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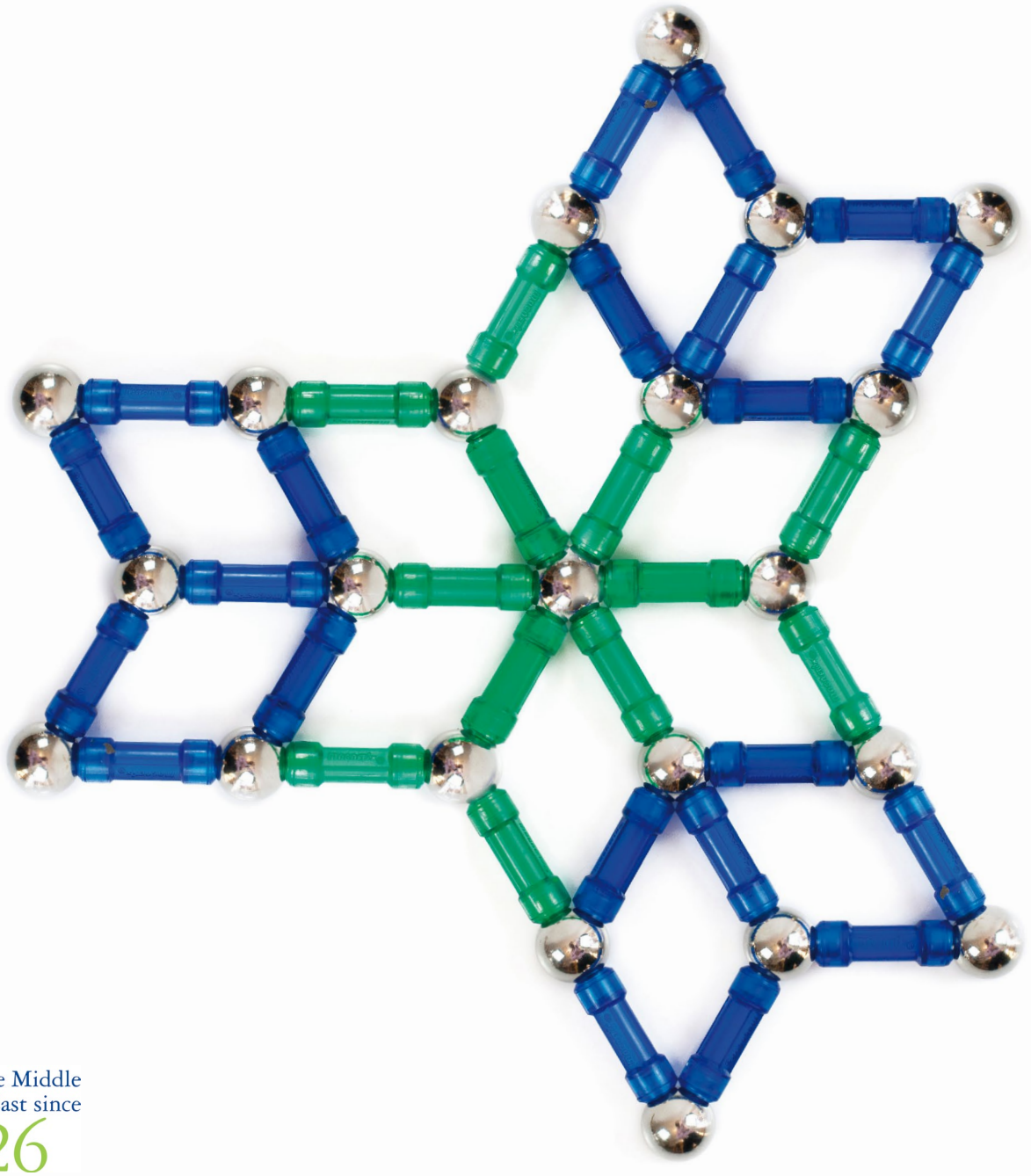
Middle East



In the Middle East since 1926

Short messaging services versus instant messaging: value versus volume

Deloitte predicts that in 2014 instant messaging services on mobile phones (MIM) will carry more than twice the volume (50 billion versus 21 billion per day) of messages sent via a short messaging service (SMS)[343]. This is a significantly greater ratio than in 2012, when 1.1 instant messages were sent for every text message[344]. It might be supposed that the growth in MIM is coming at the expense of SMS and mobile carriers. However despite the burgeoning volumes of messages carried over MIM platforms[345], we expect globally SMS to generate more than $100 billion in 2014, equivalent to approximately 50 times the total revenues from all MIM services[346].

So MIM services may win the battle for volume in 2014, but SMS will be victorious in global revenue terms. We expect SMS to continue to generate significantly greater revenues than MIM even as far out as 2017, by which point global SMS revenues are expected to have started falling[347]. We would also expect MIM services on mobile phones to continue to substitute not just for SMS, but all other forms of communication, from e-mail to phone calls.

Text messaging's superior revenue-generating ability is due to three main factors: ubiquity, infrequency and price.

SMS is the one messaging standard common to almost every mobile phone[348]. There are 3.2 billion unique mobile subscribers that can send and receive SMS[349]. MIM is popular, but it requires a smartphone, tablet or MP4 player. It also needs a mobile data plan, or a connection to a Wi-Fi network. Both are ubiquitous in some regions in the world, but in some markets, such as most of the African region, only a minority has mobile broadband, and even fewer have fixed broadband.

Further, many over-the-top (OTT) providers are incompatible with each other. Communication via an OTT service requires all parties to have the same app. A WhatsApp customer cannot message a WeChat user directly. In order to communicate, the requisite app would need to be downloaded; otherwise SMS would have to be used[350].

Some MIM services only work with a single brand of phone. When sending a message to someone using a different manufacturer's phone, SMS is the choice by default.

While SMS is common to all smartphones, most smartphones are likely to send far fewer SMSs than MIM messages in 2014. But the relative infrequency of sending SMS compared with MIM may be a key reason why SMS is able to generate greater value. Mobile phone users may be relatively insensitive to SMS tariffs as they send few text messages relative to those sent via MIM services. Feature phone users may send few messages via their phones. For both types of mobile phone, users may be willing to spend 10 cents per message on the assumption that in a given month they would send fewer than 10 messages.

It is also important to note that while MIM and SMS are based around messaging that is predominantly text based, there are subtle but fundamental differences which engender different behaviors. MIM is based around two-way communication and an interchange of quick-fire responses. Presence awareness often acts as a signal for one correspondent to start conversing with another – or multiple others. Further, instant messaging's origins are as a free-of-charge PC-based service. By contrast SMS is more about individual, paid-for messages, for sending information.

Smartphone users travelling abroad may prefer to use text messaging, as it may be cheaper while roaming to send an SMS than to purchase a mobile data package so as to be able to send and receive MIM. And some users may simply not have mobile data roaming enabled.

MIM's lower direct revenues may also be due to the provider's business model. Some MIM services are a value-added offering to all users of a manufacturer's device. For example Apple's iMessage service is a feature of the device ecosystem and there is no subscription involved[351]. Facebook's communications services for mobile devices may help drive mobile advertising revenues. Some services such as WhatsApp seem to be focused, at least for now, on capturing the largest possible user base, and are not focused on revenue. Other services such as Snapchat may focus more on the value from accumulating large volumes of users, to whom value-added services can subsequently be sold[352].

In 2014 it is very likely that trillions of MIMs will be sent in place of a text message. But it is also very likely that, billions of times per day, MIMs will also be sent instead of e-mail, tweets or other forms of communication such as phone and video calls.

SMS's significant revenues and margins in 2014 are likely to contrast with the challenges facing some standalone MIM service providers. Competition between MIM providers may prevent significant profitability from being achieved[353]. With some providers relying on revenues from app purchases or one-off annual fees, average revenue per customer is low. For example, WhatsApp charges a dollar a year per subscriber[354]. Other providers have included virtual goods or games in their offering, and their revenues are growing fast[355]. For example Line generates about 69 cents per customer per quarter from in-app purchases, advertising and games[356]. As more services become available and competition increases, some providers are forced to buy TV ad space to raise awareness, rather than relying on free viral marketing[357]. Indeed the MIM business model may face substantial challenges in 2014, and the upper limit on revenues may be surprisingly low: a MIM provider with seven billion users, charging a dollar per year, would have a fraction of SMS' global revenues.

MIM and SMS are likely to be regarded as direct competitors in 2014[358]. One analyst estimated that in 2013, MIM depleted SMS revenues by $32 billion. A single text message costs a few cents to send, but an MIM consisting of 200 characters of text may generate about 0.01 cents if the subscriber is paying $10 per gigabyte, and the MIM provider may not earn anything from this[359]. Given the rising volumes of MIM messages in 2014, the implicit loss might be even higher[360]. However over the past few years, global SMS and MIM volumes and revenues have grown in tandem[361].

But while MIM may be taking revenue from mobile operators in the form of lost text messaging revenues, it may also be driving demand for mobile broadband. And in 2014, revenues for mobile broadband may overtake SMS[362]. While it is difficult to assign an exact value for the impact of instant messaging on the take-up of mobile broadband, it is sizable, and should become larger still over time, as MIM services are used increasingly to send large audio and larger video files. A one minute-long video sent via MIM is more than 1,000 times larger than a text-only MIM (see Figure 12 for approximate file sizes by different type of messages).

Figure 12: Approximate file sizes by type MIM message

Type of MIM message	Approximate size (in KB)*
Text-only MIM (approximately 150 characters)	10
Photo	100
Audio file (one minute long)	150
Video file (one minute long)	12,000

Source: Deloitte analysis based on publicly available information[363]

* File sizes are considerably compressed when sent via an MIM application and will not reflect its actual size.

Bottom line
Text messaging's heyday is approaching but in 2014 it should still generate significant margin for the mobile industry. Its importance should be neither overlooked nor underestimated.

There are several ways for operators to respond to the negative long-term outlook for SMS.

One would be to try and create an operator-owned OTT MIM to rival the existing providers. For this to work as well as SMS, it would need to be a global standard; if the industry relies on opt-ins on a per carrier basis, adoption is likely to be too slow[364].

A further option would be to incorporate MIM-type features into SMS, such as by replicating the ability to send messages to groups easily, and to include audio and video clips. Presence functionality may also help.

A third option would be, rather than compete with MIM services, to encourage their adoption, so as to increase take-up and usage of mobile data. Carriers should evaluate the merits of exposing network and data assets to OTT players via APIs (Application Programming Interfaces)[365]. Carrier APIs allow third parties to integrate their applications and services more closely with the mobile device, the SIM card and elements of the network. Functionality ranges from in-app advertising through to 'add-to-bill' processing, which allows the value of in-app purchases, such as emoticons, stickers and games, to be added to the monthly phone bill. Given that MIM services tend to have low consumer loyalty, carriers could help improve the dynamics of OTT MIM, whilst at the same time positioning themselves to capture a share of MIM revenues. Figure 13 provides an example of some of the APIs that a carrier could expose.

Figure 13: examples of carrier APIs

Source: Deloitte research using various publicly available sources[366].

A final option for carriers would be to encourage the usage of SMS as a bearer for application to person messages (A2P), which are used to send personalized messages to individuals, from advice of bank balance, to warning of a delay to a flight, to a reminder for a medical appointment. One analyst has estimated that A2P messaging volumes could grow an average six percent per annum over 2013-2017[367].

Standalone MIM service providers aiming to maximize revenues may need to diversify their income streams. Some providers may become content platforms. In Asia Pacific, companies such as KaKao and LINE are monetizing their significant installed bases by positioning their service as a platform for games, virtual goods and advertising. Deloitte estimates that revenues generated for MIM service providers from games bought or played on their platforms and other virtual goods, such as stickers, will be worth over $1 billion in 2014 – a significant sum, albeit still a fraction of revenues generated by SMS services. Standalone MIM providers may also want to generate additional revenue from advertising, but this might cause some users to change their service.

Middle East perspective

The global decline in SMS volumes at the hands of mobile instant messaging (MIM) is also felt by telecom operators in the Middle East. In the UAE, SMS volumes have dropped considerably in recent years, with a decline of 24 percent between 2009 and 2012[368]. MMS declined even faster, almost 50 percent over the same period[369]. This trend should not surprise, particularly in the UAE, which at 74 percent has emerged with the highest smartphone penetration rate in the world[370], and where MIM are the most popular, frequently downloaded and used apps. Surveys amongst users in the region reaffirm this, with 77 percent ranking communication apps the most popular and 58 percent using them the most frequently[371]. For example in Saudi Arabia, the largest smartphone market in the Middle East and third globally with 73 percent[372] penetration, WhatsApp was the most downloaded paid app towards the end of 2012[373].

Two areas of concern for regional telecom operators arise from this. The first is the fact that both globally and locally, SMS and MMS is declining. The second is the pace of that decline in the Middle East, estimated at 9 percent per annum so far in the UAE alone. In dollar terms, we expect the impact of OTT on operators' SMS and MMS revenues to be in the range of 5 to 6 percent in the next 5 years[374]. Though this seems small, SMS is still one of the highest margin services provided by operators, so the impact on profit could potentially be greater. At the same time, higher smartphone penetration and stronger affinity to MIM makes it more ubiquitous in the Middle East than anywhere else in the world. Coupled with increased multimedia sharing in the region, MIM is a stronger driver for data consumption. For example, WhatsApp's recently rolled out cross-app content sharing capability has enabled one Middle Eastern music streaming service to share 50 percent more of its songs via WhatsApp than on Facebook[375]. That said, we also expect Facebook's recent acquisition of WhatsApp to accelerate the region's MIM data sharing and consumption habits as well as to increase the user base across both, as it seeks to integrate messaging and photo services across the two platforms[376].

Globally operators have used one of the following strategies to combat OTT: defend (block OTT MIM, improve SMS pricing), replicate (compete with their own OTT MIM, acquire an existing OTT MIM) or partner. In the region, we expect operators to adopt a partnering approach to encourage data consumption and expand new revenue streams. Saudi Arabia's Mobily has already taken this step through its partnership with WhatsApp in 2012. Under the agreement, Mobily can exclusively launch WhatsApp packages in the Kingdom, in which users pay a monthly or weekly subscription fee to enjoy unlimited WhatsApp usage[377].

In the interest of maximizing the bottom line, operators in the region should also aim to retain and extract the most value from their SMS share while they can, for instance through application to person (A2P) messaging from GCC mGovernment programs, mobile banking and business to consumer (B2C) SMS advertising. At the same time, operators should capitalize on the greater volume of data consumption that the region presents with its broader MIM base.

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Endnotes

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364 When it comes to innovating new services, the scale and complexity of the global mobile industry means that decision-making is inevitably slow, and the standards that underpin the industry's uniformity have often acted as a straightjacket. Though some carriers have delivered innovative services in isolation, as a group, they have struggled to cooperate in the development and deployment of new services, especially for data. It may well be that trying to negotiate a common MIM messaging standard for operators is simply too hard.

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