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the Bandwidth DESK

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Reporter's Notebook: *Capacity 2002 Coverage*

Carriers Finding Their Own Way to Efficient Marketplace; Traders Need Not Apply

When Ron Harden says he has had a religious argument with his power trader son for the past two years about whether bandwidth is a commodity, he leaves no doubt which side of the fence he is on. The Grande Communications executive vice president of network services is not a bandwidth trading fan, even though he chaired Ascent's bandwidth trading council.

"Bandwidth trading was a flawed strategy and the execution was not good," he says. "But there are some things about bandwidth trading that create tremendous opportunities. Risk management will play out in different ways, not the bandwidth trading model we knew over the last few years."

Bandwidth is no commodity, he says, strongly emphasizing the relationship side of telecom as well as the "true valuation proposition" of buying not just capacity but a range of network services.

Harden relates an hour and a half spent calling around for a price on four

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Telecom Hangover II

The Day After

It's the services, stupid. That was one of the themes running through TelCap Capacity 2002 conference last week. Lots of head shaking about the "build-it-and-they-will-come" business plan. Lots of bandwidth trading bashing. Lots of talk about the "telecom hangover" now that the building bender has come to an end.

But amidst the talk, numbers. Nancy Bedard, director of the wholesale communications service practice at the Yankee Group, brought stacks of charts that indicate wholesale services is a growth market that will shake off three years of stagnation to hit $46.9 billion next year, $54.8 billion by 2004 and $66.7 billion by 2005. Bandwidth, wavelengths, minutes and colocation are in. Infrastructure, except in the lesser markets, is out.

Bandwidth continues to be the most common wholesale service, but wavelengths, a long-haul substitute for

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A Story of Substance

Merkato Rollout

It's a familiar comment in the telecom industry: "We're not sure we want to be first, but we sure as hell want to be second." It's a comment that the new president and CEO of Invisible Hand Networks, Jim Brown, has heard frequently about adoption of the firm's Merkato automated transaction platform.

Brown is excited because that "first" – Telehouse America, a major carrier-neutral colocation firm that's one of a handful of Merkato beta-testers – is about to launch live commercial deployment of the technology as a liquid IP exchange. Brown believes the market's struggles, and the solutions he offers, will make the second-to-market crowd put their money where their mouth is, just in time for the rollout of Merkato 2.1.

"We believe we have a revolutionary technology but we've tried to be wise, taking an evolutionary path to getting it adopted," says Brown, a JP Morgan telecom financial veteran and former

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Around the Desk

Lots of News Around the Desk…

One of the last risk management warriors has left the fold. Sharon Crow has parted ways with Williams Communications following the troubled firm's decision to fold its risk management practice into the broader business development division. Crow was unique among traders who moved into the bandwidth arena in that she bridged an often uncomfortable gap between carriers and energy players as the industry wrestled with standardized contracts and other elements of

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Commentary: Telecom Risk

The Intelligence Behind Risk Management for Telecom Capacity

By Carlos J. Alarcon and JP Crametz

First in a series

"Problems cannot be solved at the level of awareness that created them." – Albert Einstein

Great value can be derived from combining telecommunications capacity's unique variables and economic principles to arrive at a commonly understood set of definitive economic terms and metrics. This new understanding will enable telecom commerce and financial risk man-

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InPerspective

A Corporate Cancer That Must Be Cut Out

By Richard Thayer, Ph.D.

The sudden crash of hundreds of dot-com and high-tech companies two years ago did not happen mysteriously or by accident.

Their stories may not have the headline-grabbing power of debacles at Global Crossing, Lucent, Qwest, WorldCom or AT&T. They may not have the egregious legislation-inducing scope of Enron. But the managers and directors of those dot-com and high-tech companies – and their allies in the accounting, securities and banking firms – knew,

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"86" List For April

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Invisible Hand board member who came to the firm from Polaris, its largest investor.

While Telehouse marks the first commercial use of the software, Invisible Hand will reach cash-flow positive in the next two quarters with its own Streaming Hand, an IP reseller that uses Merkato to arbitrage wholesale bandwidth prices and resell at retail. The proof of concept business is selling capacity at two or three times the purchase price – but its 60-plus customers are saving an average of 30 percent, he says. These are content providers, gaming firms and others whose costs are 90 percent bandwidth.

"The traditional pricing models were killing them – high fixed cost and variable revenue line," Brown says. "Now they buy the bandwidth they need when they need it at a market-based price and aren't locked into any long-term contracts."

Merkato interests Telehouse customers for the same reason: "They want to make their cost variable with their revenues, to make their business model work." But carriers have now latched onto the product as well, in part because the product keys in on some increasingly popular telecom terms: increased revenue and reduced opex on existing infrastructure.

"With all of the financial pressures the service providers are under…these folks are desperate for a story with some substance, to tell the investment community they've got a sustainable business model," he says. "What's been exposed here is that circuit-based business models don't work. You can't throw more fiber at the problem. You can't throw more boxes at the problem. In fact, the more you do, the worse the problem gets." The business model works better when companies can dynamically price and bill for what goes through the pipes, rather than trying to price and allocate the pipes themselves, Brown says.

Service provider's capex budgets have flopped over the last few years, now typically decreasing 30 percent a year, so "they're not looking for another piece of expensive equipment to put it," Brown says. Merkato installation is in the high five, low six-figure range.

The existing infrastructure angle doesn't hurt either, since most service providers already own the switches and other network hardware needed to interface with Merkato. Most service providers utilize about 15 or 20 percent of their capacity, but Invisible Hand claims capacity utilization can be bumped up "immediately" to the tune of 60 to 80 percent, "depending on how aggressive you want to be for unpredictable, bursty traffic," Brown says.

Merkato also enables IP providers to use price to manipulate demand – an opportunity to smooth traffic in a way that's common to the voice market but hasn't been available on the data side. Voice customers tend to follow the rules of price elasticity: They talk longer during cheaper off-peak hours. That's good for service providers because they can attract callers by virtue of price, but even better because it frees up much of the peak capacity for high-dollar customers who need reliable service during business hours. "This software allows IP folks to have that luxury for the first time," Brown says.

Among added features in the new release of the transaction software is a feedback valuation that captures historical data from recent bandwidth allocations and uses that to automatically acquire capacity based on actual usage patterns. The buyer sets the parameter for the historical data, from five minutes to a day or more, allowing increased efficiency in pricing, allocation and selling of bandwidth, he says.

He expects Telehouse's plunge into live commercial deployment to stimulate action from Merkato's other beta testers, which include a Tier One provider and a group of colocation and exchange facilities providers. Colo firms in particular are already wired to take advantage of the platform, he says.

"These are exchanges that exist in nature. They've got multiple service providers, multiple content providers and other high bandwidth-using enterprises coming in," he says. "For the most part, [colocation] has been a real estate play. So while they have a unique advantage of having all of the right participants already colocated to put a marketplace in motion, they are at the same time desperate for new revenue streams because the leasing of rack and floor space isn't getting it done."

Telehouse is the prototype for this. The firm plans to use the Merkato technology to create an IP exchange free of traders and the attached overhead, with a provisioning time of five minutes. Look for further announcements of new colo and exchange customers over the next two quarters – and wait for a Merkato user to go public in the carrier space as well. A major Tier One service provider is in lab trials with the software, as are several other Tier One and Tier Two carriers.

"As soon as a Tier One provider stands up and says this meets technical muster, I think those [carrier announcements] are going to accelerate," he says. Brown compares the industry in its current shakeout to a scared herd: When one "forward-thinking Tier One provider" darts toward a field trial, the rest of herd will immediately move with it in order to survive.

Over the next year, business models based on IP flow rather than pipes will become a survival mechanism, Brown says. "This has the potential to become the de facto standard in the industry."

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