# A SPUTNIK MOMENT:

## STRATEGIES FOR INCUMBENT TELCOS

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## INTRODUCTION: A SPUTNIK MOMENT FOR THE CONNECTED AGE

In the most recent State of the Union address, the President reflected on the changing times and when observing the nation's declining global dominance in the areas of technology and education, he stated, "The rules have changed. In a single generation, revolutions in technology have transformed the way we work, live and do business." Referring to this time as our "Sputnik moment", he suggested that "the outcome means whether new jobs and industries take root in this country or elsewhere."

For the telecommunications industry the analogy holds true. We now live in a time that has been referred to as the Connected Age, where people care less about the nature of technology but more about how they interact with it and how it enables their ability to grow relationships and simplify their lives. For service providers seeking to enable this, the rules for winning have changed as well, and the outcome will determine whether new jobs and industries will take root in our communities, powered by our networks and managed by our people.

For some service providers, the opportunities have never been so abundant. But for legacy mindsets, the future looks challenging and perhaps overwhelming, particularly as the confluence of marketplace and regulatory shifts compounds elements of uncertainty of the Connected Age.

This paper squarely addresses the challenges of Independent telecommunications companies and provides a roadmap on the many opportunities to emerge as winning "Integrated Communications Providers." By meeting the challenges and taking advantage of the opportunities, such providers can fulfill their mission to serve as the economic engines of their community now increasingly connected with the rest of the world.

## HOPE IS NOT A STRATEGY

According to Bill King at JSI Capital Advisors, there are six potential business strategies for RLEC Operators.[1] Unfortunately, the one that is "arguably the strategy most followed" is the Default Strategy or Melting Ice Cubes. This is characterized by "denial, ineffectiveness, or simple inaction."

In this Sputnik moment, inaction is not an alternative and hope is not a strategy. Hope that Google won't come to town or that Microsoft will fumble Skype, or that the regulatory winds will blow my way, is not a strategy. There must be honesty and acknowledgement of the two truths of the industry.

First, the replacement of core legacy voice service with broadband connectivity as 'local service' is assured. What remains then is how to best plan and execute a future broadband strategy.

Second, the current regulatory scheme, which is based on voice service built upon POTS and minutes of use, is unsustainable, and a shift to regulatory policies based on broadband and bits is already underway. With rational thinking, the regulatory changes which so influence the business will not be done quickly but over a period of years.

This provides a window of opportunity to reform, prepare, plan, and build a new broadband framework and position integrated communications providers to thrive. This window is small and will not be without challenge and pain—some may not succeed, at least not in their current form. However, those who do, have every opportunity to prosper.

1. www.jsicapitaladvisors.com/the-ilec-advisor/ 2010/11/3/defining-rlec-ownership-strategies

## THE INNOVATION GAP—FEAR, DOUBT, AND UNCERTAINTY

Since the industry's inception, we have recognized that our prosperity is based on bold ideas put into practice through innovation.

Innovation can be broken into three types:

**1** **Business Model Innovation - developing a flexible, dynamic network that enables the rapid deployment of services and applications.**

**2** **Organizational Innovation - evolving the corporate culture by shedding legacy habits, adopting unfamiliar skills and elevating our "IP IQs."**

**3** **Marketing Innovation - responding to and serving our customers and community with applications they need to compete and thrive in the Connected Age.**

Unfortunately, few feel capable of innovation. According to a recent Metaswitch survey of service providers, this innovation gap is driven largely by fear, doubt, and uncertainty:

**17%** **Fear of jeopardizing brand heritage or concerns over technical failures**

**20%** **Doubt in own abilities**

**63%** **Uncertainty of regulatory impacts or service demand and uptake**

## YOUR NETWORK, YOUR ROOTS

Along with its customers, the greatest asset of any service provider is its network. Connectivity into every home, business, and institution within a community presents a tremendous opportunity. The obvious involves the ability to control the quality of experience and to leverage the established billing relationships that it enables. But beyond that, the network represents community, in the truest sense of the word. It connects people and institutions. A robust communications network is a community's roots in today's Connected Age. Successful service providers will recognize and understand this role and exploit its many opportunities as it is the economic underpinning which can drive growth and consumer loyalty.

To succeed, service providers must not only build the required communications infrastructure, but also build the brand and the perception that their network best meets its community's economic needs as the enabler of the Connected Age. So, this compels service providers to:

- **Build Your Broadband Backbone** - The perception of broadband is unmatched and whoever delivers it the best has an advantage.
- **Connect Anchor Institutions** - Providing robust connectivity to schools, governments, hospitals, and libraries is a priority, even if it means accepting lower margins. Ensure that community institutions look to you first for communications solutions.
- **Consult With Your Customers** - Don't just sell products and services. Provide consultation on how your company's solutions will help businesses better compete or make consumers' lives easier.

- **Prepare Wholesale Strategies** - Service providers will not win 100% of retail relationships. For those that can't be won, be in a position to provide the wholesale connectivity that enables others.
- **Enable Applications** - Customers, residential and business alike, want applications. Ensure your network is best able to accommodate that expectation.

The goal should be a perception by the community, its people, businesses, and institutions, not that the local service provider merely provides pipes, but that operates and maintains the community's economic engine and is vested in its prosperity.

## A NETWORK BUILT FOR APPLICATIONS

Next generation networks are better defined as application platforms than as communications networks. Customers don't buy flowers for their roots, but for the positive impact they make in their lives. Customers don't want pipes; they ascribe value to the applications that can be delivered over them. This represents a significant shift for legacy providers, who historically have built infrastructure, not platforms.

Providing an end-to-end IP connection will win the day in an applications-driven ecosystem, and regulatory shifts appear to recognize this reality to allow for this transition. Winners will move rapidly to develop all IP connectivity as quickly as possible, to incubate an innovative application culture, and to be able to quickly evaluate, launch, and bill for applications.

## VOICE AS AN APPLICATION

Making the applications transition does not mean forsaking voice services. To the contrary, the reality behind accelerated line loss has less to do with demand and more to do with perspective. Customers are not disconnecting voice service. They are choosing to receive it from a different provider—for some perceived value or convenience that was not being provided before.

IP enabled integrated communications providers are in a much better position to meet these changing expectations of voice customers and offer a better voice product. Customers who don't cut the cord entirely, but select a different voice provider, do so primarily to gain access to new and better features, or to save money, or both. First mover advantage in services innovation is evidenced by the use of triple play bundling with a digital voice component by a range of competitors. This has been quite successful in taking telco landlines. Telco service providers can play that same game with an application-enabled IP network.

Voice as an application is best described as digital voice (or digital phone). Digital voice builds upon the legacy POTS model with highly desirable features more in tune with the digital and mobile lifestyle that customers now demand. Incoming call management services, unified messaging, and integration across platforms are better able to keep up with a mobile lifestyle. Customers use an ever-growing suite of smartphones, tablets, PCs, phones, TVs, etc,—and they expect easy command and control functions. They need online access to their communications profile from multiple devices and they need to be able to easy manage that profile as well. In effect, digital voice is the voice application answer for the Connected Age, and integrated communications providers who embrace it quickly are better positioned to meet the voice needs of customers.

Early adopters of this approach have seen positive results. SureWest of Roseville, CA introduced a digital voice product two years ago and effectively bundled it with an FTTP triple play offering. They use the strategy to gain new customers, as well as to prevent existing voice customers from leaving them. In fact since instituting their digital voice product, they convert, on average, 40% of customers who call in to disconnect their legacy POTS service to their voice-as-an-application offering. Among new FTTP bundled customers, roughly 85% select their digital voice product.

AT&T has also embraced voice as an application, labeling it U-Verse Voice. It's a feature rich digital voice product, which they are effectively using as a component of a triple play bundle. On average over 70% of new bundled subscribers are selecting U-Verse Voice for their bundle. Of particular note with AT&T—those same voice-as-an-application subscribers had an option of selecting a mobile voice product as the voice component for their triple play bundle, but chose the feature rich wireline voice option.

The voice as an application approach also expands your scope outside of your incumbent territory. Building this capacity affords you the opportunity to go out of market and approach neighboring communities with a robust digital voice product in a bring-your-own-broadband approach. While this application will not appeal to everyone, it can build incremental margin rich revenue for those who have interest.

## WHITHER WIRELESS?

For customers who decide to cut the voice wireline cord, all is not lost. Integrated communications providers should also be focused on wireless backhaul. Ensuring your network is the preferred provider of wireless backhaul is paramount, and guarantees that your wireline network generates revenue from an exploding wireless business segment. While incumbents have had historical success with wireless backhaul for their community, future success is by no means guaranteed. The competitive landscape is sure to change in part as Broadband Stimulus funds middle-mile transport; and movement to 4G wireless and its Ethernet-optimized packet optical demands for backhaul require integrated communications providers to adapt.

Beyond wireless backhaul which is ostensibly a legacy “pipes to pole” strategy, integrated communications providers with a digital voice arsenal should not cede to wireless only customers. There is an opportunity to rekindle their interest in wireline telephony, regardless of whether the service provider owns wireless facilities as well. Fixed mobile convergence is no longer a theory.

Integrating mobile and fixed services into a seamless value-added experience is now a reality in the Connected Age. Tools including unified messaging, video telephony, home security monitoring, and “over the top” (OTT) voice and applications services now make wireline telephone service in the home an easier proposition for a would-be cord cutter.

By taking a voice as an application approach, service providers now have better options to extend and expand the wireline voice value proposition. Indeed, one way to ensure accelerated landline loss and an uncertain future is to maintain the POTS status quo.

## BUILDING AROUND THE PIPE

While the application or “app” phenomenon has been dominated by the mobile landscape to date, its movement into the home and business environments is well underway. In fact, apps are at the core of an apps lifestyle. Both residential and business customers increasingly depend on them to help manage their personal and professional lives. It is a great example of the Connected Age and its impact on society in general and on integrated communications providers specifically.

The app lifestyle creates expectations, and customers will select the service provider who best meets them. While there is much discussion around business models for application enablement, there is little time to debate the arguments. The time is now to build services around the pipe that meet the app needs of customers. These include:

- **Data Backup and Storage** - The digital lifestyle produces a lot of digital activity, much of which customers want to preserve. The digital locker opportunity has great promise.
- **Home Security and Monitoring** - An IP enabled network provides an excellent opportunity for robust home security options with advanced features including real time monitoring and notifications.
- **Unified Messaging** - Simplifies a customer’s life by providing a single mailbox across multiple numbers with access from multiple digital devices.
- **OTT Content and Entertainment Apps** - While most OTT content is associated with Netflix or Hulu, there are a variety of other OTT options, including original locally produced content, which gives service providers interesting opportunities.
- **“Geek Squad” Services** - The growing number of PCs and gadgets in possession by customers exponentially increases user confusion and security risks. Mitigating those risks while easing deployment is a natural fit for an integrated communications provider.
- **Child Monitoring** - Unfortunately, the information age significantly increases the dangers and threats to young children. Helping parents better protect their loved ones in this environment presents unique opportunities.

Perhaps most important is the need for integrated communications providers to build the platform which allows them to quickly add to this list of example services.

## EMBRACING THE ENTERPRISE

The Connected Age challenges businesses and enterprise as well. They too are trying to position themselves in this digital economy to maximize opportunities with their customers. To best leverage those opportunities, they need help. They need to better understand how technology and an app enabled communications network can contribute to a growing bottom line and they’re willing to pay for it. Many service providers recognize this, and that’s why we’re seeing significant movement towards enterprise services by incumbents like CenturyLink, Windstream, TDS, and Cincinnati Bell.

Failure to act now will bring disastrous consequences. According to market research sponsored by Metaswitch in the fourth quarter of 2010:

- **64% of the market were considering IP voice services like SIP Trunking or Hosted PBX connectivity in the next two years**
- **Of the 27% who have already adopted, nearly three-fourths have opted for a new service provider.**
- **This implies that over 40% of an incumbent service provider's base may be at risk if steps aren't taken to address this market demand for IP voice service.**

What is at risk is not only today's revenue, but tomorrow's growth. Adopters of IP voice, particularly hosted VoIP, are twice as likely to adopt other services from the IP service provider, particularly those now categorized as Cloud Services in today's taxonomy. The IP pipe with voice and PBX functionality as the first and most logical application can serve as a ladder for your customer to your cloud.

Cloud computing and managed services have growing appeal to business customers. These applications, and the service provider partners who enable them, can relieve business customers of the technical details of running their business so they can focus on what's most important—serving their customers and growing their top line. Connected Age providers need to build the capability to capture this opportunity.

Regardless of the enterprise service portfolio, the consultative approach is what adds the most value. Helping your business customers improve their business through the utilization of your services will help build a profitable enterprise focused business line, providing diversification of revenue.

## THE WHOLESALE OPTION

Robust communications networks tend to have excess capacity, and lots of it in most cases. Expanding your scope outside of your incumbent territory for the provision of wholesale network capacity may make perfect sense. Neighboring wireless carriers, ISPs, CLECs, and other integrated communications providers are good candidates to leverage excess capacity.

Easing of legacy regulatory requirements may make what are now prohibitive tariffs more appealing to transit of traffic to and from neighboring communities. The changing regulatory environment and the impact it will have on revenues requires carriers to explore all opportunities for revenue diversification. There may even be wholesale opportunities within your incumbent territory with the right partner. For example, partnering with the local electric utility for smart grid applications presents interesting business options worth exploring.

## CONCLUSIONS

Half a century ago, when the Soviets beat the United States into space with the launch of Sputnik, we had no idea how we'd beat them to the moon. We were engulfed in our own fear, doubt, and uncertainty.

But after investing in innovation, we didn't just surpass the Soviets—the Information Age unleashed a wave of new innovation that created new industries and millions of new jobs.

Incumbent operators cannot allow their ice cubes to melt in the flames from Sputniks launched by competitors, but must rather face the future and acknowledge the demands of the Connected Age.

This starts with a foundation of an all broadband and IP environment, and committing the resources necessary to transition human and network resources from providers of infrastructure to enablers of applications.

This process is not without challenge and requires dedication and commitment from all involved. It is more than just technology innovation and improvement. It's a cultural transition as well, which requires the shedding of legacy habits and the adoption of unfamiliar skills.

There will be a definite window of opportunity to make these necessary changes. Today's incumbent service provider should take full advantage of it. What lies ahead is an exciting future which will be extremely fulfilling. But only for those who prepare and accept the challenge.

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