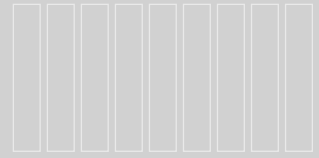




## THE DRIVE FOR HIGHER MARGINS

### How the global communications industry is tackling margin enhancement

Overview and analysis of the results of KPMG's global margin enhancement/revenue assurance survey among communications industry executives





## Foreword

Few industries have been as hard-hit by the economic down-turn as communications. It is no surprise, then, that achieving the best possible returns from their investment in products and services is now top of the agenda for most companies in this sector worldwide. It is no longer sufficient to grow revenues and market share without focusing on costs and profitability, in other words enhancing margins.

KPMG's Margin Enhancement/Revenue Assurance survey looked at how companies approach the key issues and attitudes surrounding margin enhancement, against a background of tight financial markets, pressure on balance sheets, and increasing focus by analysts and shareholders on the bottom line and cash flow.

We found that the four cornerstones of margin enhancement (ME) – revenue enhancement, cost management, construction management and profitability enhancement - have traditionally been left to relatively small, under-resourced and uncoordinated revenue assurance departments. However, in an emerging world of multi-products and services, and against a current reality of poor market conditions, there is a real necessity for the whole organization to get involved.

Our survey highlights the need to establish a robust margin enhancement function in order to effectively manage critical business risks across key revenue generation processes. In order to assess the health of such processes, a comprehensive set of key

performance indicators (KPIs) should be implemented across an organization, to include all functions - senior management, revenue assurance, billing, networks and so on - and all elements of an effective margin enhancement program (revenues, costs, capital and profitability). These indicators will be critical in enabling communications companies to monitor, in real time, the revenues and costs associated with individual functions, products/services, suppliers and customer relationships and take the appropriate action to address weaknesses and issues continually throughout the year.

As the industry moves into a new business environment - with organizations having to manage numerous products and services throughout their life cycles - effective margin enhancement is likely to emerge as one of the critical determinants of success.



## 1. Summary

The principal purpose of our survey was to identify current practice in the fields of revenue assurance and margin enhancement, and to benchmark this against KPMG best practice - thus highlighting changes which the industry needs to consider if it is to maximize the opportunities and minimize the risks inherent in its marketplace.

Communications executives operating in the US, Europe, Middle East and Africa (EMA) and Asia completed this survey. Responses were collected from a wide range of professionals, in fields such as sales and marketing, operations management and finance. Approximately 100 executives representing all major industry segments, (wireline, wireless and ISP/data service providers) completed the survey.

### How is margin enhancement currently being addressed?

We found that traditional revenue assurance activities involving retail/voice revenue streams continue to constitute the majority of margin enhancement efforts across the industry. Key aspects of margin enhancement – such as product profitability and cost management – are currently accorded a low priority. The expertise of many revenue assurance employees centers on revenue accounting, auditing and IT/billing skills that have traditionally been deployed to tackle revenue leakage from voice services. A relatively low level of resource is devoted to revenue assurance, a potential problem as small teams are unlikely to have the breadth of skills necessary to address wider margin enhancement issues.

### How effective is the campaign?

The findings show that in many key risk areas there is a misalignment between the perceived gravity of risk and the effectiveness of the measures designed to control it. Billing and reporting systems are not necessarily weak in themselves, but the co-ordination of business processes and critical information systems that enable such processes - culminating in a bill to the customer - need to be improved.

The most frequent estimate of annual exposure to revenue leakage as a percentage of total revenue is in the range of 2-4 percent in Asia, 5-7 percent in EMA and 8-10 percent in the US. Respondents in Asia felt that exposure will increase over the next 12-18 months. Globally, 60 percent of respondents estimated the effect of their revenue assurance department on the bottom line to be between 2 and 7 percent, however.

While revenue enhancement, cost management and profitability enhancement are all considered to be critical areas, relatively little effort is being focused on the last two.

### The way ahead

The survey suggests that communications companies need to:

*Think of margin enhancement in broader terms* – by widening the scope and skills of revenue assurance departments, by involving other management functions and by gaining senior management sponsorship (CEO/CFO).

*Establish robust Key Performance Indicators (KPIs)*, using real time monitoring of revenues, costs and profitability to ensure weaknesses and issues can be rapidly addressed.

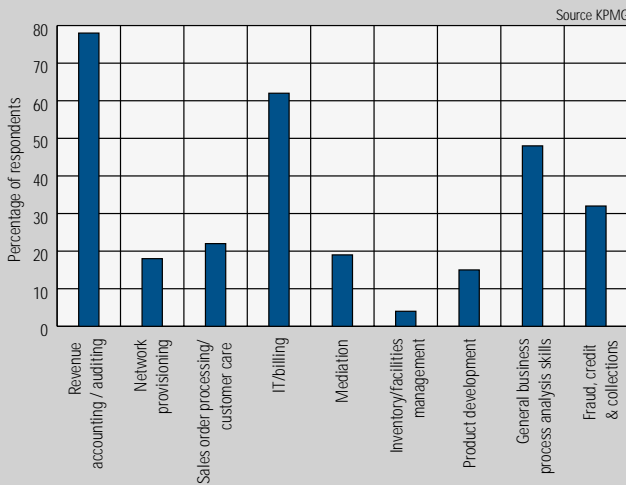
*Act quickly* – in readiness for their role in providing non-voice and next generation services.





### Revenue assurance skill sets

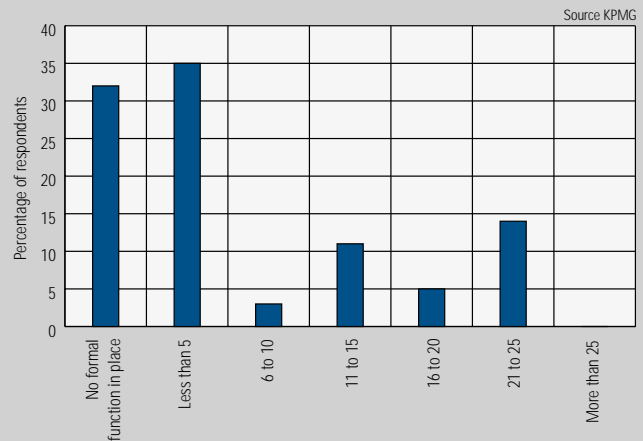
Perhaps not surprisingly in view of the above, the backgrounds and expertise of many revenue assurance employees center on revenue accounting, auditing and IT/billing skills. Traditionally, these skills have been deployed to tackle revenue leakage from voice products:



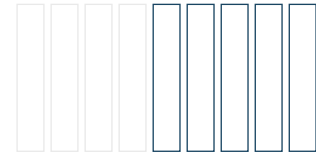
If communications companies are to embed controls into their business processes rather than merely auditing revenue streams, new skill sets will be required – for example, the ability to understand and address network (cost and construction), customer care (credit, collections, adjustments and disputes) and third party (wholesale/intercarrier, vendor/contractor) issues.

### Level of resources directly involved in revenue assurance

The chart below shows that relatively few people are currently employed to carry out revenue assurance tasks – although the level of resource committed to the function varies widely from company to company. The average number of full time equivalents in revenue assurance varied widely between communication companies although most had less than 10.



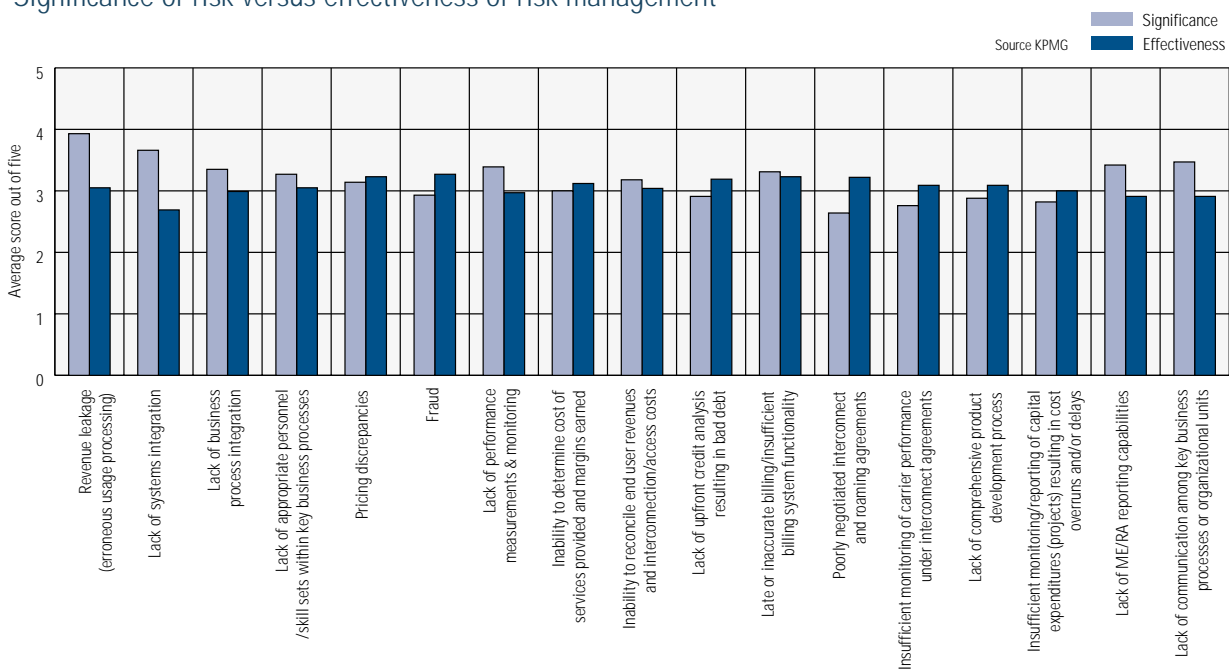
While some variance is expected relative to the size and complexity of individual carriers and products/services offered, it is clear that a base level of skills is necessary to adequately address the critical revenue, cost and profitability risks faced by each carrier. The current low level of resource may cause problems, as it is difficult for small teams to encompass the wide range of skills to cover all revenue streams and to address product and service profitability and cost management issues. Rather than increasing the size of departments, however, a preferable route may be to ensure that management functions throughout the company assume some responsibility and accountability for margin enhancement.



### 3. How effective is the campaign?

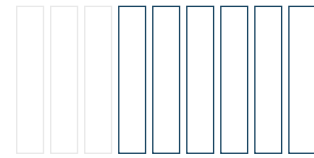
In order to assess communications companies' efforts to tackle the issues of revenue assurance and margin enhancement, we asked respondents to weigh the significance of various risks facing their organizations and to comment on how effectively in their opinion these risks are controlled.

#### Significance of risk versus effectiveness of risk management



Globally there appears to be a high degree of consensus over what the most significant risks are. In all three regions revenue leakage and lack of integration between systems or business processes were cited as critical issues. Respondents from Asia and EMA also emphasized the lack of margin enhancement/revenue assurance reporting capabilities. In EMA and the US, the absence of effective performance measurement and monitoring is a concern, while Asian respondents also referred to the shortage of appropriate personnel or skill sets within key business processes.

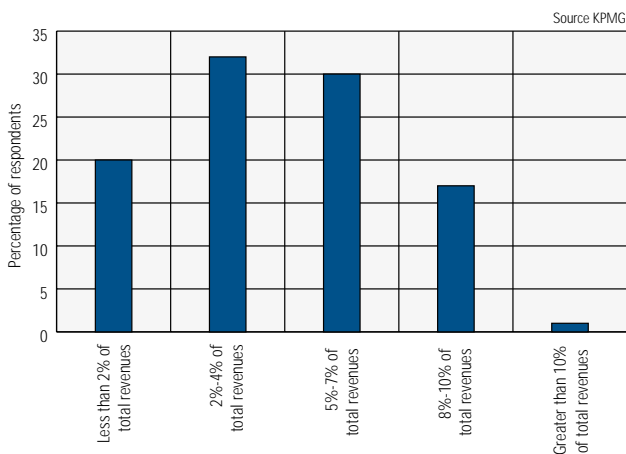
The findings suggest that there are several areas where there is a misalignment between the perceived gravity of risk and the effectiveness of the measures designed to contain it. For example, revenue leakage is seen as a key risk but is relatively poorly controlled. At the same time, considerable effort is being channeled into fraud detection even though this is not believed to have a substantial impact on revenue. In general, the misalignment was greater in EMA and Asia than in the US.



While the survey highlights potential weaknesses in systems integration and the coordination of business processes, the controls over billing system functionality are generally believed to match the significance of the risk involved. This suggests that the billing systems are not inherently weak, but rather that communications companies need to improve integration across the different areas that comprise the end-to-end revenue stream. A similar picture emerges in connection with reporting procedures.

### Revenue leakage

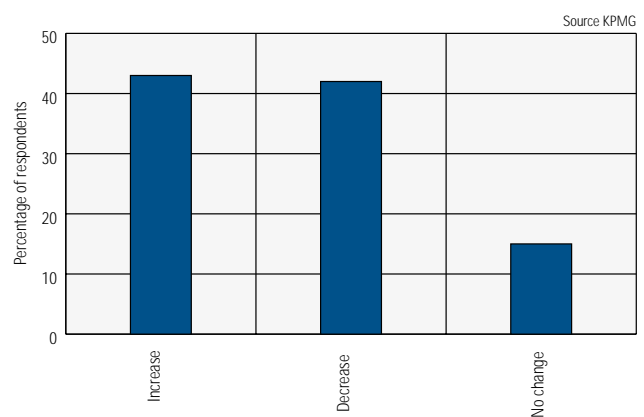
Given the significance attached to revenue leakage, an important indicator of effectiveness is the proportion of revenue lost in this area. The most frequent estimate of annual exposure to revenue leakage as a percentage of total revenue is in the range of 2-4 percent in Asia, 5-7 percent in EMA and 8-10 percent in the US:



Clearly leakage has a direct impact on margins. However, to tackle the root causes of the losses, communications companies need to have appropriate measures in place to identify where they are occurring, on which products and services, and for which customers.

### Anticipated trends in leakage

Respondents from Asia felt that the exposure to revenue leakage is likely to increase over the next year to 18 months, while those in EMA and the US took the opposite view:



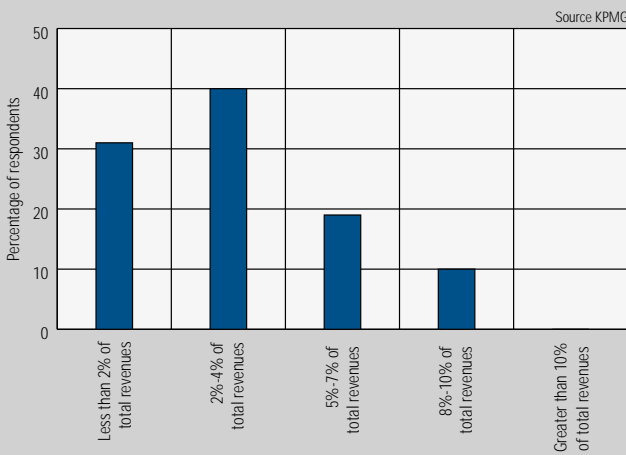
While the difference in responses may be largely attributed to the degree of privatization, deregulation and competition in each region, it may be that US and EMA respondents are being overly-optimistic in this area. The requirement for communications companies to provide increasingly complex – and often bundled – products and services, and the required interaction with third parties, suggests that exposure to revenue loss will become more acute.

Marketing departments are under pressure to offer increasingly tempting packages to customers in order to maintain market share. But as more products and services are bundled together to create enticing 'lifestyle' packages, behind the scenes the burden on communications companies to process, settle and measure profitability of such bundled products (and individual products within bundled offerings) can only intensify.



### Impact of revenue assurance departments on the bottom line

Nearly 70 percent of respondents estimated the effect of their revenue assurance department on the bottom line to be less than 4 percent.

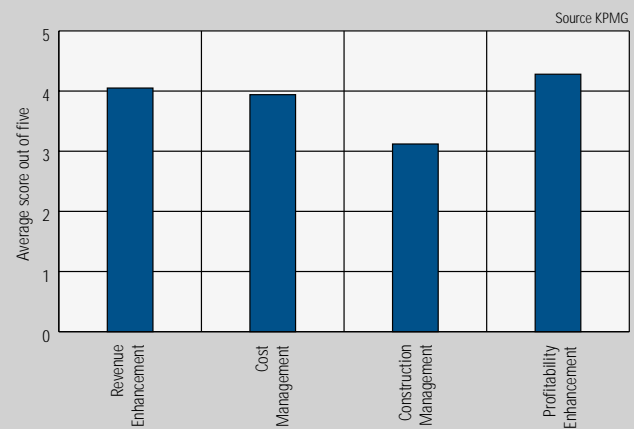


As has already been noted, to achieve greater impact, communications companies will need to broaden the scope of the revenue assurance function beyond revenue leakage, placing greater emphasis on profitability enhancement and cost management.

Our experience with margin enhancement activities shows that they are self-funding with the benefits outweighing the costs. In other words, the opportunities to generate additional revenues (as shown above) as well as cost savings are significant. Usually such benefits are a significant multiple of the related costs of margin enhancement activities.

### Importance of margin enhancement objectives

We tested the assertion that companies in the sector should broaden the scope of the revenue assurance function by asking them to rate the importance of various margin enhancement objectives:



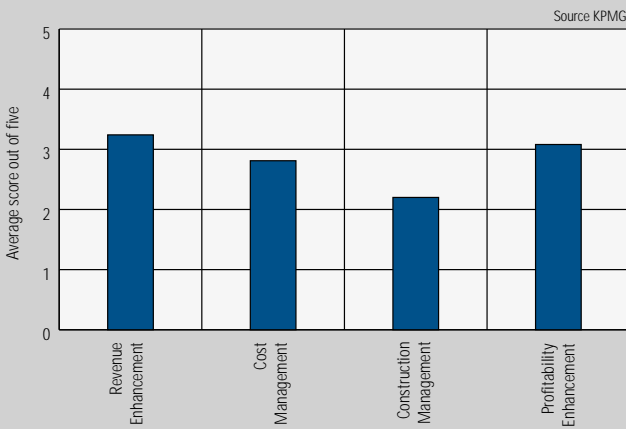
There was little difference in how the respondents rated the relative importance of revenue enhancement, cost management and profitability enhancement – all three were deemed to be critical by our respondents. Only construction management was seen as less important, although this is still considered to be a key area. The lower rating given to construction reflects the transition in the industry's focus from network creation and customer acquisition to maximizing the return on assets, for example by increasing average revenue per customer.



### Degree of effort focused on margin enhancement objectives

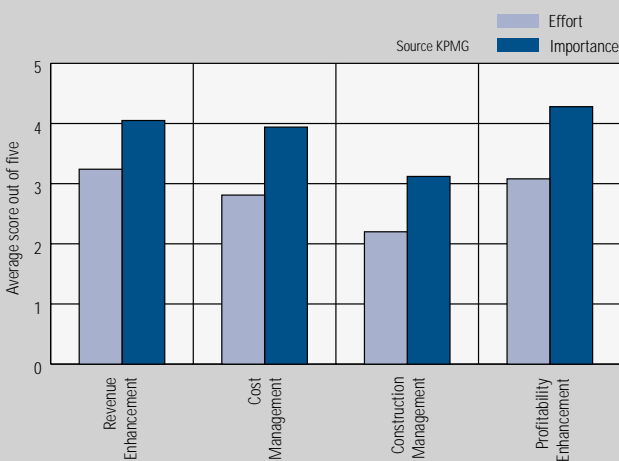
According to the survey, respondents devote most of their efforts towards revenue enhancement:

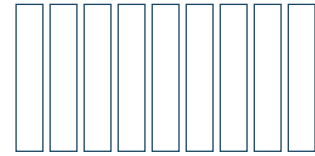
Generally, respondents felt that the overall level of effort related to margin enhancement activities was insufficient given the significance and high-risk nature of the end-to-end revenue process.



### Misalignment between effort and importance

There is a substantial gap between the importance our respondents attribute to cost management and profitability enhancement, and the amount of effort devoted to these areas.





## 4. The way forward

What steps, then, should communications companies be considering if they are to drive higher margins? The results of the survey give some clear indications.

### Expand the focus of revenue assurance departments

The traditional emphasis on retail revenue streams, particularly in relation to voice, is still prevalent. The focus of these departments should evolve to focus on emerging high risk areas, including wholesale and roaming revenue streams, cost management and profitability enhancement. In other words, traditional revenue assurance activities should evolve into more comprehensive margin enhancement activities.

### Build an organization-wide approach

Communications companies must think of margin enhancement in broader terms. Revenue assurance departments need to forge strong links across the organization, and other management functions should be encouraged to play an active role in margin enhancement.

### Establish robust performance measurement

There is a limit, however, to the progress that can be achieved unless communications companies have the means to measure performance, and therefore identify and address weaknesses. KPIs should be embedded throughout the organization, including the areas responsible for networks, IT, billing and external relationships, such as with customers and suppliers.

### Act quickly

Finally, these changes need to be implemented quickly. Current shortcomings in margin enhancement processes can only be accentuated by the development of non-voice services – a more complex commercial environment where the customer will be paying for added value rather than for carriage.



*For further information*

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