Mobile Retail Sales - The Coming Changes in Channels

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Digging deeper than its advanced touchscreen, the iPhone phenomenon highlights the beginning of a more fundamental change as the mobile device market integrates into the larger consumer electronics (CE) industry. With the notable exception of Nokia, three of the top four mobile handset manufacturers are diversified CE manufacturers with significant retail experience. In addition, mobile devices are evolving beyond voice-centric handsets to encompass a wide range of “connected” CE devices. As mobile devices increasingly integrate into the CE ecosystem, one of the most significant changes in the U.S. mobile industry structure will be the increased use of new and diversified sales channels.

In the U.S., more than 60% of the approximately $10B in mobile handset sales is still generated through mobile service providers’ stores, according to NPD Group. Contrast this with the rest of the world, where third-party retailers and CE vendors’ stores account for more than two-thirds of handset sales, according to Informa Telecoms & Media.

Why do carriers dominate the U.S. sales channel, while third-party and CE retailers prevail in markets abroad? In part, “network linkage” – where phones generally only work on a single carrier’s network (in part due different air interface standards) – is the norm in the U.S. But, this alone does not explain the entire difference. The U.S. is also more dependent on handset subsidies while being less mature in terms of penetration.

However, the domestic market is likely to shift away from carrier channels towards “alternative” channels. Although several reasons will drive this change, two critical factors stand out: Reduced handset subsidies and increased third party retail efforts.

Handset subsidies will come under pressure from multiple sources. Today, early termination fees (ETFs) are being reduced or pro-rated because of increasing legal and political pressure. Also, growth is slowing as the mobile post-pay voice market approaches saturation, creating competitive and cost pressures. Over time, these cost pressures may force carriers to reduce subsidies and find lower cost sales channels. Consumers also see greater value in handsets with advanced features, and are willing to spend more, making subsidies slightly less critical in phone selection for the mass market.

Simultaneously, CE stores are becoming more important for consumers who are seeking a phone. As mobile phones become CE devices, the network is de-emphasized and data and entertainment features are highlighted. CE stores are well positioned to address this new demand, as they can serve as a one stop shop for a variety of traditional and ‘connected’ CE devices (e.g., Amazon’s Kindle). Additionally, these stores are uniquely positioned as unbiased advisors to any consumer comparing devices from multiple carriers. Can carriers’ internal stores keep up with this complex demand for entertainment and data solutions spanning a variety of consumer electronics devices, or will electronics retailers and mobile phone chains (e.g. Carphone Warehouse) become a preferred retail source? Without dramatic change from the carriers, chances are good that third-party retail stores will grab greater share in the mobile market.

Assuming the channel mix shifts away from internal retail channels, carriers will be forced to make difficult decisions about store closings, new store locations, and third-party retailer deals every month. Aligning channel mix and compensation with demand, in terms of geography, customer segments, foot traffic, handset inventory, customer lifetime, and network capacity, will be more difficult. The old model of simply comparing cost per gross add loses value as new mobile devices will have a wide variety of monthly ARPUs, handset subsidies, churn rates and profit margins. Under the new model of multiple mobile devices per customer, a gross add is a "blurry" concept, and CPGA is a vague calculation. As CPGA loses its economic relevance, carriers might make poor economic decisions.

Another risk for carriers will be the impact on churn. Third party retailers are naturally less inclined to promote any single carriers' service. In fact, these retailers may offer their own wireless service as they seek "residual" revenue streams. Unless some level of carrier-retailer exclusivity is negotiated, third-party retailers will drive higher churn for the established carriers.

Stepping back from carrier channel strategy, the evolving retail model raises more fundamental questions for all players in the mobile industry: How do carriers prevent commoditization of their networks? How do third-party retailers achieve a greater share of mobile industry success? How do handset OEMs balance retail distribution between carriers, third-party retailers, and their own storefronts? The evolving carrier-CE/OEM-retailer relationships will make for interesting times.

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