If Bottled Water Prices Can Be Differentiated, So Can Broadband Access

IBSG Service Provider FastFacts

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Demand for Internet services continues to build. The increasing popularity of smartphones, tablets, and video services is creating a "data tsunami" that threatens to overwhelm service providers' networks.[1]

So far, service providers have mainly reacted to the data flood with technical counter-measures—for example, by deploying Wi-Fi and small cells to offload data in heavy traffic areas such as sports stadiums and downtown urban areas. The Cisco® Internet Business Solutions Group (IBSG) believes that operators should also act on the demand side, which can be best influenced by pricing.

Back in the early 2000s, network operators were clamoring to build their Internet customer base; they replaced their old metered models for dial-up Internet, and enticed new subscribers with unlimited, flat rate, "all-you-can-eat" broadband data plans. This pricing strategy has enabled mass-market penetration—first in fixed, then in mobile. But it has not increased ARPU.

While flat rate pricing plans have contributed to the waves of Internet data swamping the capacity of broadband operators, these plans have done little to create value from all that traffic. In fact, the decoupling of connectivity and service layers can *destroy* value if you compete on easily comparable flat rate access prices only. Flat rates shift the focus from quality and service differentiation to price competition, and expose operators to the risk of cost-plus-based pricing, with diminishing returns.

In some countries, fixed-broadband providers have started altering flat rates by introducing some forms of usage-based pricing: "throttling" data download speeds for the heaviest users, switching them to potentially more costly metered data plans, or introducing new tiered price plans. Just in the last few months in the United States, both Time Warner Cable and Comcast made announcements about their plans to experiment with usage-based pricing.[2]

While usage-based pricing models are required to fight "bandwidth hogs," they must be carefully introduced and managed. Customers have learned to love flat rates. The 2011 Cisco IBSG *Connected Life Market Watch* study found that customers hate any departure

from flat rates: two-thirds of customers perceive tiered pricing as “unfair.” Moving those customers from flat rates to other pricing models can risk a company’s competitive positioning.

However, tiered pricing is only a first step toward maximizing value for operators. The long-term remedy will be new, value-based pricing strategies that capture some of the value created by broadband-enabled services. The aim is to transform users’ addiction to broadband into willingness to pay.

These strategies have not yet been widely implemented in the telecommunications industry, but they *can* be done. One only has to look at the price of water to see that it is possible to implement strongly differentiated prices for a commodity product (see Figure 1).

Figure 1. Differentiated Pricing for Mineral Water.

Source: Simon Kucher & Partners; Cisco IBSG. Retail price in Germany: € 1.00 = US$ 1.24, June 2012.

Translating such mechanisms to fixed and mobile broadband will take strong efforts in branding and promotion. More important, building premium value-based pricing plans will require an *integrated* view of Internet connectivity on one side, and Internet-based services on the other.

Successful strategies will rely on both technical characteristics and differentiated pricing:

- Important technical characteristics may include ultra-fast Internet access, turbo buttons, and guaranteed quality of service in terms of bandwidth and latency.
- Differentiated pricing strategies may include time-of-day pricing, dynamic or spot pricing, broadband access bundles shared by multiple devices and/or people (“family plans”), or embedded connectivity.

While the introduction of new pricing models is always a delicate matter, the industry should start thinking about ways to move away from flat rate penetration pricing—and beyond simple usage-based tiered models—toward value pricing. Network technologies enable sophisticated traffic analysis and traffic prioritization mechanisms that can result in more

advanced pricing structures. The time is now for mobile and fixed-line operators to unearth dormant capabilities of their networks and start experimenting with new pricing architectures.

A more in-depth analysis of Cisco IBSG's view on pricing for service providers can be found here: http://www.cisco.com/web/about/ac79/docs/sp/Rethinking-Flat-Rate-Pricing-for-Broadband.pdf

Endnotes

1. According to the May 2012 Cisco Visual Networking Index, global IP traffic will grow fourfold from 2011 to 2016, a compound annual growth rate of 29 percent; mobile data traffic will grow 18-fold from 2011 to 2016, a compound annual growth rate of 78 percent.
2. "Broadband Pricing by Usage," *The Wall Street Journal,* February 29, 2012 (http://online.wsj.com/article/SB10001424052970203833004577251761483000108.html); "Comcast Scraps Broadband Cap, Moves to Usage-Based Billing," CNN Money, May 17, 2012 (http://money.cnn.com/2012/05/17/technology/comcast-broadband/index.htm)

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