

# Telecom: Down But Not Out

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**T**he telecom industry enters the year 2002 in one of its worst slumps ever, with little expectation of resurgence until the nation's economy regains strength, perhaps in the third quarter. Not only is the national economy critical to the revival of the telecom industry, it was certainly an important contributing cause of the telecom decline. But there were other key factors as well, already leading to retrenchment. These include excessive and highly speculative building of unneeded capacity and optical networks; a surfeit of vendors attracted by an over supply of capital; failure of the industry to deploy marketable, productivity-enhancing applications; and Wall Street hype of technology stocks together with those of the ".com" firms, followed by a loss of market confidence when the market bubble burst.

Service providers are burdened by more capacity than their traffic justifies, largely because demand for broadband services, including high-speed data and streaming video, has not materialized as quickly as expected. Telecom equipment suppliers represent one of the hardest hit segments of the industry—perhaps less severely damaged than Internet service providers (ISPs), competitive local exchange carriers (CLECs) and .com start-ups—but the downturn pervades every segment of the industry. The fallout has disrupted ambitious and sometimes flamboyant domestic and international mergers and alliances and forced thousands of new local and Internet service providers into bankruptcy. Worldwide, at least a half-million telecommunications jobs have been eliminated in the past 18 months and new layoffs are announced nearly every day.

After lavish spending on fiber and optical networks by established carriers and major service providers, from 1996 to 2000, those networks remain largely idle. During the same period, large domestic and international companies made even more extravagant investments in cellular licenses, which, by and large, have not yet become productive. Many banks, investment firms and private groups poured money into start-up ISPs, CLECs and allied firms, many of which have gone into bankruptcy. According to reliable industry estimates, there were some 7,500 ISPs in the United States last year; there are about 3,500 today; and there will be about 1,000 a year from now—a precipitous drop by any standard. The dramatic collapse of .com firms has been fully reported, as it should have been; the disastrous failures in telecommunications have had far greater consequences, but have received less attention.

Investors are now quite leery of telecommunications, even when firms offer solid business proposals. The industry is wracked by enormous debt in a hesitant economy that has reduced customer demand, shrunken earnings and depressed stock prices. It will take a broad economic revival in the coming year to rejuvenate telecommunications, particularly the hard-hit equipment sector.

In addition to the needed turnaround in the broader economy, experienced observers believe that the telecom industry must do significant internal restructuring in the months ahead to recover from its present economic problems and to facilitate customer choice and advanced broadband services and applications when the recovery occurs. Consumer surveys show that

the industry needs to give more attention to value, service quality and customer care.

A senior telecom vice president, who wishes to remain anonymous, believes that the industry and federal regulatory authorities have not yet stepped up to the need for an economic model that compensates suppliers, applications developers and service providers fairly and equitably through a price structure that brings new applications to the market on a timely and affordable basis.

The current telecom trough is bringing about new efficiencies, more attention to business strategies and more careful management than existed at some companies in the late 1990's. Perhaps if companies survive the present more demanding environment, they will come back stronger than they are today.

### **Federal Policy**

The FCC appears likely to continue the deregulatory path set by Chairman Michael Powell at the time he took that office earlier this year, undoubtedly with guidance and direction from the Bush Administration. The Commission has promoted its deregulatory agenda even when the regulations were designed to foster competition. The FCC has unveiled proposals that are likely to ease restrictions that were intended to implement provisions of the Telecommunications Act of 1996—encouraging competition in local telephone service, for example. The FCC and Congress may go further in that direction in 2002.

At the same time, in the wake of the September 11 destruction of an important switching center in New York City, Verizon has insisted that it must restrict access to its facilities by CLECs, for security reasons. Verizon is also lobbying Congress to raise the wholesale prices that CLECs must pay for such connections because, in Verizon's view, only a large established carrier such as itself can provide reliable telecommunications services in such crises.

After the September terrorist attacks, Congress quickly enacted the USA Patriot Act, which requires broad electronic surveillance of telecom, IT and cable services and institutes a "roving subpoena" process that raises new legal and technical concerns.

### **Mass Media**

The key question for 2002 in the mass media market is, "Who gets to own what?" Observers believe the FCC will either eliminate or at least relax current ownership restrictions, allowing major TV and radio station owners new freedom to expand into newspapers or vice versa. The FCC says that previous objectives on diverse ownership and information cannot be achieved under current FCC rules and do not reflect the multimedia expansion of the past decade. The Commission will likely eliminate the newspaper/broadcast cross-interest rule, but may retain it in some form in a few media markets, where a single entity has a high concentration of advertising revenues.

### **Cable and Satellite TV**

The cable/satellite TV arena is dominated at the moment by mergers: the pending merger of EchoStar with DirecTV, perhaps strengthened by the offer of the French media company, Vivendi Universal, last week, to invest \$1.5 billion in EchoStar; the merger of AT&T Broadband with Comcast, and the possibility of other combinations. The planned EchoStar-DirecTV union is complicated by the fact that it will leave some rural areas of the U.S. with just one provider and may be further complicated by the interest of foreign-owned Vivendi in EchoStar and USA Networks.

Members of Congress are taking positions on different sides of these complex deals, publicly stating concerns about the potential for adverse effects on rural consumers' service choices and about foreign ownership of U.S. media. The AT&T-Comcast combination will surely get federal antitrust scrutiny, but likely less than

an AT&T sale to AOL Time Warner would have invited.

The cable TV industry will remain, as it has been for years, a stormy industry with an assortment of entangled and uncertain business structures and wide variations in the quality of providers' networks and commitment to good and dependable service at fair prices. Cable providers see consolidation as a way to win new customers, expedite introduction of new service options, reduce costs and improve revenues through greater economies of scale; federal policymakers and consumer advocates are not so sure. It is important to know how well a given cable company is managed and whether or not its network is supported by state-of-the-art systems. Federal policy in cable is unclear and continues to shift with the political winds.

The FCC plans to take up regulatory treatment of broadband services early next year.

### **Wireless**

Wireless growth is strong, with a particular spurt in the latter part of this year, driven by a widespread need for greater personal and family security and a desire to stay in touch. Immediately after the attack on the World Trade Center on September 11, commercial mobile calls to and from New York City skyrocketed to 1,300% above normal. Cellular and PCS companies and other wireless service providers handed out 30,000 free phones to rescue workers, police officers and people injured or driven from their homes and businesses. The huge increase in calls and the loss of more than a dozen wireless antennae caused many calls to be blocked, but wireless had nonetheless gained new importance.

Concerns about spectrum availability will continue to dominate the wireless industry. The FCC has decided to eliminate the wireless spectrum cap by January 31, 2003, and has raised the cap from 45 MHz

to 55 MHz in most markets in the interim. Raising the spectrum cap is likely to trigger further consolidation within the industry.

The recent agreement reached by bankrupt NextWave Communications with the Department of Justice, the FBI and large wireless service providers on spectrum originally licensed to NextWave would free up 95 wireless licenses and bring some needed new capacity to a number of service areas. But the issue may quickly wind up back before the Supreme Court.

Another heated controversy over wireless spectrum has arisen because of interference that can now occur between public safety and commercial wireless systems. Nextel has engaged the issue, pushing aggressively on Capitol Hill and at the FCC for a complicated transfer of spectrum that the company says will eliminate the interference problem; the Association of Public Safety Communications Officials (APCO) and others argue that Nextel's proposal is an administrative nightmare that would disrupt wireless services extensively and indefinitely; other wireless companies insist the interference problem can be alleviated by

adherence to carefully defined standards. The controversy may be settled by a rulemaking at the FCC.

An inherent strength of telecommunications is that there is consistent demand for new services and applications, if they are made available at a reasonable price. The reason is simple: telecom is a fundamental resource for all major industries—manufacturing, banking and financial services, transportation and travel, energy production and distribution—and is equally essential to the functioning of government, police and emergency services, education and health care. For customers, state-of-the-art telecommunications services and applications increase efficiency and productivity.

To paraphrase one observer's views, at least three things must happen for the telecom industry to regain its strength: the federal government must develop a regulatory environment that more effectively promotes competition throughout the industry and assure real customer choice; management must demonstrate greater responsibility in the use of capital, to restore investors' enthusiasm for telecommunications; and the various players in the industry

must take a broader view, considering the interests of all parties, which will help speed new applications to the marketplace.

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