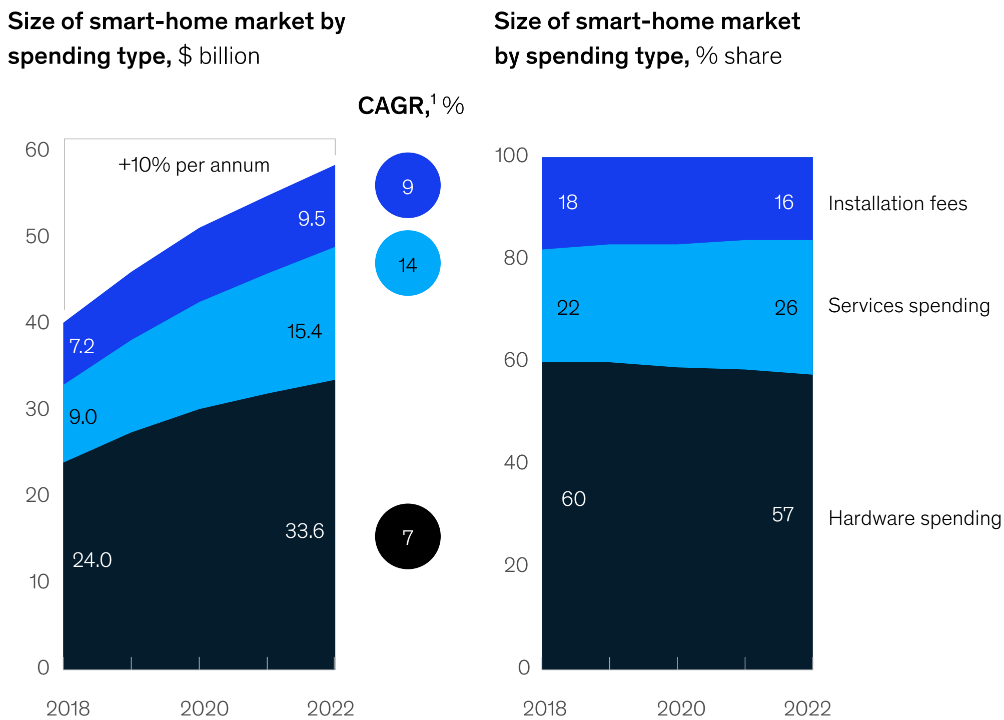
Cablecos also have assets in their sizable field forces. McKinsey's recent Smart Home Survey indicated that a lack of setup or installation ease was the top factor for potential consumers opting not to purchase such services.[4] Many consumers are understandably daunted at the prospect of installing and configuring an array of sensors, speakers, voice-activated devices, security systems, cameras, climate-control units, and smart appliances. Cableco technicians make up an experienced workforce used to working in people's homes that, with additional training, can become a go-to resource for consumers unwilling or unable to tackle a smart home on their own.

Still, the cable industry will first have to determine what role it wants to (or can) play in a smart home. With Amazon, Apple, and Google (or the "big three") rapidly emerging as the ecosystem platforms of choice for these smart services, it should assess whether the best approach is to develop its own competing offering or become a partner (and enabler) for the tech giants' already established platforms and emerging standards, such as the recently launched Project Connected Home over IP effort.

[3] IDC, idc.com; Strategy Analytics, strategyanalytics.com.
[4] McKinsey Smart Home Survey, 2018.

Exhibit 3

Cable has an opportunity in the US smart-home market but needs a strategy to leverage its connectivity to millions of customers.



Note: Figures may not sum to 100, because of rounding.
[1] Compound annual growth rate.

Source: IDC, idc.com; Strategy Analytics, strategyanalytics.com

Given the sizable momentum of the big three's platforms, an aggregator strategy could be the ideal approach for the cable industry. It could seek to make sure its home end point (such as the set-top box or the broadband and Wi-Fi router)—and its application for home end-point management—can serve as the aggregation point. That should seamlessly integrate the functionality of all major platforms, such as those of the big three, similar to how cable set-top boxes today seamlessly aggregate multiple content sources and apps, such as Hulu and Netflix.

The integrated platform (which some industry leaders, such as Comcast, have started to roll out) could handle home security and access, energy management, entertainment, and home maintenance. It would include camera integration, smart-lock control, and remote video monitoring. It would be a 24/7 resource manager for the home, regulating heat, air conditioning, energy consumption, solar panels, gray-water reuse, and peak-load management. In the future, it could also control predictive maintenance, with diagnostics alerting users about necessary roof repairs; plumbing fixes; heating, ventilating, and air-conditioning upgrades; and pest-control services. Cablecos might even be able to tap into the insurance market by offering a hub connected to a homeowner's home- and auto-insurance providers for customized policies and pricing, with cablecos taking a cut of any transaction.

Cablecos could directly monetize smart-home products and services by reselling existing hardware products and bundling them with connectivity. In some cases, companies may consider acquiring an existing player in a high-value vertical (such as home security) to capture market share immediately.

Another opportunity for cable lies with “tech aspirationals,” a key segment of customers (revealed in our Smart Home Survey) that see technology as an essential part of their daily lives. At the same time, however, their relatively modest incomes limit their budgets for smart-home devices. As a result, they make up an ideal market for subscription programs that would allow them to acquire smart-home devices without a large initial outlay of funds. The cable industry would be well placed to serve those consumers by providing smart-home gear and installation for an additional charge on their monthly bills rather than selling such a service to them as a wholly separate product.

To unlock the smart-home opportunity fully, the cable industry needs to ask several questions:

— How can the cable industry leverage aggregated customer metadata from being a smart-home enabler to explore radical new partnerships? Could it partner with insurance companies, utility companies, and home-service and predictive-maintenance agencies to offer personalized services grounded in smart-home-based data analytics?

— What strategic M&A opportunities should the cable industry bet on to jump-start its smart-home efforts? Which parts of the smart-home value chain should it target initially?

— How can the cable industry provide aggregated and anonymized smart-home data married with insights from video and broadband usage to enable smart-home-ecosystem partners, such as Amazon, Apple, and Google, to enhance and improve their offerings?

Cable’s uncertain long-term outlook

Even if cablecos manage to succeed at these key strategic shifts, they will likely have to grapple with more existential challenges in the long term. Cord cutting may not be posing much of a serious threat yet, but the industry’s video business is clearly trending toward potentially subscale levels.

At the same time, streaming services, social-media powers, and deep-pocketed tech-platform companies seem likely to gain greater control of the cable industry’s relationship with customers (and their data). Amid that competitive upheaval, as well as regulatory uncertainty, cablecos must update their strategies for a new era and grapple with several major issues:

— *Regulatory risks.* As cablecos continue to grow their share of the broadband subscribers to well beyond 60 percent, they will end up becoming a de facto essential service. This would naturally attract the attention of state and federal regulators, and cablecos will need to be prepared to respond to concerns ranging from pricing to privacy.

— *5G’s imminent challenge.* Around 20 percent of Americans are smartphone-only internet users with no home broadband connection. Although the fears related to 5G and wireless convergence in the near term have been largely unrealized, particularly in the B2C arena, the future threat could be more substantial. 5G has the potential to increase the proportion of broadband cord cutters and “cord nevers.” Furthermore, as 5G use cases, such as network slicing, become a reality in enabling wireless alternatives to B2B connectivity, the cable industry could find itself challenged in the B2B arena.

— *An economic downturn.* Given the current economic and market turmoil, cablecos need to identify which areas of their businesses will likely be most challenged during a major slump and how they will have the best chance to weather its effects. At the same time, it would help greatly to pinpoint the best areas for investment during a downturn to create a competitive advantage as the market recovers. Any serious downturn would likely have a significant effect on B2B spend, particularly for the segment of small and medium-size businesses that drives the bulk of cable B2B revenue. As a result, this area could be an opportunity for the industry to double down and then be well positioned to capture a larger share during the recovery.

Cable operators that take targeted and sustained action to update their strategies have a much better chance than others at continued growth in the medium term. They should also be better positioned to overcome the complex challenges the industry is likely to face further in the future.

In some cases, that means doubling down on strategies that are already working. Cablecos' success in the B2B market has been mostly in the small- and medium-size-business segment, leaving considerable room for growth in the large-enterprise space. In other instances, cablecos should work to execute better on forward-looking strategies, in which advances have been slow and uneven. Becoming a smart-home leader and transforming into a digital-first enterprise aren't easy undertakings by any means, but they are essential to fuel longer-term growth.

Above all, cablecos can't let the success of the recent past lull them into complacency. About a decade since the introduction of data over cable service interface specification 3.0,[5] as the cable industry transitions to being primarily a broadband-connectivity provider, cablecos face the same issue that telcos struggled with ten years ago: how to avoid becoming just a "dumb pipe." The answer must include finding innovative new ways to increase the value of their customer relationships. If they fail to do so, they risk discovering just how fast a high-speed connection can suddenly slow down.

[5] Data over cable service interface specification 3.0 greatly increased the rates of high-speed data transfer over an existing cable TV system.

Shamik Bandyopadhyay is an associate partner in McKinsey's Dallas office, **Jay Jubas** is a senior partner in the Stamford office, **Mihir Vaidya** is an associate partner in the Toronto office, and **Saf Yeboah-Amankwah** is a senior partner in the Washington, DC, office.

Designed by Global Editorial Services