Breaking the Speed–Price Paradigm for Consumer Broadband

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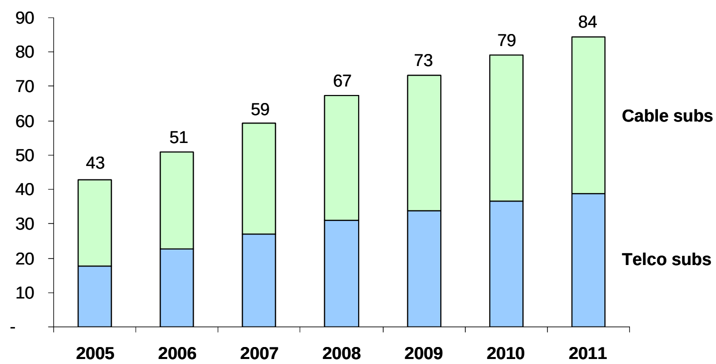
Competition for customers in consumer broadband is primarily focused on speed and price. Network investment and increasing competition has led to declining pricing per unit of capacity ($ per Mbps). Any provider who wants to avoid the spiral of declining bandwidth prices needs to consider alternative methods for delivering value to consumers. This will become increasingly important as the US broadband market reaches saturation.

Explosive Growth of Consumer Broadband

Since 2000, broadband adoption has grown aggressively as both telco and cable providers have expanded their networks, improved their speeds, and launched compelling double play and triple play bundles with broadband. US broadband subscribers have grown from just over 6 million in 2000 to nearly 60 million at year end 2007 with cable holding a 55% share and telco capturing the majority of the remaining shares (Figure 1). At the same time, broadband average revenue per user (ARPU) has remained relatively flat or declined, although average speeds have increased considerably during this period.

The openness of the Internet *supported by broadband* has been a primary factor in stimulating demand for broadband access services. Access to rich on-line content, growth in multi-user households, expansion of telecommuting practices and home-based offices, and demand for higher bandwidth applications (such as peer-to-peer file sharing and video streaming) have driven millions of customers from dial-up Internet services to DSL, cable modem, or fiber-based services.

Figure 1: Consumer Broadband Households (in Millions)



Source: Credit Suisse, Bear Stearns, CSMG analysis

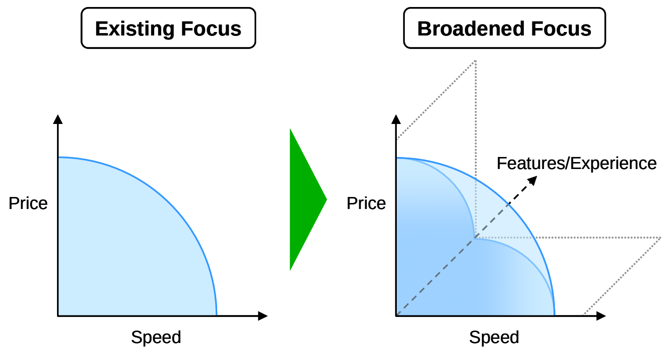
Service Providers Missing Value

Through this period of usage growth, most service providers have been left out of the value created by these new Internet services, even though such services depend critically on providers' broadband networks. Many providers have attempted to bring a more robust offering and feature set to their broadband customers; however, most emphasis remains on speed and/or price with only a secondary emphasis on advanced features, which are often perceived to be of limited value to the masses.

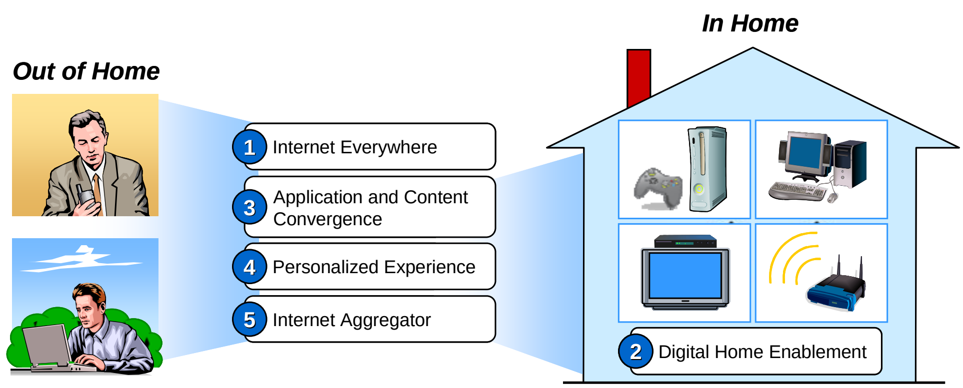
While both telco and cable broadband providers have invested in rich applications and content partnerships, the majority of their marketing strategies remain centered around basic purchasing criteria: speed and price. ISP services that are central to consumer enjoyment/appreciation of broadband (such as email and portal offerings, and related services such as home networking) are not presented as core to broadband. Instead, service providers emphasize either price (e.g., $9.95 introductory DSL offers) or speed (5 to 10 Mbps or higher).

A key question, therefore, remains: can broadband escape the fate of other landline services, or is it doomed to commoditization (falling $/Mbps and exclusive focus on price and speed) as the markets reaches saturation? We believe there are numerous ways for multi-platform service providers to break the speed-price paradigm and grow broadband-related revenues. Success requires differentiation along feature dimensions to position the use and experience of broadband over the speed or price (Figure 2).

Figure 2: Paradigm Shift towards Feature / Experience



Potential differentiation strategies provide enhanced features and experience both inside and outside the home. Five specific examples we've identified include:



1. **Internet Everywhere** – Service providers can pursue or leverage assets to extend high speed Internet outside the home (i.e., more pipes in more places). While not all providers have affiliated wireless divisions, providers can (through a combination of build, buy or partnerships) leverage technologies such as mobile broadband (EVDO or HSPA), WiFi (hotspots, hot zones, etc.), or WiMAX to extend their broadband services for greater end-user utility. The marketing emphasis remains on network and its reach and the ability to take your broadband services wherever you go.

2. **Digital Home Enablement** – While many players, from Microsoft to Sony, are battling for control of the home, the importance of the Internet and digital content distribution ensure a vital role for broadband service providers in this battleground. In an era where consumers face mounting challenges in setting up and managing home entertainment centers, where content resides in both

physical and digital format, where new platforms (music, gaming, computing, in home security and automation, etc.) require connectivity to other devices and the Internet, there are numerous opportunities for the broadband provider (especially one that interfaces with the PC and the set-top box) to act as a central point of control and content aggregator. Thus, from technical networking support to managed in-home services, the broadband provider could arguably offer a rich set of value-added services.

3 **Application and Content Convergence –** Telco and media companies have been talking about convergence as a killer strategy for at least the last 5 years, yet few “must-have” features or services have really hit mainstream. Service providers need to accelerate convergence across platforms and services, using broadband access and the desktop as a central point for account management, set up, and preferences.

While opportunities in convergence include many communications-centric applications (network-based address book, desktop calling and video conferencing), consumers are more likely to value and pay for content-centric converged features (access to DVR content from the desktop). In the arena of entertainment, cable companies are perhaps better suited than telcos, given their history, to address the needs of consumers. Although with investments by AT&T and Verizon into video services, the telcos may not be far behind.

4 **Personalized Internet Experience –** The leading portal providers have been emphasizing service customization for individual users. At the same time, new tools (*e.g.*, AJAX programming) enable individuals to create their own personalized home pages, organizing content and tools (search, weather, stock quotes, etc.) from various web sites together for a unique Internet experience. These tools enable average users to develop a sophisticated presence with limited time and effort while allowing advanced users greater functionality than individual third-party portals allow. More importantly, they can be integrated into service providers’ own portals providing account information, self-care, and ISP applications (email, security, search, web hosting, storage and back-up). Providers can help make the Internet easier to reach, manage, and personalize for their broadband base.

5 **Best-of-the-Internet Aggregator –** Many service providers would say that they attempt to do this today, either through their own portals or through partner portals. However, our experience suggests that these are not part of a planned or concerted effort by the provider to be an aggregator. Often, partnership discussions between broadband providers and Internet players have resulted in launch delays and limited success. Pursuing an aggregation strategy would involve integration of Internet services offering music, video, games, interactive content, user generated content, etc. through strategic partnerships.

Service providers could differentiate by providing the best experience through quality and selection of content and applications, though quality of service, and through access to billing or other platforms (mobile or digital TV, etc.) that only the service provide can deliver. Service providers’ considerable content acquisition resources have been primarily focused on video content, but their efforts could be extended to acquiring Internet content to help take service provider offerings to the next level.

Implications for Service Provider Business Models

In all cases, service providers need to think beyond a network-centric focus and leverage their assets in new ways. Many of the strategies to differentiate based on enhanced features or experience involve significant changes to service provider business models. New forms of partnerships with so-called “over the top” players may be necessary. Providers need to re-examine their role in the value chain and develop partnering skills to create deep collaborations. This increased organizational flexibility is critical to enabling them to add and tightly integrate key solution elements as the pace and intensity of competition increases.

Considering Broadband Tiers

Any provider who wants to avoid the spiral of declining bandwidth prices needs to consider each path (or some combination of paths) to differentiate its broadband services. Reconsideration of broadband tiers, feature/service restriction to higher speed offers, must be a part of breaking the speed-price paradigm. A single service offer is not the solution, but does the mass market need 15-25 Mbps broadband speeds without a compelling killer application? Certain applications and users benefit from these speeds, but providers are not necessarily getting commensurate greater value for providing this faster pipe. Additionally, delivering those speeds can potentially erode other revenue streams (i.e., video and traditional voice). Where networks can deliver high speeds, it may make more sense to monetize them through burstable bandwidth associated with individual services, such as a direct-to-PC/entertainment center movie rental service rather than trying to upsell millions of customers to higher speed broadband offers.

Strategies Vary by Service Provider

While the speed-price paradigm has worked to date, its effectiveness is reaching the end of its useful life in the maturing broadband market. A change is necessary to preserve and capture the value enabled by the broadband pipe. The options for broadband evolution are varied and complex. Different service providers will find different strategies and combinations of strategies effective given their existing competencies and resources and their competitive environments. Maintaining the status quo seems unwise and unsustainable. A continued focus on speed and price will likely lead to future revenue erosion and declining returns on assets as greater network investment will be required to deliver increased broadband speeds.

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