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WINNING THE RUSH FOR DATA SERVICES IN THE MIDDLE EAST AND AFRICA

Demand for data is set to explode. The region's telecom companies must position themselves now to take advantage.

by Daniel Boniecki and Chiara Marcati

Most new industries reach the same crossroads after a period of rapid growth. On one side lie territories where revenues, customers, and even margins will probably continue their dizzy upward path; on the other, maturing markets where it's starting to become clear that the old model has run its course.

This crossroads is precisely the position reached by the Middle Eastern and African telecom sector, which has enjoyed a spectacular ten-year run but now faces an important turning point. The region, home to some of the world's largest telecom operators, boasts penetration growth and profitability far above global averages (exhibit), contributing nearly 20 percent of the industry's global economic-profit pool and supporting a mobile-broadband subscriber base of well over one billion. Smartphone penetration is set to exceed 50 percent before long.

New McKinsey research, however, suggests that the next chapter for telecommunications in the Middle East and Africa will be defined more by exploding demand for data than by a further expansion in the number of subscribers. Granted, the region's young, increasingly urban, and social media–savvy population still offers scope for subscriber growth—in some markets, of 50 percent per annum over the next five years. But shareholder returns have been slowing of late, though from high levels: 9 percent annually in the postcrisis years from 2009 to 2014, against 14 percent annually from 2004 to 2007. That decline reflects the new competitive terrain across the region.

We've identified three telecom-market archetypes—growth, polarized, and mature markets—defined by GDP per capita and the penetration of mobile phones, fixed-line phones, and smartphones. Our analysis reveals dramatic differences between these groups of countries in macroeconomic context, urbanization, stages of market development, and, importantly, competitive dynamics and future growth opportunities. The growth markets are Africa's low-income countries such as Tanzania, which present the greatest remaining opportunities for increased penetration. The mature markets are the high-income countries of the Middle East, such as Kuwait and Saudi Arabia. The polarized markets—wealthier economies of Africa such as Egypt, Nigeria, and

South Africa—include two distinct segments: a more affluent metropolitan population (mature) and a lower-income rural one (developing).

Operators in mature markets will have no easy wins. Cash flows will be under pressure from stagnating revenues and a need for increased investment—trends already reflected in diminishing enthusiasm for telecom assets in the region. Across the board, the economic challenge is acute: for example, our research suggests that the region's operators must realize significant cost savings to stay competitive. There are, however, tangible opportunities not just to reduce costs but also to boost revenues.

By applying advanced analytics to the data they continually collect, for instance, telecom companies can dramatically improve their accuracy in predicting churn and, accordingly, reduce their capital expenditures as much as 30 percent.

On the revenue side, video appears to be the lowest-hanging fruit. The Middle East and Africa generate much less revenue from video consumption than other countries and regions do: $5 to $6 per capita compared with, for example, $30 per capita in Brazil, China, India, and Russia. This gap results only partly from low incomes—even in the more affluent countries of the Middle East and Africa, video's potential is still untapped.

The Middle Eastern and African telecom sector boasts penetration growth and profitability far above global averages.

MEA[1] telecom has expanded at 12 times the pace of the industry as a whole …

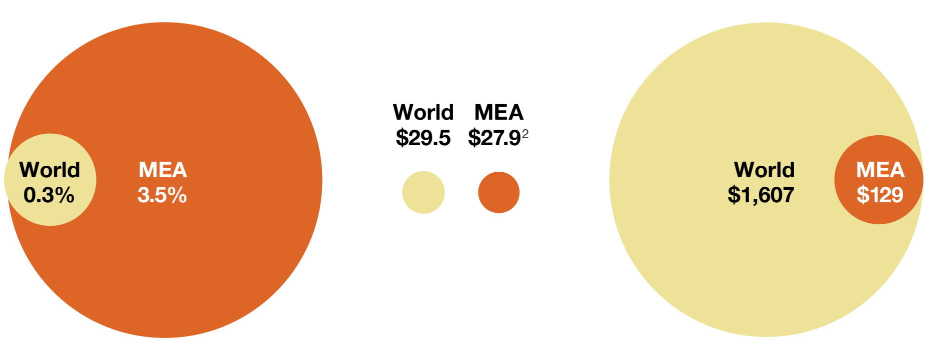
Annual growth rate, 2008–15, %

… generating $27.9 billion in net growth …

Growth, 2008–15, $ billion

… and holding 8% of the global market in 2015.

Market size, 2015, $ billion



[1]MEA = Middle Eastern and African.
[2]Excludes machine-to-machine revenue.

Source: Analysys Mason; McKinsey analysis

Operators that can crack the code on video and other "over the top" content should therefore enjoy rich rewards.

Consolidation and new types of partnerships are also likely. Historically, market share has been strongly correlated with margins, and scale has facilitated investment in essential infrastructure. In the data era, spectrum in attractive frequency blocks is a scarce asset that may give rise to consolidation (pending regulatory feasibility), asset sharing, or both.

As operators prioritize their opportunities, the need for continued digitization will be a constant. More digitized business models will help regional players to meet the high levels of customer satisfaction required in the data age and to reduce operating expenditures significantly. More specifically, the smart use of technology should help operators develop a digital ecosystem to propel demand for data services; invest in the core business of connectivity; adopt a segmented, targeted approach to customers; and foster innovative new customer relationships. While the exact details will differ by company, the broad contours of a more digital, data-driven business model will be important for all. Q

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Download the full report on which this article is based, *Telecommunications industry at cliff's edge: Time for bold decisions*, on McKinsey.com.