Cable vs. Telcos: The Battle Over Business Voice Services

EXECUTIVE SUMMARY

North American cable operators have long coveted the $100 billion commercial voice services market, entranced by the sector's huge revenue potential and steady growth. But with a few notable exceptions, most MSOs were slow to push into the commercial voice market, deciding instead to invest capital and marketing resources into bolstering their consumer video and broadband offerings.

Competition for business voice is about to heat up significantly. Thanks to the emergence of lower-cost VOIP technology and the development of advanced technology standards, the competitive dynamics are quickly changing. Flush with the success of the residential voice offerings they've introduced over the past five years, North American cable operators are now looking to duplicate that performance in the more demanding commercial sector. Big MSOs are now offering or preparing to launch targeted phone service for business customers as they open up another broadband battlefront against AT&T, Verizon, and the other incumbent phone companies.

Inspired by such pioneers as Cox Communications and Cablevision Systems, the large MSOs are rolling out business-focused voice services offering low calling rates and a range of customized features enabled by VOIP. Just as they have done in the residential phone market, MSOs are seeking to use these features, lower service prices, and multiple-product bundles to lure business users away from the well-entrenched telco incumbents.

For example, Time Warner Cable has spent the past year and a half rolling out commercial phone service in more than two dozen markets throughout the U.S. Most recently, the nation's second-largest MSO began offering its "Business Class Phone" product in the San Diego metro area, leaving just two large regions uncovered. Plans call for extending service to the company's two other major regions by the fall.

Besides the vast size and steady growth of the market, cable operators are branching into the commercial phone business now because of the high profit margins of the business, the more favorable economics of VOIP technology, their need to expand beyond the more mature consumer video market, and what they perceive to be the increased vulnerability of the incumbent telcos. They also view the move as a great way to strike back at the phone companies while the Bells seek to encroach upon cable's core consumer video business.
What's more, cable providers believe that they can move into the commercial VOIP space without spending heavily to upgrade their hybrid fiber/coax (HFC) plant, extend their coax lines, or deploy new equipment in the field or at the customer premises. They also think they can boost the penetration rates of their commercial high-speed data products and reduce the churn rates of their overall business telecom packages.

North American cable providers are especially aiming to snatch small-to-midsize businesses (SMBs) away from their telecom rivals. The MSOs view the continent's roughly 25 million SMBs and small offices/home offices (SOHOs) as an extremely lucrative market well within the reach of their primarily residential HFC networks. They also see SMBs as underserved phone customers aching for alternatives, making them low-hanging fruit that could be especially ripe for the taking.

**Excerpt 1: MSO Projections of SMB Market Opportunity in Their Regions**

<table>
<thead>
<tr>
<th>MSO</th>
<th>NUMBER OF SMBS</th>
<th>MARKET OPPORTUNITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comcast</td>
<td>5 million+</td>
<td>$12 billion to $15 billion</td>
</tr>
<tr>
<td>Time Warner Cable</td>
<td>2.8 million</td>
<td>$13 billion</td>
</tr>
<tr>
<td>Cox Communications</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Charter Communications</td>
<td>1 million</td>
<td>$5.5 billion</td>
</tr>
<tr>
<td>Cablevision Systems</td>
<td>600,000</td>
<td>$3.5 billion</td>
</tr>
</tbody>
</table>

*Sources: Companies, Morgan Stanley*

Voice service is now emerging as the key to cable's success in the small-business sector. For every dollar that smaller firms spend on data and video services, they spend an estimated $3 to $4 on phone service. Cable operators can give their average revenue per user (ARPU) a big boost if they can convince the business customers now using their broadband data services to take a voice package as well.

**Excerpt 2: MSO Commercial Service Customers & Revenues**

<table>
<thead>
<tr>
<th>MSO</th>
<th>COMMERCIAL SERVICES CUSTOMERS – 2007</th>
<th>COMMERCIAL SERVICES REVENUES – 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cox Communications</td>
<td>240,000</td>
<td>$700 million</td>
</tr>
<tr>
<td>Time Warner Cable</td>
<td>280,000</td>
<td>$400 million</td>
</tr>
<tr>
<td>Comcast</td>
<td>260,000</td>
<td>$384 million</td>
</tr>
<tr>
<td>Cablevision Systems</td>
<td>N/A</td>
<td>$216 million+</td>
</tr>
<tr>
<td>Charter Communications</td>
<td>152,000</td>
<td>$205 million</td>
</tr>
</tbody>
</table>

*Sources: Companies, Morgan Stanley*

But as they gear up for a run at the commercial voice market, cable operators do face some tough challenges. Chief among them are the primarily residential design of their local cable systems, and their relative lack of experience serving business customers. The delivery of top-grade commercial services calls for greater flexibility, quality-of-service (QOS) control, and scaleability than many, if not most, MSOs have ever managed to muster.

In particular, medium-sized companies and larger enterprises – companies quite accustomed to the reliability, flexibility, and durability of the public switched telephone network (PSTN) – are unlikely to switch voice providers unless they’re offered strong service guarantees and secure back-
up systems by the cable industry. So MSOs cannot get away with simply retooling and repackaging their existing residential VOIP products for commercial users, as many have started off doing.

Unlike such telecom giants as AT&T and Verizon, most North American MSOs also don't have full national networks or footprints, making them less appealing providers for larger commercial clients that have operations scattered across several regions. To address these concerns, MSOs must build their own carrier-grade national backbones, link their regional fiber networks, and/or offer extensions over tail circuits leased from the incumbent local exchange carriers (ILECs).

**Cable vs. Telcos: The Battle Over Business Voice Services** explores the cable industry's initial forays into the commercial voice market, examining the prospects for MSOs as they seek to expand beyond residential service. The report analyzes the opportunities for cable operators to capture various segments of the SMB market through targeted network improvements, technology deployments, equipment upgrades, service rollouts, and marketing maneuvers. It also takes a close look at the numerous hurdles that cable providers must overcome to realize their dreams of commercial success.

The report profiles and analyzes the commercial voice plans of five major North American MSOs, and provides details for 18 technology, equipment, and service suppliers in this growing sector, assessing their products, strategies, strengths, and weaknesses. The findings and analysis in this report are based on four months of in-depth interviews with the suppliers, financial and market experts, and eight of the largest U.S. and Canadian MSOs.

**Report Scope & Structure**

**Cable vs. Telcos: The Battle Over Business Voice Services** is structured as follows:

**Section I** is an introduction to the report, with complete report key findings.

**Section II** provides an overview of the commercial voice market. It sizes up the business phone opportunities for cable operators, breaks down the overall market into three basic segments, and zeroes in on the promising SMB segment. It also spells out the early vertical markets targeted by MSOs and outlines the various voice applications and services that cable providers are planning.

**Section III** focuses on the prime assets that the cable industry brings to the commercial voice market, including the proximity of cable's HFC plant to many, if not most, business locations and the extensive number of high-bandwidth fiber lines that MSOs have already installed. The section also details other cable assets, such as the industry's small but climbing commercial data customer base, soaring residential voice customer base, relative service and price flexibility, growing commercial voice product lineup, and increasing business receptivity.

**Section IV** delves into the myriad challenges facing cable operators, grouping the hurdles into a number of major categories. It also looks at the other service providers competing with MSOs to be the preferred alternatives to the incumbent telcos.

**Section V** examines the new industry technology standards that will play a big role in shaping cable's commercial voice play, particularly as cable MSOs seek to expand beyond the smallest business customers.

**Section VI** explores the commercial phone deployment plans of the five biggest North American cable operators, comparing and contrasting their technological, operational, business, and marketing strategies.

**Section VII** provides in-depth profiles of 18 leading and innovative suppliers of technologies enabling commercial voice services for the North American cable market, including softswitch designers, equipment makers, software specialists, and application developers.
Cable vs. Telcos: The Battle Over Business Voice Services is essential reading for a wide range of industry participants, including the following:

- **Cable technology suppliers:** How will the push by cable MSOs into the business voice services market affect technology deployment plans? When is the ramp up for commercial voice service likely to occur, and what's the most likely timeframe for service rollouts? Which operators are likely to be most aggressive with their commercial voice packages, and which types of businesses will they be targeting? Where are the emerging opportunities to increase market share? Are your products and marketing messages in line with cable MSO plans and expectations in the business voice sector? Are there significant gaps in your product line coverage that need to be addressed to meet future demand from cable MSOs?

- **Cable network operators:** How do the current technology options for delivering business voice services compare with one another in terms of cost and effectiveness? How are other cable MSOs approaching the commercial voice market? What are their expectations regarding market share and revenue? Are their plans and expectations in line with your company’s approach? Which technology suppliers are in the best position to meet your company’s requirements?

- **Telecom competitors:** How much of a threat will cable MSOs in your operating region pose regarding business voice services? Which customers are most likely to be targeted by cable operators, and what can you do to keep churn to a minimum? What types of services are cable MSOs most likely to offer in a voice package, and how do your services compare?

- **Investors:** Which cable MSOs are likely to succeed in the commercial voice business, and which technology suppliers are best positioned to take advantage of that success? How will the need for new technology and infrastructure affect profitability for the cable MSO sector in the coming months and years?

Cable vs. Telcos: The Battle Over Business Voice Services is published in PDF format.