



ERICSSON

DEALING WITH OVER-THE-TOP SERVICES

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HOW OPERATORS CAN RESPOND TO THE THREAT OF OTT SERVICES

THE RISE OF OVER-THE-TOP SERVICES

Over-the-top (OTT) services are those delivered to the customers over the internet and not usually provided directly by the telecom operator. Services such as searching tools provided by Google or webmail provided by Microsoft Hotmail are examples of OTT.

OTT services became a concern to telecom operators when they started to compete directly with services traditionally offered by telcos: voice, messaging and pay TV. For example, Skype, which now belongs to Microsoft, was founded in 2003 and has currently achieved 250 million active users per month, who talk 100 minutes on average, avoiding the use of traditional telephony. As Skype became a telco competitor on voice, several new OTT service providers have entered as substitutes to traditional telecom services. Some of them are shown in Figure 1.

Mobile customers have been eager to adopt OTT services, which are predominantly free of charge, relying only on advertising revenues or one-off application download fees. Others, such as Netflix, provide services at a huge discount when compared to telco services.

OTT services also bring innovative features, such as video calling, location sharing and file transfer. Most of them are deployed as social network tools, enabling their users to search, discover, recommend and share content with friends.

Unsurprisingly, OTT services were first adopted by teens and young adults, a group that highly appreciates social networking.

Finally, OTT services are often held by powerful companies, such as internet giants (e.g., Google, Facebook, Microsoft), consumer electronics manufacturers (e.g., Apple, RIM), and even media enterprises (e.g., Sony Music, Universal), which secure global reach and financial strength.

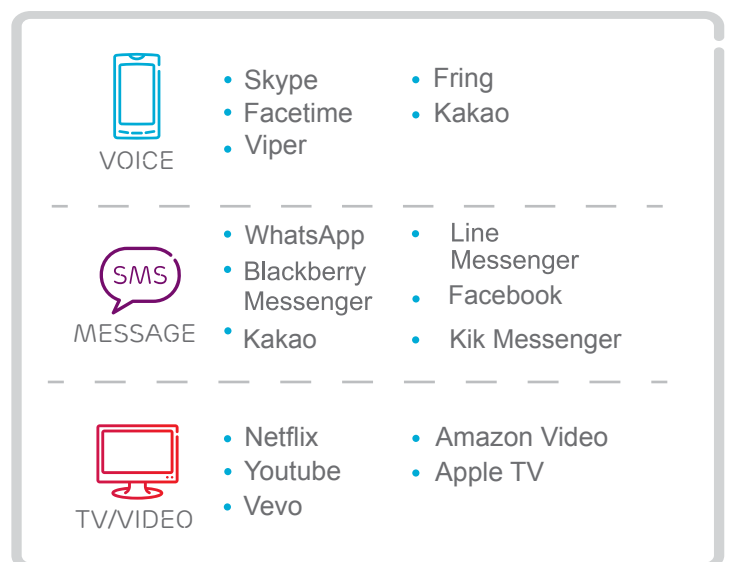


Figure 1: Examples of OTT service providers

THE OTT DAMAGE TO TELECOM OPERATORS IN LATIN AMERICA AND THE CARIBBEAN

OTT services primarily pose a revenue erosion threat to telecom operators, when customers refrain from using traditional telecom or pay-TV services in favor of similar services provided by internet sites or applications installed on the smartphone. Moreover, OTT services put heavy traffic pressure on telcos' broadband networks.

One might expect that the adoption of OTT services to be low in Latin America and the Caribbean, given the lower penetration of enabling-OTT technologies compared to more developed regions. Currently, internet penetration in the region is 35%—far below the 77% and 58% rates of North America and Europe, respectively. Smartphone penetration accounted for 20% of mobile subscribers in 2012, significantly lower than the 48% in USA and 31% in Europe, according to Informa.

Nevertheless, ABI Research has found that the number of text messages sent by Latin American subscribers fell 5.8% in the first quarter of 2012 as compared to the previous quarter, due to OTT messaging applications.

Skype, which is the largest international long-distance carrier in the world and represents one-fourth of all international worldwide traffic, is highly active in Latin America, where it is estimated to have more than 20 million subscribers. In August 2012, the company launched a physical prepaid card in Mexico, available at local retailers, which allows monthly unlimited calls to fixed and mobile lines in the United States for just 100 pesos (US\$7.80). The initiative addresses the need of Mexican customers who do not own credit cards to purchase Skype credit online.

Regarding video services, the OTT menace seems harmless so far. Netflix is estimated to have 1.2 million subscribers, negligible when compared to the almost 50 million pay-TV subscribers in Latin America. According to ComScore, the online video consumption from sites such as YouTube, Vevo and Globo.com represents from 11 to 13 hours per month per user, depending on the country. This is only a fraction of monthly TV consumption, which amounts to between 100 and 165 hours.

THE EFFECTIVE RESPONSE TO OTT SERVICES

One possible reaction from telecom operators to OTT services might be blocking them or throttling the traffic directed to OTT service providers. However, this would upset customers and raise regulatory concerns about net neutrality.

Another possible measure could be cutting prices of telecom services to make them more attractive in face of OTT competition. Still, price discounts do not address the innovative features of OTT services appreciated by customers, and might be ineffective against revenue erosion.

The most effective strategies that operators have pursued are described in Figure 2. These strategies are related to both revamping traditional telecom services to make them more attractive and taking advantage of the OTT model. Telcos can have their own OTT offers to reinforce relationships with current customers, enter new markets and conquer new customers.

Differentiate telco services

One way to avoid revenue erosion of traditional services is to make them still relevant to end users in comparison to OTT services.

For instance, Brazilian mobile operators are using the traditional text message as a way to deliver attractive value-added services, such as training courses. SMS-based language courses such as Kantoo (Vivo) are very popular. Claro in Brazil offers specific preparation training on exams for public service job openings.

Banks, credit cards and airlines use SMS for announcements of transactions and purchases. Healthcare services warn their customers about the right time to take pills through text messages, which has a broader reach to their elder patients, who frequently are not smartphone users.

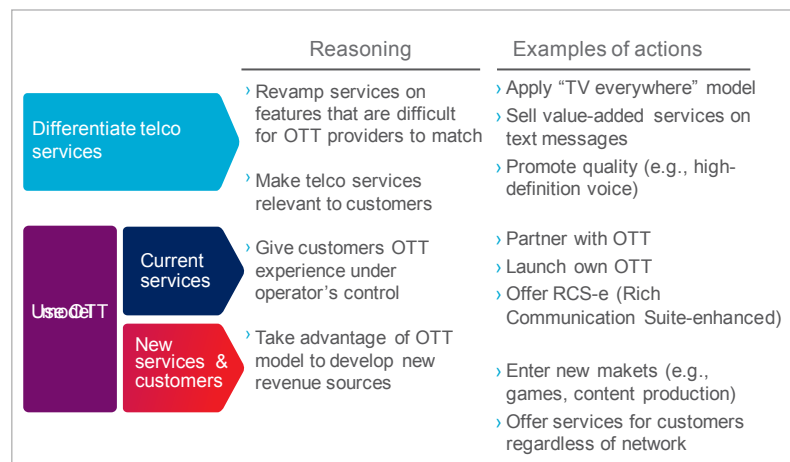


Figure 2: Effective strategies against the OTT services threat

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Operators that offer pay-TV services can extend their presence to multiple screens, such as PCs, tablets and smartphones. Such is the case with Columbus Communications, present in 23 nations in the Caribbean, with plans to launch its IPTV service under the "TV everywhere" concept currently being trialed in Trinidad.

Even the most traditional telecom service, the voice call, can be differentiated. In August 2012, both South Korea Telecom and MetroPCS (USA) launched voice over LTE (VoLTE) services with high definition voice, which significantly improves voice recognition and understanding.

Under favorable conditions, OTT services such as Skype might have better sound quality than ordinary phone calls; however, Skype cannot assure end-to-end quality of service.

Use OTT model in current services

Operators might also take advantage of the OTT model. For example, Claro in Colombia offers Claro Video, an online video rental service similar to Netflix and available to Claro fixed broadband customers.

Operators can also partner with OTT providers. In 2011, for instance, Movistar Colombia sold mobile phones with the WhatsApp application preinstalled for free with the purchase of subscription voice and mobile broadband plans.

This strategy relies on the fact that the operator could lure prepaid subscribers to migrate to data-enabled postpaid plans. Recently, the operator launched its own service, TU Me, based on Rich Communication Suite-enhanced (RCS-e). This service comprises, in the same interface, text and voice messages, plus photo and location sharing.

Use the OTT model to offer new services and reach new customers

Telecom operators can use the OTT model to enter new markets. For example, Telmex in Mexico launched in April 2012 gaming platform Infinitum Games, which offers more than 750 game titles. The service is available to Telmex fixed broadband customers for a subscription priced from US\$4 to \$8 per month.

During the London Olympic Games in 2012, Telefónica's web portal Terra not only live broadcast the games in HD and 3D format, but also employed 220 commentators and produced content in Spanish, Portuguese and English to 16 countries in Latin America. The open transmission could be watched on PCs, tablets, smartphones and connected TVs – no subscription to Terra or any Telefónica-specific service was required. However, online advertising was included.

Over-the-top services have a strong potential to transform the communications industry. The aforementioned cases demonstrate that telecom operators are able to actively participate in this change, sustain their relevance to customers and even explore new business opportunities.